

GENERAL LITIGATION BULLETIN



Department of the Treasury Internal Revenue Service

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**BAD NEWS, GOOD NEWS  
COURT ALLOWS EQUITABLE TOLLING IN WRONGFUL LEVY ACTIONS  
(BUT NOT IN THIS CASE)**

The Service levied on the taxpayer's wages, receiving from the taxpayer's company the amount of the taxpayer's retirement benefits. A year later, the taxpayer pled guilty to multiple criminal charges, and was ordered to pay restitution to his company. With the taxpayer in jail, the company sought a refund of the amount previously levied by the Government so as to satisfy the restitution order. However, the action under I.R.C. § 7426 was brought beyond the statute of limitations for wrongful levy, under I.R.C. § 6532(c). The company argued that, under the circumstances, the limitations period should be equitably tolled.

In **Becton-Dickinson and Company v. Wolckenhauer, 1998 U.S. Dist. LEXIS 17125 (D. N.J. Oct. 28, 1998)**, the court found the possibility of equitable tolling had not been foreclosed by the Supreme Court's decision in **United States v. Brockcamp, 519 U.S. 347 (1997)**. In **Brockcamp**, the Supreme Court found that I.R.C. § 6511, the statute of limitations applicable to tax refund claims, was not subject to equitable tolling. The New Jersey court, however, found none of the controlling elements of **Brockcamp** present in this case. First, the court held that section 6532(c) does not contain detailed and technical language, as does section 6511. Second, section 6532(c) does not contain substantive limitations on the amount of recovery. Third, the court found little risk of overburdening the Service with administrative and legal claims under section 6532(c). The court concluded that section 6532(c) was an ordinary statute of limitations, subject to equitable tolling under **Irwin v. Department of Veteran's Affairs, 498 U.S. 89 (1990)**.<sup>1</sup>

However, the court decided that the company's actions did not warrant equitable relief. Noting that equitable relief is an extraordinary remedy, the court found that the company failed to pursue its right to an extension of the limitations period under section 6532(c)(2). By virtue of its failure to actively and diligently pursue available judicial and statutory remedies, the company was not entitled to equitable tolling of the statute of limitations.

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<sup>1</sup> The court noted that equitable tolling would be precluded under section 6532(a).

The court went on to rule that the company would not have prevailed on the merits of its claim. The court found that although the restitution order gave the company a right to receive money, it did not confer specific, possessory rights in the levied retirement funds. Further, any such right would be inferior to the Government's prior interest, secured by its Notice of Levy. Finally, there was no issue that the Government's levy was wrongful, in that the taxpayer owned the pension funds and owed taxes to the Government. **LEVY: Wrongful**

**GOOD NEWS, BAD NEWS**  
**FIRST CIRCUIT AFFIRMS SERVICE'S DECISION BUT NOT ITS POSITION**

In **Fredyma v. Lake Sunapee Bank, 1998 U.S. App. LEXIS 28376 (1<sup>st</sup> Cir. Nov. 3, 1998) (unpublished)**, the First Circuit upheld the district court's favorable decision, but chose to affirm on different grounds which may be less favorable to the Service in future cases. In **Fredyma v. United States, Slip. Op. 96-477-SD (D. N.H. Jan. 6, 1998)**, the lower court had dismissed the taxpayer's claim for damages arising from the Service's levy of a bank account into which worker's compensation benefits had been deposited. The Service argued that I.R.C. § 6334(a)(7) only protects benefits that are "payable," not those already paid. The district court found the Service's interpretation reasonable and decisive of the issue.

On appeal, the First Circuit in an unpublished opinion agreed that the Service's interpretation was reasonable, and that therefore the taxpayer had no basis for recovery under I.R.C. § 7433(a), which provides relief only for "reckless" or "intentional" conduct in violation of law. However, the court of appeals expressly voiced no opinion as to whether or not the Service's interpretation of section 6334(a)(7) was correct. See also Cathey v. United States, digested below. **LEVY: Exempt Property**

1. **BANKRUPTCY CODE CASES: Automatic Stay (§ 362)**  
**In re Holden, 1998 Bankr. LEXIS 1420 (Bankr. D. Vt. Oct. 6, 1998) (unpublished)**  
- Without requesting relief from the automatic stay, the Service froze tax refund debtors intended to use to pay current bills. The court found that the debtors could claim damages for emotional distress, and could present medical evidence to prove their claim.
2. **BANKRUPTCY CODE CASES: Chapter 11 (Reorganization): Confirmation of Plan (§ 1129): Pre-petition Priority Taxes**  
**United States v. TM Building Products, Inc., 1998 U.S. Dist. LEXIS 16669 (S.D. Fla. Oct. 5, 1998)** - Service objected to classification of its claims as "secured" under debtor's plan of reorganization, which would be paid "when funds are available," rather than priority claims, payable within six years. The court found the Government had recorded tax liens against the debtor prior to the bankruptcy, and thus its claims were secured.

3. **BANKRUPTCY CODE CASES: Chapter 13: Discharge (§ 1328): Hardship Discharge - Non-Dischargeable Taxes**  
**In re Anderson, 82 AFTR2d ¶ 98-5527 (Bankr. W.D. Va. Nov. 4, 1998)** - Trust fund taxes are not dischargeable when a chapter 13 debtor receives a hardship discharge under B.C. § 1328(b).
4. **BANKRUPTCY CODE CASES: “Cram-Down” in Plan**  
**In re Nunez, 1998 Bankr. LEXIS 1387 (Bankr. M.D. Fla. Oct. 21, 1998)** - Chapter 13 debtor may propose full payment of the secured portion of a tax claim and avoid the tax lien on the unsecured portion. The court found B.C. § 506(d) controlling over I.R.C. § 6325, and dismissed the Service’s argument that the tax liens should not be released until all plan payments are completed.
5. **BANKRUPTCY CODE CASES: Exceptions to Discharge: No, Late or Fraudulent Returns**  
**In re Barber, 1998 Bankr. LEXIS 1388 (Bankr. N.D. Ind. Oct. 23, 1998)** - Taxpayer failed to file 1981 income tax return, so the Service filed a substitute return. Under B.C. § 523(a)(1)(B)(i), a substitute return does not constitute the filing of a return, and consequently the debtor’s 1981 tax liability is nondischargeable.
6. **BANKRUPTCY CODE CASES: Jurisdiction of the Bankruptcy Court**  
**In re Williams, 156 F.3d 86 (1<sup>st</sup> Cir. 1998)** - Bankruptcy court determined that Justice Department lawyers were not responsive to discovery requests and ordered sanctions in an opinion that personally denigrated the attorneys. The district court reversed the award of monetary sanctions, but added its own “unflattering comments.” The attorneys appealed the lower court’s description of their conduct, but the First Circuit declined to vacate the lower court’s factual findings. The appeals court, wary of inviting litigation over judicial commentary, found a judge’s derogatory comments about a lawyer’s conduct, without more, do not constitute an appealable sanction.
7. **BANKRUPTCY CODE CASES: Liens**  
**In re Pansier, 225 B.R. 657 (E.D. Wis. 1998)** - Debtor was receiving disability benefits, which Service levied on prior to debtor’s filing bankruptcy. The court held that when a debtor has an unqualified right to receive certain payments prior to the date on which he files bankruptcy, the right to receive those future payments constitutes a “right to property” acquired pre-petition. Such a right to property is subject to the Service’s pre-petition tax lien under I.R.C. § 6321, even if the underlying tax is discharged.
8. **BANKRUPTCY CODE CASES: Statute of Limitations: Multiple Petitions**  
**In re Emerson, 224 B.R. 577 (Bankr. W.D. La. 1998)** - Debtors were assessed taxes in July, 1991, and made an offer in compromise in October, 1991. Debtors then filed an amended offer in May, 1992, and the Service rejected the offer in August, 1992. Debtors appealed the rejection in September, 1992, which appeal

was denied in February, 1993. Debtors then filed for ch. 7 bankruptcy in April, 1994, and received a discharge in July, 1994. For purposes of the timeframe established by B.C. § 507(a)(8)(ii), the court found the debtor's amended offer was not filed within the 240 day period, and so could not extend the period. As to the original offer, the court held it was rejected in August, and that the debtors' appeal did not revive the rejected offer. Consequently, the debtors' taxes were discharged.

9. **BANKRUPTCY CODE CASES: Trustee's Avoidance of Transfers**  
**In re Bakersfield Westar, Inc., 1998 Bankr. LEXIS 1346 (B.A.P. 9<sup>th</sup> Cir. Oct. 16, 1998)** - Pre-petition revocation of a corporation's subchapter S election is a transfer that a bankruptcy trustee may avoid, if fraudulent, under B.C. § 548. The court rejected the Service's argument that because the election has no present value, the election is not an "interest of the debtor in property," finding the ability not to pay taxes has value to the estate. Further, the court held that the bankruptcy trustee has the power under B.C. § 548(a) to avoid an otherwise irrevocable election under the I.R.C., citing In re Russell, 927 F.2d 413, 417 (8<sup>th</sup> Cir. 1981).
10. **DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection (§ 7433)**  
**Gary v. United States, 1998 U.S. Dist. LEXIS 16722 (E.D. Tenn. Sept. 4, 1998)** - Service seized taxpayer's business vehicle. Taxpayer asked Service to return the vehicle, contending Service failed to provide 30 days notice under I.R.C. § 6331(d) and that the truck was essential to the taxpayer's business. The Service refused, and the business failed. The taxpayer then sued under section 7433. In deposition, the revenue officer testified he thought a collection quota was in place, and that the revenue officer had been disciplined for being "too easy" on another taxpayer just prior to the seizure. The taxpayer then moved to produce the revenue officer's personnel file. The court ordered production of the file subject to a protective order, finding the potential relevancy of the file information as to whether the revenue officer had unlawfully seized other property outweighed Privacy Act concerns.
11. **LEVY: Exempt Property**  
**Cathey v. United States, 82 AFTR2d ¶ 98-5471 (S.D. Tex. Oct. 5, 1998)** - Lump sum worker's compensation benefits deposited into widow's bank account were not exempt from tax levy. I.R.C. § 6334(a)(7) exempts workmen's compensation benefits payable to a taxpayer, but because benefits already had been paid out, those benefits were not exempt from levy.
12. **LEVY: Wrongful**  
**City View Trust v. Hutton, 1998 U.S. Dist. LEXIS 17952 (D. Wyo. Nov. 2, 1998)** - Husband and wife established irrevocable trust, which later purchased residential property that now is their home. Service filed NFTL against the property for taxes owed by the couple, who in turn filed a wrongful levy suit against the Service. The court distinguished a tax levy from a tax lien, dismissing the couple's I.R.C. § 7433 action as premature. The court further found the trust lacked standing under

section 7433, as third parties are limited to actions under I.R.C. § 7426. Finally, the couple's quiet title action was dismissed because the court's factual findings established the trust as the nominee of the couple.

13. **LEVY: Wrongful  
LIENS: Action to Quiet Title**  
**Entenmann's, Inc. v. United States, Slip Op. No. 8:97CV623 (D. Neb. Oct. 9, 1998)** - In November, 1996, Service recorded a tax lien and levied on taxpayer's funds held by a bank. In February, 1997, creditor obtained judgment against taxpayer and served bank with a garnishment summons. When the summons was unsuccessful, the judgment creditor filed a quiet title action against the Service in December, 1997. The court held that a civil suit for wrongful levy under I.R.C. § 7426(a)1 is a third party's exclusive remedy, and so dismissed the quiet title action. Further, the court found that by issuing its notice of levy, the Service took constructive possession of the taxpayer's assets. Thus, even if the Notice of Federal Tax Lien was not properly recorded, the judgment creditor could not prime its lien against previously levied property. Finally, the court held the Government's "secret lien" prevailed over the judgment creditor's lien, because under Nebraska law the judgment creditor's lien could only be perfected, and thus choate, after seizure. Seizure could not occur since the Government already had constructive possession of the assets.
14. **LIENS: When Lien Arises:**  
**United States v. Brumfield, 1998 U.S. Dist. LEXIS 17478 (M.D. La. Sept. 30, 1998)** - An individual made a valid renunciation of his interest in his mother's estate under Louisiana law. Thus, under the majority "acceptance-rejection theory" (Leggett v. United States, 120 F.3d 592 (5<sup>th</sup> Cir. 1997)), the federal tax liens should not attach. However, because the individual tacitly accepted the succession by renouncing in favor of another heir, the tax liens would be valid.
15. **PENALTIES: Failure to Collect, Withhold or Pay Over: Responsible Officer**  
**United States v. Tarlow, 1998 U.S. Dist. LEXIS 16908 (E.D. N.Y. Oct. 7, 1998)** - Taxpayer was officer and director of security guard business, with 7% ownership interest. Although taxpayer ran business for several months while CEO was incapacitated, by the time that the trust fund taxes went unpaid, taxpayer was not active in day-to-day management, did not hire or fire employees, did not make decisions regarding payment of debts or taxes, nor did he exercise control over bank accounts or have check signing authority. Consequently, taxpayer was not a responsible person under I.R.C. § 6672.
16. **PRIORITY: Insolvency (31 U.S.C. § 3713)**  
**Straus v. United States, 1998 U.S. Dist. LEXIS 16942 (N.D. Ill. Oct. 20, 1998)** - Under the Insolvency statute, federal tax liens have priority to the assets of an insolvent corporation over earlier filed state tax liens, where the state did not have title to or possession of the assets.

17. **SUMMONSES: Defenses to Compliance**

**United States v. Henkell, 1998 U.S. Dist. LEXIS 16666 (E.D. Cal. Oct. 9, 1998) -**

The court found a trustee in civil contempt for failure to produce documents pursuant to an administrative summons. The court found that voluntary relinquishment of documents is no defense to a summons.