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

OFFICE OF
CHIEF COUNSEL

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February 22, 2000

MEMORANDUM FOR DISTRICT COUNSEL, NORTH FLORIDA CC:SER:NFL:JAX

FROM: Mitchel S. Hyman
Senior Technician Reviewer, Branch 2 (General Litigation)

SUBJECT: Taxpayer X – Suspension of Collection Limitation Period During Chapter 11 Bankruptcy Plan

LEGEND:
Taxpayer X
Company Y
Year 1
Date 1
Date 2
Date 3
Date 4
Date 5
Date 5A
Date 6
Date 7
Date 8
Date 9

This responds to your request for advice concerning the above taxpayer[1] and confirms the oral advice previously given to the referring attorney in your office. For the reasons described further below, we agree with your analysis that the ten year collection limitation period with respect to the trust fund recovery penalty (TFRP) assessed against the taxpayer on Date 3, was suspended from the assessment

[1] As discussed with your referring attorney, this memorandum does not concern the taxpayer's former spouse, who is not seeking any relief from Special Procedures. The taxpayer's former spouse filed a second solo bankruptcy case, after the joint bankruptcy case with respect to the taxpayer and the former spouse was completed, so the ultimate answers with respect to the taxpayer's former spouse would be different.

date until the taxpayer substantially defaulted on her payments of the TFRP under her Chapter 11 plan on or about Date 5, plus six months, pursuant to I.R.C. § 6503(h)(2). Accordingly, the Service's collection limitation period for the TFRP at issue is due to expire on or about Date 9, based upon the information provided to our office.

FACTUAL BACKGROUND

For the last three quarters of Year 1, Company Y. failed to pay over trust fund employment taxes due the Service. The Service determined that the taxpayer was a responsible person of the corporation within the meaning of I.R.C. § 6672 for each of these three quarters, but the Service did not assess the TFRP against the taxpayer before she and her former spouse filed a joint Chapter 11 bankruptcy petition on Date 1. While the automatic stay arising from the bankruptcy case was in effect, the Service was prohibited from assessing the TFRP against the taxpayer under bankruptcy law provisions operative for bankruptcy cases begun before October 22, 1994, and the Service's assessment limitation period for this TFRP was suspended pursuant to I.R.C. § 6503(h)(1). However, the Service filed a timely proof of claim for the taxpayer's TFRP liability in the taxpayer's bankruptcy case and the Service's claim for this TFRP liability was allowed in the bankruptcy proceeding.

On Date 2, the taxpayer's Chapter 11 plan was confirmed. The taxpayer's confirmed plan provided for full payment of the Service's proof of claim for the TFRP liabilities at issue (along with interest after the plan effective date), over a period of six years from the assessment date, with annual installments due commencing in Date 4. Soon after the automatic stay was lifted following confirmation and the effective date of the taxpayer's Chapter 11 plan, the Service timely assessed the TFRP liabilities owed by the taxpayer on Date 3.[2]

The taxpayer made the first payment of the TFRP liability due under her confirmed plan in Date 4. The taxpayer failed to make the payments of the TFRP liability due under her Chapter 11 plan in Date 5A and in later years. On November 5, 1990, the Service's general collection limitation period (not including any periods of suspension) for any taxes assessed before that date where the limitation period had not expired was extended by law from 6 years after the assessment date to 10 years after the assessment date.[3]

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[2] In accordance with I.R.C. § 6601(e)(2)(A), the TFRP liability the Service assessed at that time did not include any pre-assessment interest, so there was no interest accruing on this tax debt between the date the taxpayer filed bankruptcy and the date the taxpayer's Chapter 11 plan became effective.

[3] See I.R.C. § 6502(a)(1); Behren v. United States, 82 F.3d 1017 (11th Cir. 1996).

The bankruptcy court closed the taxpayer's Chapter 11 bankruptcy case on Date 7. In Date 8, the Service mailed the taxpayer a letter which observed that the taxpayer had defaulted on the TFRP liability payment installments due under her Chapter 11 plan and demanded that the taxpayer fully pay her surviving TFRP liability to the Service. The Service received no response from the taxpayer to this default notice and demand payment letter.

DISCUSSION

The statute of limitations on collecting a tax provided for by a confirmed Chapter 11 plan is usually extended automatically, via I.R.C § 6503(h)(2), while the taxpayer is current on Chapter 11 plan payments for the tax, up until the time the taxpayer is in substantial default on the plan payments for the tax, plus six months. While the automatic stay is the most commonly cited bankruptcy case "reason" why the Service may be prohibited from collecting a tax, within the meaning of I.R.C. § 6503(h), it is not the only bankruptcy case reason recognized by the courts and the Service for suspending the Service's limitation period for collecting a tax from a former bankruptcy debtor. See United States v. Wright, 57 F.3d 561 (7th Cir. 1995) (suspension while confirmed Chapter 11 plan was in effect, until default, plus six months); In re Montoya, 965 F.2d 554, 557 (7th Cir. 1992) (dicta regarding suspension not being limited to automatic stay circumstances, where a Chapter 11 plan was in effect before default and where the Service's claim had been disallowed and later was reinstated) ; United States v. McCarthy, 21 F.Supp.2d 888 (S.D. Ind. 1998) (suspension while a confirmed Chapter 11 plan was in effect until the default exceeded 30 days, plus six months); Nelson v. United States, 94-1 U.S.T.C. ¶ 50,206 (E.D. Mich. 1994) (suspension between the dates the taxpayer received a Chapter 7 discharge and the discharge was revoked, plus six months). If payment of a tax is provided for by a confirmed Chapter 11 plan and plan payments of the tax are not in default, then the Service is generally prohibited from attempting to collect the tax (outside of receiving payments provided for by the plan) from the debtor or the debtor's property, pursuant to the plan injunction arising pursuant to the terms of most Chapter 11 plans and B.C. §§ 1141(a) and (c).

It is our office's position in the case of Chapter 11 corporate debtors with confirmed plans that the Service should not resort to use of its administrative remedies to collect a tax provided for by a confirmed plan until there is a default. The Seventh Circuit's decision in Wright, supra, approved the Service's position that the limitation period on collecting employment taxes from a partnership debtor remained (after the stay was lifted) suspended following confirmation of the partnership's Chapter 11 plan until the partnership defaulted on its plan payments, plus six months. See also United States v. Colvin, 203 B.R. 930 (N.D. Tex. 1996), following remand, 222 B.R. 799 (N.D. Tex. 1998) (considering equitable tolling of the 240-day period for priority income tax claim purposes during the time that a serial Chapter 11 corporate debtor was not in default on its first confirmed plan).

We similarly conclude that in individual debtor cases, the Service may generally rely on the section 6503(h)(2) suspension with respect to taxes provided for by the plan. On the other hand, the Service will not generally be able to rely upon a suspension with respect to taxes which are still owed by an individual debtor but which are not provided for by full payment under the debtor's plan. However, the TFRP taxes at issue in the present case were allowed in the bankruptcy proceeding and were required to be paid in full by the taxpayer's confirmed Chapter 11 plan, so the section 6503(h)(2) suspension applies in this case.

The Service's position regarding collection of non-dischargeable tax debts, like those at issue in the present case, from an individual debtor with a confirmed Chapter 11 plan is stated in IRM 5.9.9.5:(1), as follows:

> Confirmation of the plan binds the debtor and creditors to the terms of the plan. Although confirmation does not discharge an individual debtor from taxes excepted from discharge under B.C. § 523(a), the IRS will not attempt to collect nondischarged pre-petition taxes outside of the plan unless there is substantial default, the non-dischargeable tax is not fully provided for by the plan, or circumstances allowing collection through setoff arise.

Notwithstanding the survival of certain tax debts as non-dischargeable for an individual with a confirmed Chapter 11 plan, the collection limitation period is suspended for such debts, pursuant to I.R.C. § 6503(h)(2), as long as (1) the Service's claim for the debt is allowed, (2) the plan provides for full payment of the tax debt, and (3) the plan is not in substantial default (considering any period provided to the debtor in the plan for curing a default)[4], plus six months. This was the situation and result in United States v. McCarthy, supra. The Government also made an argument along these lines in Montoya, supra, but the Seventh Circuit did not address the argument because the Service's claim also was disallowed, before being reinstated, for a period long enough to achieve the Service's desired suspension of the priority claim calculation periods at issue in that case.

Although the Service may still use setoff opportunities in individual taxpayer cases to obtain payment of these non-dischargeable tax debts outside of the plan before the plan is in substantial default, this ability to continue to make setoffs has not stopped the Service from arguing nor the courts from finding that the Service is prohibited from "collecting" by reason of the bankruptcy case, for purposes of I.R.C.

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[4] The General Litigation User Guide to Chief Counsel's Macros, Document 9765 (9-96), recommends at page 1129-6 that Chapter 11 plans contain default language that allows the Service to collect tax debts provided for by a confirmed plan 14 days after the Service has made a written demand for the debtor to cure the default, if the default is not cured. We understand that the plan in this case did not contain a specific default provision of this type for the taxes at issue.

§ 6502(h)(2). See Montoya, supra, at 558 (specifically addressing and dismissing the taxpayers' argument that the Service's ability to perform offsets after plan confirmation meant the Service was not barred from collecting the taxes owed).[5]

In light of our advice above – that the Service's collection limitation period with respect to the taxes at issue in this case was suspended from the post-confirmation assessment date until the taxpayer substantially defaulted on her tax payments due under her confirmed Chapter 11 plan, plus six months – you have asked us two further questions. First, when should the Service consider the taxpayer as being in "substantial default" under the facts of this case? Second, did the collection limitation period resume running for the taxpayer's total tax balance due under her Chapter 11 plan six months after the taxpayer first substantially defaulted or did the collection limitation period only resume running for those portions of the tax balance due under the plan as the taxpayer failed each January (plus six months) to make the particular annual installment payments due under the plan?

The taxpayer first missed a tax payment due under her confirmed Chapter 11 plan in Date 5A. For the sake of convenience and prudence, we assume in our analysis that the missed tax payment was required on the first of the month, so the taxpayer's first tax payment default occurred on Date 5. Some Chapter 11 plans contain specific remedial provisions in the event of a default, which limit a creditor's right to resume collecting a debt due after a default to the period after the creditor has given the debtor a notice of the default and a reasonable period of time thereafter to cure the default. We understand that the Chapter 11 plan in this case did not contain specific default notice provisions of this type. Even if a Chapter 11 plan contains no default provisions, IRM 5.9.9.6.3 recommends that the Service first immediately send the debtor in these circumstances a notice of default and that the Service next wait to see whether the debtor cures the default by the date mentioned in the notice of default letter, before the Service begins to consider its administrative collection options anew.

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[5] See also I.R.C. § 6330(e)(1), which suspends the collection limitation period while the Service is prohibited by the new collection due process procedures from using a "levy" to collect a tax debt, even though "setoff" to obtain payment of the same debt would not be prohibited while the collection due process procedures are pending. In some districts, local bankruptcy rules or general orders now allow the Service to make setoffs of prepetition tax debts against prepetition tax refunds while the automatic stay is still in effect, without the Service moving to lift the stay. In these districts, we conclude that the Service's ability to obtain setoff in this manner, while the automatic stay otherwise prevents the Service from attempting to collect the tax, does not remove the suspension of the collection limitation period, under I.R.C. § 6503(h)(2), for the tax left unpaid after the setoff is made.

We understand that the notice of plan default letters in use in your district in Date 5A (when the taxpayer missed her first tax payment due under the plan) and the notice of default letter ultimately mailed to the taxpayer in this case in Date 8 (21 months after the first missed payment) provided a 15 day period for the taxpayer to cure a default. If the Service had mailed the taxpayer in this case a notice of default letter of this type reasonably soon after the Service should have first noticed the taxpayer's default, then we believe the Service would have a reasonably good case for arguing that the taxpayer should not have been considered in substantial default, for purposes of our suspension analysis under I.R.C. § 6503(h)(2), until after the debtor failed to cure her plan default by a reasonable cure date stated in the Service's notice of default letter. In McCarthy, supra, the court agreed that the Service's collection limitation period for the tax was suspended during the 30 day cure period (described in the plan), plus six months, following the taxpayer's missed plan tax payment.

In this case, the Service waited to send its notice of plan default letter to the taxpayer until 21 months after the taxpayer first missed the tax payment due under her plan and 8 months after the taxpayer's bankruptcy case was closed. In these circumstances, we recommend that the Service treat Date 5, as the date of the taxpayer's substantial default on the tax payments at issue due under her Chapter 11 plan.

Our office's position is that a debtor's substantial default under a Chapter 11 plan generally permits the Service to collect the entire amount due under the plan.[6] Accordingly, we conclude that upon the date of substantial default in this case, plus six months, the period of limitation for collection began running for the entire amount due under the plan, and not just for the missed annual payments. Thus, the collection statute for the entire remaining TFRP due under the plan began running six months after approximately Date 5, on or about Date 6. Accordingly, the collection limitation period for the taxpayer's TFRP at issue is due to expire on or about Date 9, based upon the information you have provided to our office.

We are sorry for the delay in reducing this advice to writing and hope that we have addressed all of your concerns. If you have any questions regarding this advice or

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[6] We understand that there is no controlling case law precedent, no local bankruptcy rule, and no local general order of the court in your district which limits a creditor to collecting only its missed installment(s) when a debtor defaults on its payment obligations due under a Chapter 11 plan. We also understand that the terms of the Chapter 11 plan in this case did not limit the Service's administrative collection remedies upon default to only seeking to collect the missed installment payment(s). This also is not a case where the debtor missed a tax payment and then resumed making payments due under the plan.

if we can be of further assistance, please contact the attorney assigned to this case at 202-622-3620.

cc: Assistant Regional Counsel (GL), Southeast Region