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CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR MILTON J. CARTER
SPECIAL LITIGATION ASSISTANT CC:WR:PNW:SEA

FROM: Richard G. Goldman
Special Counsel (Tax Practice & Procedure)
Field Service Division CC:DOM:FS:PROC

SUBJECT: _____ v. Commissioner,
Docket No.

This Field Service Advice responds to your undated memorandum. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

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X=

ISSUE(S):

Can the Internal Revenue Service (Service) assess and collect income tax deficiencies which were discharged in bankruptcy if the Tax Court decision upon which the deficiency assessments were based is vacated subsequent to the discharge order?

CONCLUSION:

Assessment and collection against A and B for the discharged tax liabilities would be a violation of the section 524(a)(2) post-discharge injunction. To the extent a judicial proceeding would arise as a result of assessment and collection of A and B's discharged tax liabilities, the government would lose any such case under the principles of *res judicata*.

FACTS:

A and B were test case petitioners with respect to certain tax shelter programs. On Date 1, the Tax Court filed its opinion in A and B's case. The Tax Court entered the decision in this case on Date 2. On Date 3, A and B timely filed a notice of appeal. Because A and B did not file an appeal bond, the Service assessed deficiencies for Year 1 through Year 5 on Date 4. The Service properly made notice and demand for payment of the assessed taxes. However, no tax liens were filed.

On Date 5 (which was more than 240 days after the assessments were made), A and B filed a petition under Chapter 7 of the Bankruptcy Code. As of that date, neither A nor B had made any payments on the deficiencies assessed against them. On Date 6, A and B commenced an Adversary Proceeding in the Bankruptcy Court against the United States and the Service. In their complaint, A and B sought a determination that the Year 1 through Year 5 income tax liabilities were dischargeable. On Date 7, the Bankruptcy Court entered an order relieving A and B from all dischargeable debts. On or about Date 8, the United States filed its answer

to the Adversary Proceeding complaint, admitting that A and B's income tax liabilities for Year 1 through Year 5 were dischargeable debts.

Notwithstanding the bankruptcy proceedings and the entry of a discharge order, A and B continued to prosecute their appeal before the X Circuit. On Date 9, the X Circuit vacated the decision of the Tax Court and directed the Tax Court to conduct an evidentiary hearing concerning government misconduct. On Date 10, the Tax Court vacated and set aside the decisions entered in the test cases, including the Decision entered in A and B's case. Subsequently, the Tax Court held an evidentiary hearing in accordance with the X Circuit's mandate.

On Date 11, the Tax Court issued its opinion, determining that the misconduct was harmless error. Also on Date 11, the Tax Court severed the consolidated cases, and re-entered decisions in the test cases. The Decision entered in A and B's case was identical to the one previously entered.

On Date 12, test case and non-test case petitioners represented by attorneys C and D filed a motion for attorney's fees and costs and a motion for sanctions. On that date, the Tax Court vacated the decisions it had entered on Date 11.

LAW AND ANALYSIS

The Tax Court is a court of limited jurisdiction. Commissioner v. Gooch Milling & Elevator Co., 320 U.S. 418 (1943). The Tax Court has jurisdiction to redetermine deficiencies. However, this determination is separate and apart and has nothing to do with the collection of any deficiencies assessed as a result of the Tax Court's redetermination. The Tax Court's jurisdiction does not extend to deciding whether deficiencies were discharged in a bankruptcy proceeding. Neilson v. Commissioner, 94 T.C. 1, 8-9 (1990); Graham v. Commissioner, 75 T.C. 389, 399 (1980).

Even if a deficiency has been discharged, the Tax Court still has jurisdiction to enter the amount of the deficiency in the decision. However, the fact that the Tax Court entered a decision for a deficiency does not affect whether the Service can collect deficiency assessments which have been discharged.

Bankruptcy Code § 524(a)(2) provides that “[a] discharge . . . operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor” This post-discharge injunction against collection of discharged debts embodies the “fresh start” concept of the Bankruptcy Code and is a barrier that prevents creditors from reaching the Debtor's wages, property or other assets. In re Hardy, 97 F.3d 1384, 1389 (11th Cir. 1996). The government can be cited for contempt, including monetary damages, for willful violations of the post-

discharge injunction. To prove a willful violation all the debtor has to show is that the government received notice of the discharge and intended the actions which violated the injunction. Id. at 1390. Assessment and collection against A and B for the discharged tax liabilities would be a violation of the section 524(a)(2) post-discharge injunction.

If litigation should arise concerning the collection and assessment of these discharged tax liabilities (for instance, in the case where A and B would reopen the bankruptcy case and bring an Adversary Proceeding for violation of the post-discharge injunction) then the doctrine of *res judicata* would apply. The doctrine of *res judicata*, or claim preclusion, bars relitigation of claims. A bankruptcy order is entitled to the “effect of *res judicata*.” United States v. Taylor, 204 BR 10, 12 (E.D. Tex. 1996). There are four requirements that must be satisfied for claim preclusion to apply:

- (1) The prior judgment must be valid;
- (2) The prior judgment must be final and on the merits;
- (3) There must be identity of parties;
- (4) The later proceeding must involve the same cause of action.

In re Justice Oaks II, Ltd, 898 F.2d 1544 (11th Cir. 1990).

There is no dispute that the prior order of the bankruptcy court discharging A and B was valid. The United States did not seek to appeal the decision of the court granting the taxpayers a discharge and in fact, conceded that the income tax liabilities were dischargeable debts. Bankruptcy courts are courts of competent jurisdiction and as such may render final judgments on the merits of cases. United States v. Alfano, 34 F. Supp. 2d 827 (E.D. N.Y. 1999). The court’s order of discharge in this case was a final order on the merits. Since both the United States and the taxpayers (A and B) were parties to the Adversary Proceeding concerning the discharge, the identity of parties requirement has been met. 4 Collier’s ¶ 502.02 (15th Ed. 1999). To the extent a judicial proceeding would arise as a result of assessment and collection of A and B’s discharged tax liabilities, the government would lose any such case under the principles of *res judicata*.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

None.

If you have any further questions, please call the branch telephone number.