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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR SOUTH FLORIDA DISTRICT COUNSEL

FROM: Alan C. Levine
Chief, Branch 1 (General Litigation)

SUBJECT: _____

This memorandum responds to your memorandum regarding the application of res judicata. This document is not to be cited as precedent.

LEGEND

Amount A = $

ISSUES:

(1) If the Internal Revenue Service ("Service") files a Notice of Federal Tax Lien ("NFTL") prior to a debtor's Chapter 7 bankruptcy case and the bankruptcy court sells the estate assets free and clear of all liens, is the bankruptcy court's order res judicata, if the order was not appealed and has become final?

(2) If the Service levied on the retirement plan administrator prior to a taxpayer's Chapter 7 bankruptcy case (but the Service did not receive anything on the levy), can the Service enforce the levy after bankruptcy?

(3) Does the answer to question two change if a debtor could have excluded his interest in the retirement plan from the bankruptcy estate, but, instead, chose to treat the retirement plan interest as an asset of the bankruptcy estate?

CONCLUSIONS:

(1) The bankruptcy court's order selling the property free and clear of all liens is a res judicata determination and cannot now be collaterally attacked. Also, the scenario presented indicates that it is too late to attempt to revoke the discharge

and does not clearly demonstrate a debtor's fraudulent intent. Finally, because the tax liability was discharged, the federal tax lien does not attach to a debtor's post-petition property.

(2) The Service cannot enforce a prepetition levy on a retirement plan administrator after the debtor receives his discharge. The levied-upon-party has an obligation to surrender the property to the bankruptcy estate. The Bankruptcy Code then determines the treatment of the property.

(3) The answer to question two does not change if a debtor could have excluded his interest in the retirement plan from the bankruptcy estate, but, instead, chose to include it in the estate. The bankruptcy court adopted the position that the debtor treated his interest in the retirement plan as an asset of the bankruptcy estate in its final judgment, and that final order is now res judicata.

FACTS:

Prior to bankruptcy, the Service filed a NFTL and served a levy on the administrator of the taxpayer's retirement plan. Before the administrator could honor the levy, the taxpayer filed a Chapter 7 bankruptcy. The debtor neither excluded nor exempted his interest in the retirement plan from the bankruptcy estate. In his bankruptcy schedules, the debtor listed his retirement plan as The debtor scheduled the current market value of his interest in the retirement plan at . The debtor gave notice of the bankruptcy to the Service. The Service filed a secured claim in the bankruptcy proceeding. The bankruptcy court approved the trustee's sale of all the debtor's personal property to the debtor, free and clear of all liens, with all liens to attach to the sale proceeds. The sale includes the interest in the retirement plan. The bankruptcy court entered a discharge order that discharged all of debtor's tax liability. The Service did not appeal the bankruptcy court's decision. Eighteen months after the bankruptcy court entered its discharge order, the Service begins to consider taking collection action.

LAW AND ANALYSIS:

(1) Unless a timely appeal is taken, a bankruptcy court's decision becomes final and is res judicata. In re Justice Oaks II, 898 F.2d 1544 (11th Cir. 1990). Given that the Government failed to appeal the bankruptcy court's order approving the sale of the personal property, which included the debtor's interest in his retirement plan, that order is res judicata as a final order. Thus, the debtor now owns the interest in the retirement plan, free of any liens.

Additionally, it does not appear that the Government would be able to have the discharge revoked under B.C. §§ 727(d)(1) and (e)(1). Section 727(d)(1) provides that the bankruptcy court shall revoke a discharge if "such discharge was obtained

through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge." Section 727(e)(1) provides that a creditor must request a revocation of the discharge within one year after the discharge is granted. Here, the one-year period for revoking the discharge has long expired.

Moreover, it is by no means clear that the debtor's scheduling of his retirement plan at a dollar value demonstrates fraudulent intent. A false statement resulting from ignorance or carelessness is not inherently fraudulent. Bank of Miami v. Espino, 806 F.2d 1001 (11th Cir. 1986) (failure to list contingent claim was not inherently fraudulent). A false statement may be due to "mere mistake or inadvertence," not fraudulent intent. In re Brown, 108 F.3d 1290, 1294 (10th Cir. 1997). In this case, the debtor may have erroneously listed his interest in the retirement plan as having a value because (1) he had not yet reached retirement age, and (2) the federal tax lien encumbered his interest.

Finally, we note that the debtor purchased the interest in the retirement plan from the Chapter 7 trustee. The retirement plan interest is now a post-petition interest of the debtor. A prepetition NFTL for a discharged tax liability will not encumber the debtor's post-petition assets. E.g., In re Olson, 154 BR 276 (Bankr. N.D. 1993).

(2) When the Service levies on a third-party and the taxpayer files a petition in bankruptcy prior to the levy being honored, the third-party must turn over the taxpayer's property to the bankruptcy estate. United States v. Challenge Air Int'l Inc., 952 F.2d 384 (11th Cir. 1992). After the petition date in bankruptcy, the Service cannot seek to enforce the levy against a third-party who obeyed the Bankruptcy Code and turned over the assets to the bankruptcy estate. Id. at 387.

(3) In Patterson v. Shumate, 504 U.S. 753 (1992), the Supreme Court held that B.C. § 541(c)(2) excludes ERISA-qualified pension plans from the bankruptcy estate. Thus, a bankruptcy court lacks subject matter to deal with such pension plans. In re McClellan, 99 F.3d 1420 (7th Cir. 1996). However, if a bankruptcy court enters a final judgment as to such pension plans, the Service cannot collaterally attack the bankruptcy court's decision by raising the argument that the bankruptcy court lacked subject matter jurisdiction over the debtor's interest in the retirement plan. Corbett v. MacDonald Moving Services, Inc., 124 F.3d 82 (2d Cir. 1997). "Every court in rendering a judgment tacitly, if not expressly, determines its jurisdiction over the parties and the subject matter." Stoll v. Gottlieb, 305 U.S. 165 (1938). A litigant must raise subject-matter jurisdiction before the judgment becomes final or suffer the consequences. Insurance Co. of Ireland v. Campagnie des Bauxites, 456 U.S. 694, 702 (1982). Here, the Service could have argued that the bankruptcy court lacked subject-matter jurisdiction over the retirement plan interest prior to the final judgment, but this argument was never raised. Thus, the bankruptcy court's final decision is res judicata.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

[redacted]

If you have any further questions, please call me at 202-622-3610.

cc: Assistant Regional Counsel (GL), Southeast Region