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MEMORANDUM FOR NORTH CENTRAL DISTRICT COUNSEL

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

SUBJECT: Continuous Levy
GL-709823-98

We are responding to your January 5, 1999, inquiry. This document is not to be cited as precedent.

Legend
Taxpayer A
Agreement A
Transit Company A
Period A

Issue
Whether payments issued to an independent contractor who provides both equipment and labor are considered to be continuous payments of salary and wages under I.R.C. § 6331(e).

Facts
The taxpayer, taxpayer A , entered into an Agreement A with Transit Company A to lease his tractor to them. Taxpayer A agreed to take all precautionary measures to maintain the tractor and to provide the operator of the tractor. The contract did not provide that Taxpayer A was to be the driver of the tractor; however, Taxpayer A was the sole operator of the tractor for the relevant period of time.

The contract provided that Taxpayer A would be paid in the following manner. Transit Company A paid Taxpayer A within period A

of the receipt of his travel logs. Taxpayer A was sporadically given advances then after he submitted his travel logs he would receive a settlement payment. The contract did not provide for the percentage of payments allocated for the lease and the driving services.

The Internal Revenue Service (hereinafter "Service") served two notices of levy on Transit Company A . One levy, Form 668W, was a continuing levy on the salary and wage portion of the contract that allegedly resulted from Taxpayer A driving services, and the other levy, Form 668A, was on the portion earned from the lease payments. Transit Company A failed to honor both levies. As to the 668A levy, Transit Company A asserted that it did not owe any money to Taxpayer A . As to the 668W levy, Transit Company A alleged that Taxpayer A was not its employee. Therefore, it was not obligated to comply with the levy. You requested us to review your position as to whether a suit should be brought against Transit Company A for its failure to honor the 668W levy.

Law and Analysis

1. Levy 668A

I.R.C. § 6332(a) provides that "any person in possession of property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights to the Secretary, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process." Courts recognize two defenses for the failure to honor a levy: (1) the party did not possess any property or rights to property of the taxpayer, or (2) the property was subject to a prior attachment or execution. See, e.g., United States v. General Motors Corp., 929 F.2d 249 (6th Cir. 1991). Transit Company A raised the former defense in the present case. It alleges that it was not in possession of the taxpayer's property at the time of the levies.

Revenue Ruling 55-210 recognizes that while a Federal lien for unpaid taxes, and the notice of levy based on such lien, reaches a taxpayer's unqualified fixed right to receive periodic payments or distributions in property, the notice of levy does not attach to the taxpayer's right to property if the right is contingent upon the performance of future services. See, also, St. Louis Union Trust Co. v. United States, 617 F.2d 1293, 1302 (8th Cir. 1980) (Recognizing that an unqualified contractual right to receive property is itself a property right subject to seizure by levy.) The treasury regulations further define this position.

Treas. Reg. § 301.6331-1(a) states: "[e]xcept as provided in § 301.6331-2(c) with regard to a levy on salary or wages, a levy extends only to property possessed and obligations which exist at the time of the levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date." The Service steps into the shoes of the

taxpayer and can acquire no greater rights to property than the taxpayer has. United States v. General Motors Corp., 929 F.2d 249 (6th Cir. 1991). ("Because the IRS 'steps into the taxpayer's shoes' and acquires whatever rights the taxpayer has with respect to the property, the IRS can succeed to rights no greater than those the taxpayer possesses.") Id. at 252. If Taxpayer A's right to payment, at the time of the levy, was not fixed and determinable then Transit Company A's defense for failing to honor the 668A levy will prevail.

In Tull v. United States, 69 F.3d 394 (9th Cir. 1995), the Service lost a Ninth Circuit case discussing the concept of "fixed and determinable." In Tull, the Ninth Circuit held that an auctioneer did not have a fixed and determinable obligation to the taxpayer even though there was a signed auction contract. Id. The court reasoned that even though the auctioneer had an obligation to attempt to sell the property, the fact that both the buyer and the price were undetermined makes the obligation "unfixed and undetermined." Id. at 397.

However, the Government prevailed on this issue in another Ninth Circuit opinion. In United States v. Hemmen, 51 F.3d 883 (9th Cir. 1995), a bankruptcy court entered an order allowing the trustee to pay the taxpayer an administrative expense of $18,000. Although it was not to be paid until later, the Ninth Circuit found that the Service's levy on the trustee was fixed and determinable because both the existence of the claim and the amount of the claim had been established. In making this conclusion, the court differentiated between the words "determined" and "determinable," stating that determinable only requires that the "sum be capable of precise measurement in the future." Hemmen, 51 F.3d at 890, citing Accord Reiling v. United States, 77-1 U.S. Tax Cas. (CCH) P9269 (N.D.Ind. 1977) ("concluding that an obligation is 'determinable' when contractual performance has been completed despite continuing litigation over the amount due.") In Hemmen, the obligation became "determinable" when the bankruptcy court approved the proposed distribution. The court ruled that the "fixed" requirement is fulfilled when the underlying performance is completed. In the instant case the underlying performance is the contract between Transit Company A and Taxpayer A .

When the 668A levy was served on Transit Company A , Transit Company A owed no payments to Taxpayer A . [redacted] .

2. Levy 668W

Internal Revenue Code § 6331(e) encompasses an exception to the rule that a levy only attaches to obligations that exist at the time the notice of levy is served. It provides that "The effect of a levy on salary or wages payable to or received by the taxpayer shall be continuous from the date such levy is first made until such levy is

released under section 6343." In the instant case, if part of the payments made to Taxpayer A is considered to be "salary or wages" then the levy would be continuous and would attach to this obligation that Transit Company A owed Taxpayer A . In turn, Transit Company A would not have a defense for failing to honor the levy. [redacted]

You and Transit Company A are in agreement that Taxpayer A is an independent contractor. We agree with your interpretation of their relationship; however, this relationship does not prevent the funds, paid to Taxpayer A , from being "salary or wages." As discussed in your memorandum, in the only case examining the applicability of section 6331(e) to independent contractors, the Third Circuit held that a levy served on an insurance company was continuous in nature because the commissions paid to the salesman constituted "salary or wages." United States v. Jefferson-Pilot Life Ins. Co., 49 F.3d 1020, 1022-23 (4th Cir. 1995). The instant case is distinguishable from Jefferson-Pilot because the treasury regulations specifically provide that commissions are to be considered "salary or wages"; however, the regulations do not provide for the situation in the instant case. Treas. Reg. § 301.6331-1(b).

[redacted] Under the contract, any qualified operator could have served the position that Taxpayer A did. "Wages" is defined as "a compensation given to a hired person for his or her services . . . " and "salary" as "a reward or recompense for services performed." BLACK'S LAW DICTIONARY (6th ed. 1990). Proceeds Taxpayer A would receive from the work done, if someone else operated the tractor, would not be "salary or wages." Simply because Taxpayer A did the work himself, rather than hiring another operator, does not change the character of the payments he received from lease payments to lease payments and wages. Also, the sole fact that the payments were made periodically does not qualify them as "salary or wages." See In re Kirk, 100 B.R. 85, 88 (Bankr. M.D. Fla. 1989) (Concluding that there was no correlation between the concept of salary and wages and the concept of disability retirement benefits except that each may be received on a fixed and periodic basis.) [redacted]

2. Fifty-percent penalty under I.R.C. § 6332(d)(2)

I.R.C. § 6332(d)(2) provides for a 50% penalty for anyone who fails to surrender any property subject to a levy unless the person failing to honor the levy can show reasonable cause for his or her failure. There is reasonable cause in refusing to comply with a levy if there is a "bona fide" dispute over the Service's legal right to

levy upon the property in concern. United States v. Sterling National Bank & Trust Co. of New York, 494 F.2d 919, 923 (2nd Cir. 1974); United States v. Citizens and Southern National Bank, 538 F.2d 1101, 1107 (5th Cir. 1976), cert. denied, 430 U.S. 945 (1977). However, reasonable cause does not "include a clearly erroneous view of the law, stubbornly adhered to after investigation should have disclosed the error." State Bank of Fraser v. United States, 861 F.2d 954, 962, reh'g denied, 1988 U.S. App. Lexis 18065 (6th Cir. 1988) (quoting the dissent in Sterling National Bank, 494 F.2d at 924.)

Even if the decision was made to file suit against Transit Company A for its failure to honor the 668-W levy, we strongly agree with you that the 50% penalty, under section 6332(d)(2), is not appropriate. Not only is Jefferson Pilot the sole legal authority applying section 6331(e) to independent contractors, but as is apparent by our conflicting legal interpretations of the given facts, neither view is "clearly erroneous." If you decide to recommend this penalty, when your letter to Department of Justice comes through this office we will again review the appropriateness of the penalty and perhaps we will find that a proper foundation has been established for the penalty

CONCLUSION

If you have any further questions please call (202)622-3610.