

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:SB:LPLAFFERTY
GL-141163-10

date: April 13, 2011
to: Deborah Fowler
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(Small Business/Self-Employed)
from: Lisa Lafferty
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subject: Collection of Post-Petition Tax/CSED Suspension
In Individual Chapter 11 and Chapter 13 Cases

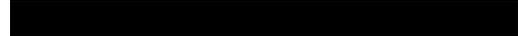
Introduction

The automatic stay prohibits any act to collect a pre-petition debt. It also prohibits any collection action against property of the bankruptcy estate, regardless of whether the debt arose pre- or post-petition. Therefore it is necessary to establish what property is property of the estate to determine which assets, if any, may be pursued for collection without violating the stay. What constitutes property of the estate varies by location and bankruptcy chapter, and is not always clear. As a result, a policy decision that weighs the need to collect the tax against the risk of violating the stay is needed to determine whether or when collection action should be pursued with respect to post-petition taxes of a debtor still in bankruptcy.

The bankruptcy stay that prevents the Service from collecting post-petition taxes works in tandem with the suspension of the statute of limitations on collection (CSED) found in I.R.C. § 6503. Generally, when collection is prohibited, the CSED is suspended. However, the CSED is only suspended if the bankruptcy stay forecloses the ability to collect against any of the debtor's income/assets. It is our current position that if collection is not stayed against all types of income/assets the debtor could possess, the CSED is not suspended, even if the debtor does not have the type of income/assets that could be collected against without violating the stay.

It is our understanding that generally a freeze code is input on an account in bankruptcy to keep collection personnel from inadvertently violating the stay. 




Chapter 11**Form 1041**

In a Chapter 11 case, the filing of a petition by an individual creates a bankruptcy estate that is a separate taxable entity. The bankruptcy estate files a Form 1041 to report the income and pay the tax of the estate. The automatic stay prohibits collection of the tax from the assets of the estate; therefore, the CSED is suspended with respect to all post-petition liabilities properly reported on the Form 1041. The estate's post-petition taxes are an administrative expense that should be paid through the bankruptcy. It is important to keep in mind that even though the CSED is suspended with respect to the estate's post-petition taxes, these taxes will generally be discharged if not paid through the bankruptcy..

Form 1040

The debtor is required to file a Form 1040 to report the debtor's post-petition income that is not property of the estate. Because the stay against collection from property of the debtor applies only to pre-petition debts, collection of the debtor's post-petition income tax liability does not violate the automatic stay (so long as the liability is not collected from assets of the estate). As a result, the CSED continues to run on post-petition liabilities properly reported on the Form 1040.

Property of the Estate

Whether post-petition income is property of the bankruptcy estate is determined by the Bankruptcy Code. All of the debtor's pre-petition assets become part of the bankruptcy estate.¹ Effective October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amended Bankruptcy Code section 1115 to include most of a debtor's post-petition income in the bankruptcy estate.² The amendment to section 1115 also provides that property acquired after commencement of the bankruptcy case, with certain exceptions, is property of the estate.³ Internal Revenue Bulletin (IRB) 2006-83 provides guidance to assist in determining whether a particular item of income is income of the estate required to be reported on the Form 1041. The debtor's post-petition personal service income and income derived from property acquired post-petition is part of the bankruptcy estate and should be reported on Form 1041.⁴ IRB 2006-83 interprets section 1115, as amended, to provide that post-petition income continues to be property of the estate irrespective of whether property reverts in the debtor under section 1114(b) after confirmation.

¹ 11 U.S.C § 541.

² Prior to October 17, 2005, the debtor's post-petition personal service income and income from property acquired post-petition was not generally property of the estate and was required to be reported by the debtor on Form 1040.

³ Section 1115 provides that all after-acquired property of the kind specified in section 541 is included in the bankruptcy estate.

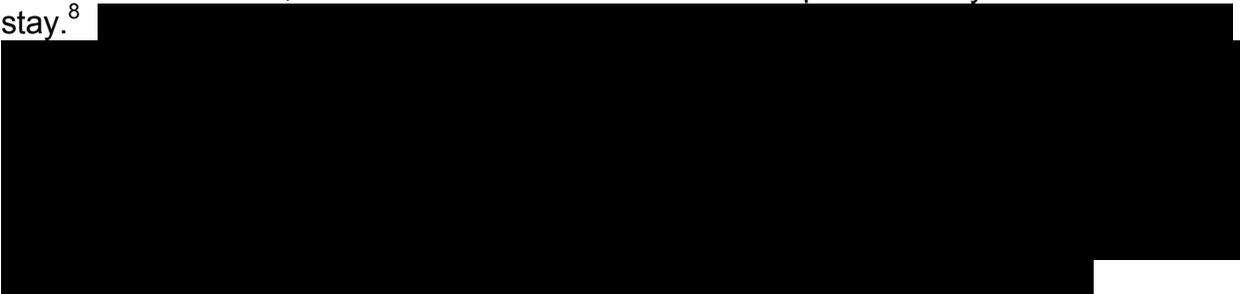
⁴ 11U.S.C § 1115; IRB 2006-83.

Although the majority of the debtor's post-petition income will typically be properly reported on Form 1041 during the pendency of the bankruptcy, there are exceptions. Income derived from property excluded from the bankruptcy estate is not property of the estate and must be reported on the debtor's Form 1040.⁵ Income derived from exempt or abandoned property will also be reported on Form 1040 after the property is removed from the estate.⁶ Additionally, self-employment tax on self-employment income that is property of the estate remains the responsibility of the debtor.⁷

Collection/Bankruptcy Freeze Code

Form 1041

As discussed above, collection of Form 1041 liabilities is prohibited by the automatic stay.⁸



Form 1040



⁵ IRB 2006-83.

⁶ *Id.*

⁷ *Id.*

⁸ I.R.C. § 6503.

In addition, the Service may not be able to rely on the Forms 1041 and 1040 to determine the income protected by the automatic stay. At least one court has required the Service to make an independent determination of whether a particular item of income was property of the estate, without regard to the fact that the debtor reported the income on the Form 1040, to determine if the tax was an administrative expense that was discharged in bankruptcy before proceeding with collection.⁹ Although the Service disagrees with this decision, [REDACTED]

[REDACTED]

Chapter 13

Although Chapter 13 cases present a similar problem as post-BAPCPA Chapter 11 cases with respect to whether, and to what extent, post-petition income is property of the estate, there are significant differences. First, the inclusion of post-petition income in a Chapter 13 bankruptcy estate has been addressed by various bankruptcy courts throughout the country. These courts have disagreed in their response, resulting in varying local law. In contrast, the courts have not addressed Chapter 11 cases and IRB 2006-83 interprets post-petition service income and income from assets acquired post-petition as property of the estate without regard for geography. Consequently, unlike Chapter 11, a uniform, nationwide approach is not practical for Chapter 13 cases and you should continue following the established local practice in these cases.

[REDACTED]

⁹ Becker v. C.I.R., T.C. Memo 2010-120, 2010 WL 2195279 (U.S. Tax Ct.).

[REDACTED]

Conclusion

[REDACTED]

[REDACTED], whether to pursue collection is ultimately a policy decision. The Service should balance the need to collect the tax against the risk of incurring damages that could result from violating the stay. We recommend [REDACTED]

[REDACTED]

Please call (202) 283-0047 if you have any further questions.

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