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MAY 2000 *BULLETIN NO. 476*

GENERAL LITIGATION BULLETIN

Department of the Treasury Office of Chief Counsel Internal Revenue Service

NO GREATER BURDEN TO BEAR
Bankruptcy Does Not Alter Who Has Burden of Proof

Bankruptcy does not alter the burden of proof imposed by substantive law. In **Raleigh v. Illinois Department of Revenue**, **2000 U.S. LEXIS 3623 (S.Ct. May 30, 2000)** the Supreme Court ruled that the trustee retained the burden of proof in bankruptcy where underlying state law put that burden on the taxpayer outside of bankruptcy.

When it purchased an airplane out of state, a corporation was charged with a use tax by the State of Illinois. The corporation went belly-up, and its principal officer, who was in bankruptcy, was charged with an equivalency penalty (like the Trust Fund Recovery Penalty). The debtor contested the penalty on the issue of wilfullness. The trustee challenged the State's claim, and argued that despite a state law provision shifting the burden of proof to the responsible officer charged with the penalty, in bankruptcy federal law controlled. The trustee argued that historically, creditors had the burden of proof in bankruptcy. The Supreme Court disagreed.

The Court found the basic federal rule in bankruptcy is that state law governs the substance of claims. As the burden of proof is a substantive aspect of a claim, it is determined by state law in the absence of explicit alteration by the Bankruptcy Code. Although the Code does provide particular burdens of proof in certain instances (such as B.C. § 362(g), relief from the automatic stay), the Code's silence in this instance means that burden remains the same as outside of bankruptcy.

BANKRUPTCY CODE CASES: Proofs of Claim

STATUTE SAYS WHAT IT MEANS AND MEANS WHAT IT SAYS
High Court Holds Only Named Party Can Invoke Statute

In a decision with implications beyond its holding, the Supreme Court ruled that only a trustee may pursue a claim for administrative expenses under B.C. § 506(c). However, its decision in **Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A., 2000 U.S. LEXIS 3624 (S.Ct. May 30, 2000)**, has potential interpretive significance for any

Bankruptcy Code provision where the statute gives a right to a particular party. In the Court's view, where a statute says that a certain party "may" act, this necessarily precludes any other party from acting.

In Hartford, an insurance carrier provided coverage to the debtor, unaware of its bankruptcy and without payment of premiums. When the bankruptcy converted to a liquidation, the insurance carrier discovered that the only assets were encumbered by a secured creditor. The carrier tried to recover its administrative expense claim under B.C. § 503(c) and § 506(c) from the secured assets. Since section 506(c) may only be used by the bankruptcy trustee, the Court held, the carrier was without a remedy.

In its final footnote, the Court noted that it was not ruling on the rights of creditors to pursue a derivative action for the estate where the trustee has been asked to pursue an action and has refused to do so, because the trustee in the present case was not asked and therefore did not refuse to pursue the present action.

BANKRUPTCY CODE CASES

STRESSED OUT
Bankruptcy Court Awards Emotional Distress Damages for Stay Violation

Finding that "peace of mind is invaluable,", the bankruptcy court in this case awarded debtors $1,000.00 for the "trauma" they experienced in receiving a Notice of Intent to Levy from the Service. **In re Covington, 2000 Bankr. LEXIS 517 (Bankr. D.S.C. March 6, 2000)**.

The debtors filed for Chapter 13 bankruptcy on April 24, 1998. The Service received notice and filed a proof of claim in the amount of $146,745. The debtors then filed amended returns for 1991 - 96, which the Service determined to be frivolous. After assessing a $500 frivolous return penalty for each year, the Service sent notices of the assessments using Form 866A. A second notice was mailed on November 9, 1998. On December 21, the Service mistakenly sent Notices of Intent to Levy for each frivolous return penalty. On December 23, the debtor's attorney mailed the Service, requesting the notices cease. The Service's bankruptcy specialist, who had been on Christmas vacation, responded on January 4 by putting a hold on the debtors' accounts and telephoning the debtors' attorney's office. The debtors then filed suit for damages resulting from the violation of the stay.

The Service argued that a "Notice of Intent to Levy" was really a notice of assessment, and so did not violate the automatic stay. The court didn't buy it. Where the creditor has actual knowledge of the bankruptcy, which the Service did, a violation of the stay is willful. The court would not award punitive damages, nor attorneys fees to the pro se litigants. However, the court found that the debtors previously had a bank account levied by a creditor (not the Service) and were fearful that this would occur again. This was sufficient for a finding of actual damages.

The court stated that "while damages for mental anguish can be difficult to prove, the natural and powerful emotional reaction cannot be dismissed as fleeting or inconsequential." The court also found that such mental anguish need not be proved by medical or other expert testimony.

BANKRUPTCY CODE CASES: Automatic Stay (§ 362): Contempt for Violation

CASES

1. ANTI-INJUNCTION ACT

Fayeghi v. Commissioner, 2000 U.S. App. LEXIS 8645 (9th Cir. May 3, 2000) - Taxpayers filed a 1990 return, listing a tax debt of $107,000 which was not paid. The Service assessed the tax in 1991, after which the taxpayers filed an amended return claiming only a liability of $7,000 (which again was not paid). The Service treated the amended return as a claim for abatement. In 1995, the Service proposed to determine that the taxpayers had a deficiency of $321,000 for their 1990 return. In 1997, the Service sent a Notice of Deficiency, to which the taxpayers filed a petition for redetermination in tax court. The taxpayers then filed a motion for injunctive relief under I.R.C. § 6213(a), but only as to the $107,000. The Ninth Circuit found that the Anti-Injunction Act, I.R.C. § 7421(a), bars relief. Although section 6213(a) is an exception to the Act, it applies only to collection of taxes in deficiency proceedings, and the $107,000 is not a deficiency, but is the amount of tax admitted as due by the taxpayers. The filing of an amended return has no effect on the collection process, the appellate court held, and does not require the Service to treat the amount of tax due on the taxpayer's original return as a deficiency.

2. BANKRUPTCY CODE CASES: Chapter 12: Effect of Confirmation

In re Black, 2000 U.S. Dist. LEXIS 5880 (D. Az. March 30, 2000) - Service filed Notice of Federal Tax Lien before debtor filed Chapter 12 bankruptcy. Service then filed proof of claim for $29,000, which debtor did not object to. Debtor's plan, however, provided for payment of only $13,000 in priority taxes. The Service did not object, and the plan was confirmed. After the bankruptcy closed, the Service gave notice of its intent to collect the remainder of the secured debt. The district court, affirming the bankruptcy court, held that when a creditor has notice and opportunity to object, the finality of a confirmation order is absolute, even if the plan conflicts with the Bankruptcy Code or Rules.

3. BANKRUPTCY CODE CASES: Chapter 13: Effect of Confirmation
BANKRUPTCY CODE CASES: Setoff (§ 553): Refunds

In re Munson, 2000 U.S. Dist. LEXIS 6536 (C.D. Ill. April 25, 2000) - Confirmation of a Chapter 13 plan does not alter or extinguish a creditor's right to setoff. Debtor filed a Chapter 13 plan, listing the Service's claim for 1996 taxes. The debtor then filed for a 1998 tax refund, claiming it as exempt, then had her plan confirmed without objection. The Service filed a motion to lift stay and setoff, which the bankruptcy court denied. The district court disagreed with the bankruptcy court's conclusion that a confirmed plan binds all creditors. Instead, the court ruled, a creditor with a valid right of setoff, as the United States had here, under B.C. § 553, trumps section 1327.

4. **BANKRUPTCY CODE CASES: Determination of Tax Liability (§ 505): Amount or Legality of Any Tax Liability**
In re Karlsson, 247 B.R. 321 (Bankr. M.D. Fla. 2000) - Bankruptcy court's ability under B.C. § 505(a)(1) to determine the amount and legality of any tax does not extend to penalties or interest. In addition, court cannot review Service's failure to abate interest under I.R.C. § 6404(e)(1).

5. **BANKRUPTCY CODE CASES: Exceptions to Discharge: No, Late or Fraudulent Returns**
In re Carnes, 244 B.R. 435 (Bankr. W.D. Mo. 2000) - Debtor failed to file tax returns because he lacked funds to pay taxes, but cooperated with Service audit. Debtor then filed Chapter 7 bankruptcy, arguing that his taxes were dischargeable under B.C. § 523(a)(1)(C). Examining the applicable case law, the district court concluded that although mere nonpayment of taxes, without more, is insufficient grounds for nondischargeability; where debtor is aware of his duty to pay, has the ability to pay, and takes steps to avoid payment, as in this case, debtor wilfully attempted to evade or defeat payment of taxes.

6. **BANKRUPTCY CODE CASES: Interest: Administrative and "Gap" Expenses**
In re Stacy, 2000 Bankr. LEXIS 484 (Bankr. W.D.Va. April 20, 2000) - Post-petition, pre-confirmation interest on a nondischargeable tax claim survives bankruptcy against the Chapter 11 debtor personally.

7. **BANKRUPTCY CODE CASES: Liens: Determination of Secured Status**
In re Hoekstra, No. 99-12361-SSM (Bankr. E.D. Va. May 10, 2000) - Service's tax lien against real property was third in priority after two mortgages, which combined exceeded the equity in the property. The bankruptcy court allowed the Chapter 7 debtor to strip the Service's unsecured lien, based on In re Yi, 219 B.R. 394 (E.D. Va. 1998).

8. **BANKRUPTCY CODE CASES: Preference (§ 547)**
In re Anderson, 2000 Bankr. LEXIS 475 (Bankr. E.D. Ky. April 18, 2000) - Taxpayer, against whose property NFTLs had been filed, was injured in an auto accident and subsequently filed Chapter 7 bankruptcy. When the trustee recovered certain settlement payments as preferences, the Service claimed priority under its liens. The court agreed that as the Service's lien attached to the debtor's rights in the settlement proceeds, any such proceeds recovered also would be subject to the NFTLs. Consequently, the Service had a secured claim to the extent of such recoveries.

9. **BANKRUPTCY CODE CASES: Proofs of Claim (§ 501)**
United States v. Johnson, 2000 U.S. Dist. LEXIS 5649 (N.D. Ga. March 30, 2000) - This bankruptcy opinion deals primarily with income allocation issues, but a portion is devoted to an analysis of who bears the burden of proof in establishing a claim

in bankruptcy. The court here held that the Service, like any other creditor, has the ultimate burden of proof in establishing the validity and amount of its claim.

10. BANKRUPTCY CODE CASES: Setoff (§553): Refunds: Taxes
United States v. Luongo, 2000 U.S. Dist. LEXIS 5536 (N.D. Tex. April 3, 2000) - Service is entitled to setoff debtor's income tax refund, despite debtor's claims that tax refund is exempt property and that the tax liability was discharged in bankruptcy. The court found I.R.C. § 6402(a) creates a valid right of setoff, and that B.C. § 553(a) is clear and unambiguous in permitting the Service to exercise that right, notwithstanding the discharge of the tax debt in bankruptcy.

11. DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection (§ 7433)
Abel v. United States, 2000 U.S. Dist. LEXIS 1237 (D. Or. Feb. 10, 2000) - Taxpayer sued Service for wrongful levy on stock brokerage accounts. The court found that the taxpayer did not sustain actual economic damages under I.R.C. § 7433(b) because the value of his funds increased during the period they were frozen by the Service levy. The court dismissed as too speculative the taxpayer's argument that he could have reinvested the funds, and increased the amount of gain, during the period of the levy.

12. INJUNCTIONS
Gardner v. United States, 2000 U.S. App. LEXIS 11035 (D.C. Cir. May 19, 2000) - Part of this decision dealt with the taxpayer's request for injunctive relief under I.R.C. § 6213(a). The appellate court reversed the lower court's determination that the Anti-Injunction Act, section 7421(a), barred such relief unless the debtor could show irreparable harm and the lack of an adequate remedy at law. Instead, the court of appeals ruled, a taxpayer is entitled to injunctive relief under section 6213(a) without establishing equitable grounds for relief.

13. INNOCENT SPOUSE
Corson v. Commissioner, 114 T.C. 24 (T.C. May 18, 2000) - Tax Court holds that a non-electing spouse has a right to challenge by litigation the Service's decision to grant relief under I.R.C. § 6015 to the other spouse.

14. INNOCENT SPOUSE
Fernandez v. Commissioner, 114 T.C. 21 (T.C. May 10, 2000) - Tax court has jurisdiction under I.R.C. § 6015(e)(1)(A) to review Service's denial of innocent spouse relief under section 6015(f).

15. LEVY: Wrongful
Oxford Capital Corp. v. United States, 2000 U.S. App. LEXIS 8604 (5th Cir. May 2, 2000) - Employee leasing company, in arrears in taxes, was taken over by plaintiff corporation. Service levied on leasing company's accounts receivables, which plaintiff then directed be deposited in its own bank accounts. Service responded by levying on plaintiff as nominee, alter ego or transferee. The Fifth Circuit held that the United States must establish, by substantial evidence, a nexus

between the taxpayer and the property levied upon. In remanding back to the district court to establish whether the Service in fact met this heightened burden of proof, the appellate court observed that the Service relied solely on tracing specific funds owed to the leasing company to the plaintiff's bank account (which may establish nominee status, entitling the Service only to the traced funds). Although the Government may later have compiled sufficient facts to establish alter ego status (and so been able to levy on any asset of the plaintiff), the only relevant factor is what the Service knew at the time of the levy. A concurring opinion elaborated that a levy made without probable cause amounts to an unconstitutional seizure under the Fourth Amendment, and so unless the Service can prove, by substantial evidence, that the plaintiff was the alter ego of the leasing company, based on facts available to the Service at the time of the levy, such levy would be wrongful.

16. SUITS: Against the U.S. or Employees
Lawyers Title Insurance Corp. v. Phillips, 2000 U.S. Dist. LEXIS 5663 (M.D.Ga. April 10, 2000) - During refinancing, attorney failed to discover tax liens filed against property. When Service foreclosed, debtor defaulted on loan, and title company sued attorney for performing inadequate title search. The attorney in turn sued the Government, alleging it misfiled the tax liens and wrongfully levied on the property. Although the attorney had not properly served the Government, the court held that the suit would have to be dismissed in any event. According to the court, the attorney could not avoid the Government's sovereign immunity, because he lacked an interest in the property.

17. SUITS: Jurisdiction: Contest of Merits of Tax
Van Fossen v. Commissioner, T.C. Memo 2000-163 (T.C. May 18, 2000) - Tax Court has subject matter jurisdiction under I.R.C. § 6330(c)(2)(B) to review Service's administrative decision. The Tax Court found, as with lien or levy proceedings under section 6320(c), that even though the taxpayer received a statutory notice of deficiency prior to assessment, without challenging the deficiency, the taxpayer had the right to have the Service's collection due process hearing determination reviewed by a court. The Tax Court, however, dismissed the taxpayer's petition, because in challenging the underlying assessments the taxpayer does not state a claim upon which relief can be granted.

CHIEF COUNSEL ADVICE

COLLECTION DUE PROCESS; BANKRUPTCY: AUTOMATIC STAY

December 23, 1999

CC:EL:GL:Br1
GL-808185-99
UILC: 09.08.01-00
50.00.00-00

MEMORANDUM FOR SOUTHERN CALIFORNIA DISTRICT COUNSEL

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

SUBJECT: Notice of Intent to Levy/CDP Notice Issued During Automatic Stay
Taxpayer:

This memorandum responds to your memorandum regarding the above subject. This document is not to be cited as precedent.

LEGEND:

Taxpayer X
Date A
Date B
Date C
Amount A
Amount B
Amount C
Date D
Date E
Date F
Date G

ISSUE(S):

1. Whether a Notice of Intent to Levy and Notice of Your Right to a Hearing pursuant to I.R.C. § 6330 issued after commencement of the bankruptcy violates the automatic stay in bankruptcy provided in 11 U.S.C. § 362.

2. Whether the taxpayer had a right to dispute the underlying liability pursuant to I.R.C. § 6330(c)(2)(B) because he did not receive a statutory notice of deficiency pursuant to I.R.C. § 6213.

CONCLUSION:

1. A Notice of Intent to Levy and Notice of Your Right to a Hearing violates the automatic stay because it is an act to collect a claim that arose before the commencement of the bankruptcy case in violation of 11 U.S.C. § 362(a)(6).

2. The taxpayer is entitled, pursuant to I.R.C. 6330(c)(2)(B), to dispute the underlying tax liability because the tax liability in dispute arose from filed income tax returns for and Date B for which no statutory notice was issued.

FACTS:

On Date C, the taxpayer filed a federal income tax return for showing a refund of $ Amount A. He then filed an amended return that showed a tax liability of $Amount B. The taxpayer filed a timely federal income tax return for Date B showing a tax liability of $ Amount C. The Internal Revenue Service (Service) properly assessed the tax liabilities and sent the taxpayer proper notice and demand under I.R.C. § 6303. The taxpayer entered into an installment agreement with regard to the Date A and Date B tax liabilities but made no payments on the installment agreement. The Service sent the taxpayer a Notice of Intent to Levy pursuant to I.R.C. § 6331(d) in Date D informing the taxpayer that he had defaulted on his installment agreement and that the Service intended to levy. It does not appear that the Service took any action prior to January 19, 1999, [1] as a result of that notice.

The taxpayer filed a Chapter 7 petition in bankruptcy on Date E . I.R.C. § 6330 became effective on January 19, 1999. Pursuant to section 6330, the Service sent the taxpayer a Notice of Intent to Levy and Notice of Your Right to a Hearing (known as a Collection Due Process Notice or CDP Notice) (Form 1058) on The taxpayer timely sent a Request for a CDP Hearing (Form 12153) which was timely received by the Service.

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[1] Prior to January 19,1999, the effective date of section 6330, enacted by the Internal Revenue Service Restructuring and Reform Act of 1998, taxpayers did not have a right to a collection due process hearing prior to levy.

The Appeals Officer contacted the taxpayer by mail to schedule a CDP hearing. In that letter, the Appeals Officer set forth I.R.C. § 6330(c)(2)(B) as his legal basis for informing the taxpayer that, by law, he could not raise the underlying liability because he had received "notices." The Appeals Officer did not specify to which notices he was referring, but it appears that he was referring to the statutory notice of deficiency mentioned in section 6330(c)(2)(B). The taxpayer met with the Appeals Officer on Date G, and set forth his reasons for challenging the underlying liability. The Appeals Officer has requested assistance from your office with respect to the wording of a proposed Notice of Determination.

LAW AND ANALYSIS

CDP Notice as Violation of Automatic Stay

In our view, the issuance of a section 6330 CDP Notice by the Service is a violation of the automatic stay in bankruptcy in violation of 11 U.S.C. § 362(a). In the present case, both Date A and Date B are prepetition years. Hence, any attempt to collect from the taxpayer-debtor would violate the automatic stay. A debtor is protected from "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. . . ." 11 U.S.C. § 362(a)(6). The Service will generally issue a CDP Notice pursuant to section 6330 only when it has identified a levy source and levy is the next planned action. Section 6330(a)(3)(C) directs that the CDP Notice inform the taxpayer of the Service's proposed action, i.e., the proposed levy.

We conclude that issuance of a CDP Notice during bankruptcy is in violation of the automatic stay; therefore, the CDP Notice is void. In re Schwartz, 954 F.2d 569 (9th Cir. 1992) (violations of the automatic stay are void). Taxpayers have the right to request a CDP hearing under section 6330 only if they do so within thirty days of the date on the CDP Notice. If the CDP Notice is void, the taxpayer does not have a right to a CDP hearing and the Service may not issue a Notice of Determination on the basis of a hearing held pursuant to a void CDP Notice. In addition, we believe there has been no statutory suspension of the limitations period on collection in this case pursuant to I.R.C. § 6330(e) because no valid CDP Notice was sent and the taxpayer, therefore, does not have the right to request a CDP hearing, which would cause the Service to suspend the statute.

Once the taxpayer is no longer in bankruptcy, the Service may send a valid CDP Notice. To avoid any confusion, we recommend delivering a new, valid CDP Notice to the taxpayer in person and explaining to the taxpayer that his prior CDP hearing was held in violation of the automatic stay of 11 U.S.C. § 362(a)(6). He should, therefore, sign a new Request for a CDP Hearing (Form 12153) and Appeals will grant him a new CDP hearing.

We do not agree with your suggestion that actions taken by the Appeals Officer that are analogous to settlement discussions or compromise agreements might be

permissible during the pendency of a bankruptcy. This approach fails to recognize that the very issuance of a CDP Notice pursuant to section 6330 was a step by a revenue officer to collect or recover a liability owed to the Government. As such it is a violation of the automatic stay and is void. If the Service intends to enter into settlement discussions or a compromise agreement while a taxpayer is in bankruptcy, there are alternative courses of action that do not include sending a CDP Notice.

Right to Dispute the Underlying Liability

When the taxpayer in this case receives a valid CDP Notice, he has a right to dispute the underlying tax liability. I.R.C. § 6330(c)(2)(B) permits a taxpayer to raise the underlying liability at a CDP hearing if he "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have any opportunity to dispute such tax liability." (Emphasis added.) The tax liability in this case arose from filed tax returns. The Service did not issue a statutory notice of deficiency with regard to these tax liabilities for and Date B; rather they were self-assessed. It appears from the facts presented that the taxpayer has never had an opportunity to meet with the Service to discuss the merits of his tax liabilities. The Service could issue a new CDP Notice to the taxpayer since we understand that the applicable statute of limitations on assessment is still open. We agree with your proposed recommendation that the Appeals Officer turn the case over to the Examination Division for resolution.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

We can identify no other litigating hazards that would change or qualify the conclusions reached in this memorandum. Please modify your advice to reflect the conclusions reached in this memorandum.

VOIDING OR RESCINDING IRS SALES

December 8, 1999

CC:EL:GL:Br1
GL-602519-99
UILC: 50.30.10-00

MEMORANDUM FOR DISTRICT COUNSEL, NORTH FLORIDA DISTRICT JACKSONVILLE

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

SUBJECT: Voiding or Rescinding IRS Tax Sales
Taxpayer:

This responds to your request for advice regarding the above subject. This document is not to be cited as precedent.

ISSUE(S):

1. Can the Internal Revenue Service (Service) adopt a more flexible administrative remedy for taxpayers who fail to file a suit to quiet title within the 180-day redemption period after the Service has conducted a procedurally defective tax sale and for purchasers in the same situation.

CONCLUSION:

The taxpayer must file a suit to quiet title within the 180-day statutory period of redemption. The Service is prohibited from adopting a more flexible administrative remedy for either the taxpayer or a purchaser than that provided by the Internal Revenue Code (Code).

FACTS:

The Service seized and sold property belonging to the taxpayer. The sale was procedurally defective because the Service did not properly serve the purchaser with the notice of sale as required by I.R.C. §6335(a) and (b). After the 180-day redemption period, the Service issued a deed to the purchaser who sued to evict the taxpayer in state court. The taxpayer successfully argued that the sale was defective because he was improperly served as noted above. The state court refused to evict the taxpayer and instead dismissed the suit. The purchaser demanded a return of the purchase price plus costs (e.g., attorney's fees and lost interest).

LAW AND ANALYSIS

Courts have held that the Service must strictly comply with the seizure and sale statutory provisions of the Code, which are for the benefit of the taxpayer, or be faced with a sale that is voidable by the taxpayer. In contrast, there is no statutory protection for the purchaser of real property pursuant to section 6335. Purchasers who have objected in similar situations have not prevailed. Powelson v. United States, 963 F.2d 1156 (9th Cir. 1992); Kulawy v. United States, 917 F.2d 729 (2d Cir. 1990); Reece v. Scoggins, 506 F.2d 967 (5th Cir. 1975).

Your office has suggested that the Service exercise greater flexibility in this area in order to promote settlement with taxpayers and to minimize litigation. Specifically you recommend that taxpayers be given two years to bring a suit to quiet title in the event of a procedurally defective sale. This recommendation of a two-year period must be analyzed in the context of the 180-day redemption period provided in I.R.C. § 6337(b)(1). A brief review of the legislative history of section 6337(b)(1) shows that Congress carefully selected the present 180-day redemption period.

The Internal Revenue Code of 1954 contained section 6337(b)(1) in a form substantially similar to the current provision in the 1986 Code with the exception that property could be redeemed at any time within “1 year after the sale thereof.” That time period carried over unchanged from the Internal Revenue Code of 1939 and earlier Revised Statutes. See H.R. Rep. No. 1337, 83rd Cong. 2d Sess., 411 (1954). In 1966, the Federal Tax Lien Act amended section 6337(b)(1) by reducing the time available for redemption to 120 days. The explanation for this change is highly relevant to the present discussion:

> While a reasonable period of time for redemption in these cases is desirable, nevertheless, such a long redemption period tends to unnecessarily depress the price which potential purchasers are willing to bid for property at these sales.

H.R. Rep. 1884, 89th Cong., 2d Sess.,18 (1966). The shorter redemption period could be interpreted as beneficial to the taxpayer because a higher price for the property would result in a greater satisfaction of his tax liability. Nevertheless, in 1982, in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Congress increased the 120-day period to 180 days. The provision appeared in Subtitle H entitled Taxpayer Safeguard Amendments. The subtitle also included provisions increasing the value of property exempted from levy and requiring the release of a lien within 30 days. While the legislative history contains no explanation for the change, we believe that the addition of an extra sixty days was considered to be beneficial for a taxpayer because it affords additional time to raise funds needed to redeem real property. It is also clear that the 180-day period for redemption, which is also the period during which the taxpayer has standing to file such a suit, does not allow for additional flexibility since it provides the basis for a waiver of sovereign immunity.

The taxpayer's ability to recover on his lawsuit depends on whether a taxpayer has standing to bring a suit for failure of the Service to strictly follow the procedures of I.R.C. § 6335. While many courts gloss over the jurisdictional and sovereign immunity waiver requirements because they were met in a particular case, taxpayers must cast their lawsuit as a suit to quiet title in order to invoke the waiver of sovereign immunity pursuant to 28 U.S.C. § 2410. This suit is appropriate where the United States has or claims a mortgage or other lien on real property. Briefly, 28 U.S.C. § 2410 provides for the waiver of sovereign immunity, and a separate basis must be present for the court to have jurisdiction over a case. Jurisdiction is provided by 28 U.S.C § 1340 which grants to district courts "original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue."

Therefore, it is incumbent upon the Service to determine whether the complaining taxpayer is still within the 180-day redemption period provided by I.R.C. § 6337 when it becomes a party to a quiet title action. Only during that period does the United States have a lien on or an interest in the property that would subject it to the section 2410 waiver provisions. See Dzuira v. United States, 966 F. Supp. 126 (D. Mass.

1997). Millitello v. United States, 970 F. Supp. 1022, 1025 (M. D. Fla. 1997), clearly states the pertinent law:

> At the time when Plaintiff commenced this action, the Government no longer had a lien interest in the property at issue. Since the Government had already sold the property prior to the filing of the suit, and no longer claimed any interest in the property, § 2410 does not apply. . . . Finally, § 2410 should not be read to provide a means of disturbing a sale long since final. (Citations omitted.)

Any attempts by the Service administratively to lengthen the period in which a taxpayer could sue to rescind a procedurally defective sale would fail because waiver of sovereign immunity is strictly construed. Koehler v. United States, 153 F.3d 263 (5th Cir. 1998) (sovereign immunity deprives the courts of jurisdiction regardless of the merits of the taxpayer's claims); Kabakjian v. United States, 99-1 U.S.T.C. ¶ 50,150 (E.D. Pa. 1998) (waiver of sovereign immunity strictly construed).
Congress also has not provided a remedy to a purchaser who is dissatisfied after purchasing property at a tax sale. A close reading of the statute on sale and redemption suggests that these provisions are for the benefit of the taxpayer since the Service is selling the taxpayer's seized property to satisfy the taxpayer's liability. The sale of property seized by the Government, as noted in Treas. Reg. § 301.6335-1(c)(4)(iii), is accomplished on a "caveat emptor" basis. Property is sold "as is" and "where is" and "without recourse to the United States." Moreover, a purchaser may not seek rescission of the sale for failure of the property to conform in any way to the representations made. A careful reading of I.R.C. §§ 6335-6339, the sale provisions, reveals no remedy to a disappointed purchaser. [2] In the event the taxpayer redeems the real property after sale, of course, a purchaser is entitled to "the amount paid by such purchaser and interest thereon at the rate of 20 percent per annum" to compensate him for the use of his money as set forth in I.R.C. § 6337(b)(2).

Recent changes to I.R.C. § 7433, by which a taxpayer can sue for intentional, reckless, or negligent actions of revenue officers and employees, does not extend to third parties or purchasers at tax sales. Certainly third parties and tax sale purchasers

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[2] See William T. Plumb, Jr. Federal Liens and Priorities–Agenda for the Next Decade III, 77 Yale L. Journal 1104, 1162 (1968), in which the author suggests that a purchaser might be reimbursed "perhaps on the ground of mutual mistake if the property sold proves not to have been property subject to the lien at all." But see Woody v. United States, 86-2 U.S.T.C. ¶ 9196 (Cl. Ct. 1986) (Court held that purchaser who claimed to be misled by a notice of sale purporting to sell two tracts when the taxpayer owned only one tract had no recourse because sale notices purported to sell only taxpayer's interest in property); accord Martin v. United States, 97-1 U.S.T.C. ¶ 50,320 (Fed. Cl. 1996) (Service's Notice of Encumbrance disclaimer precluded purchaser from asserting claim he was misled).

could have been included, but Congress chose to reserve these provisions exclusively for taxpayers.

In conclusion, the carefully crafted legislative scheme does not permit the Service administratively to provide flexibility to either taxpayers or purchasers after a procedurally defective tax sale other than those avenues discussed above. A taxpayer may void a procedurally defective sale by filing a suit to quiet title within the redemption period. A purchaser has no remedy in the event of a procedurally defective sale.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

We can identify no other litigating hazards that would change or qualify the conclusions reached in this memorandum.

DONEE LIABILITY: I.R.C. § 6324(B)

CC:EL:GL:Br1
January 11, 2000 TL-543-98
UILC: 04.10.00-00
51.09.00-00

MEMORANDUM FOR DISTRICT COUNSEL HOUSTON

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

SUBJECT:

LEGEND:

Taxpayer (Donor) X
Donee Y
Amount $Z

This is in response to your memorandum of September 9, 1999, regarding the above subject. The questions you raised concern the application of I.R.C. § 6324(b).

ISSUES:

1. Whether donee liability under section 6324(b) may be imposed where the Internal Revenue Service (Service) has asserted a deficiency for additional gift tax against the donor with respect to unreported transfers of property to third parties while the case is pending in the Tax Court.

2. What is the Service's current policy with respect to the assertion of donee liability under section 6324(b).

CONCLUSION:

The Service may impose personal liability against a donee pursuant to section 6324(b) while a deficiency proceeding is pending in the Tax Court as a result of the Service's assertion of additional gift tax liability against the donor but it will have to await the court's decision to ascertain the amount of that liability. It is the current policy of the Service to pursue donee liability only where it appears that collection from the donor is not possible.

FACTS:

X the donor, died on On October 14, 1997, the Service issued a notice of deficiency to the executor and temporary administrator of the estate of X for federal gift tax relating to transfers made by X during the taxable year. The Service had determined, among other things, that during , X had made taxable gifts of to Y. The Service also determined that during that same year, X made a taxable gift of real property valued at $Z to, a , married Y subsequent to having made the taxable gifts to her in

The decedent filed his gift tax return on or about None of the above-mentioned gifts were reported on the gift tax return. Neither Y or were listed as donees of any gift reported on the return. Although the amount of tax shown on the gift tax return was fully paid with the filing of the return, the Service, however, increased the amount of the decedent's taxable gifts and asserted a deficiency in gift tax for the year. The donor's estate filed a petition with the Tax Court in response thereto.

Prior to the decedent's death, a great majority of his assets were transferred into the donor's Living Trust, leaving his estate nearly devoid of assets. The decedent's son, , is the primary beneficiary of the trust and the decedent's long-time is the trustee. The Service has not yet taken any steps to assert transferee liability against the trust for the decedent's unpaid gift tax liabilities.

The estate contends that it has no funds and that the remaining assets of the living trust are insufficient to satisfy the outstanding gift tax liabilities. Consequently, the estate believes that the Service should assert donee liability under I.R.C. § 6324(b) against both Y and for the unpaid gift tax liabilities.

Y filed a petition in bankruptcy under Chapter 11 of the Bankruptcy Code on The bankruptcy case is currently pending and the Service did not file a proof of claim for her gift tax liability since the Service was not asserting gift tax liability against Y at time her petition was filed. The period for filing a proof of claim has expired and the plan has been confirmed. Bankruptcy Code § 507(a)(8) governs the priorities of tax claims in bankruptcy. Unlike subsection (8)(A) which refers to income or gross

receipts taxes, subsection (8)(E) provides for the priority of excise taxes under which category gift taxes fall. In re Grynberg, 986 F2. 367 (10th Cir. 1993). Pursuant to subsection (8)(E)(i), priority is awarded to a gift tax where the transaction (gift) occurs within three years prior to the date the petition is filed. In the instant case, the gifts to Y were made between and . Thus, except for any gifts that 1 may have been given to Y between , all the other gifts would fall within the three year period prior to the petition date and the gift taxes arising therefrom would constitute nondischargeable taxes. One caveat that must be considered is that B.C. § 507(a)(8) does not state that the priority afforded the government applies not only to the debtor (who is usually the taxpayer) but to transferees of the debtor as well. However, the legislative history of that section leads us to believe that the same result would apply in the case of a transferee. See, Statement of Senator DeConcini, 124 Cong. Rec. S17429 (daily ed., October 6, 1978). As just stated, it is too late for the Service to collect these taxes from the bankruptcy estate since no proof of claim was filed. In addition, the gift tax lien provided by section 6324(b) is an unrecorded lien, unlike a notice of federal tax lien, and can be avoided by the bankruptcy trustee. B.C. § 545(2). However, the tax liability will survive the bankruptcy and will be collectible from any after-acquired assets. In this regard, presently there is an adversary proceeding in which Y has filed suit against the decedent's son, , to contest the share of donor's estate to which she claims to be entitled. If she is successful in that litigation, there may exist ample funds to satisfy her gift tax liability after having satisfied all the bankruptcy claim creditors. Pursuant to B.C. § 1141(d)(1)(A), the confirmation of Y's Chapter 11 plan entitled her to a discharge from her prepetition debts. Accordingly, the automatic stay was no longer in effect following confirmation of her plan. B.C. § 362(c)(2)(C).

LAW AND ANALYSIS:

ISSUE 1:

I.R.C. § 6324(b) provides another source of collection for the gift tax when that tax cannot be collected from a donor, i.e., it imposes personal liability upon the donee. Section 6324(b) reads as follows:

> Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.

I.R.C. § 6151 provides for the time and place for paying the tax shown on a return. Subsection (a) thereof states the following:

> General Rule – Except as otherwise provided in this subchapter, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

See also, Treas. Reg. § 25.6151-1.

The liability of a donee arises as soon as the donor fails to pay the tax when due, and the liability is not contingent upon a determination of a deficiency against the donor. Mississippi Valley Trust et al. v. Commissioner, 147 F.2d 186 (8th Cir. 1945). In that case, the period of limitations for asserting a deficiency against the donor had expired. The argument by the donee there was that the donor's liability for the tax was primary and that of the donee secondary, and that no liability should, therefore, exist against a donee for any part of a tax which a solvent donor has not admitted in his return, until there has been a deficiency determination against the donor in the manner and time provided by the statute. [3] However, as noted by the Eighth Circuit, the statute itself imposes the tax, fixes its amount, and prescribes the date when the payment thereof is legally due. "If the full amount of the tax thus imposed is not paid by the 15th day of March following the close of the calendar year, the tax has not been paid 'when due,' and the unpaid portion bears interest from that date. And, 'if the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift'." Id at 187. According to the court of appeals, "Nowhere in its language does the statute make the liability of the donee contingent or dependent upon a formal determination of deficiency against the donor or upon any other steps to collect from him. . . Where there have been no proceedings against the donor, the donee is afforded a full opportunity to contest the validity and the amount of the tax, under the provision in the transferee section of the statute for assessing and collecting his liability in the same manner as in the case of a deficiency." Id at 188.

In the present case, the Service has alleged that the donor, , made gifts during that were not reflected on the gift tax return filed by his estate. The tax shown on the return was paid in full with the return. Pursuant to I.R.C. § 6151, the tax was "due" when the gift tax return was due to be filed, i.e, on . (I.R.C. § 6075(b)(1)). Had the donor not paid the gift tax shown on the return, the donee here, Y, would have been liable only, to the extent of value of the gifts she received, for the amount shown on that return assuming the Service had not asserted a deficiency. However, since the Commissioner asserted a deficiency with respect to that return, we

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[3] Although the tax in Mississippi Valley was governed by the provisions of Title III of the Revenue Act of 1932, 26 U. S. C. A. Int. Rev. Act. P. 580, et seq., the result would be the same under section 6324(b).

believe that the words of the statute, section 6324(b), "If the tax is not paid **when due** . . ." (emphasis ours) refer to the amount of the deficiency asserted. Although, the court in Mississippi Valley held that the donee's liability is not contingent upon a "formal determination of a deficiency against the donor or any other step to collect from him," it would be more prudent to await the Tax Court's decision regarding the amount of that deficiency, if any, prior to taking steps to collect the amount of the deficiency asserted by the Service. The period of limitations pursuant to section 6901(c) for asserting transferee liability against an initial transferee such as Y is one year after the expiration of the period of limitations for assessment against the transferor. The total tax due at the time of filing of a gift tax return includes the amount shown on the return, plus the amount of the deficiency. As noted by the court in Mississippi Valley, citing section 1011 of the Internal Revenue Code of 1939, "the term deficiency means 'the amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the donor upon his return'." Id at 187. Until the Tax Court redetermines the amount of gift tax liability in the present case, there has been no final determination of the additional gift tax due for 1993. The facts in Mississippi Valley do not reflect whether the donor actually paid the amount of gift tax shown on the return either prior to, or subsequent to the time the Service alleged that a deficiency existed. However, as stated above, in the present case, the tax shown on the donor's gift tax return for was paid prior to the issuance of the notice of deficiency. In any event, we do not view the fact of payment of the amount of gift tax shown to be due on the return as negating the donee's personal liability under section 6324(b) or section 6901 where the Service could assert a deficiency.

Pursuant to section 6215(a), "If the taxpayer files a petition with the Tax Court, the entire amount redetermined as the deficiency by the Tax Court which has become final, shall be assessed and paid upon notice and demand from the Secretary. No part of the amount determined as a deficiency by the Service but disallowed as such by the decision of the Tax Court which has become final, shall be assessed or collected by levy or by a proceeding in court with or without assessment." Section 6215(a) clearly is applicable to the donor's liability, not that of the donee since it was the donor here who petitioned the Tax Court for review. Thus, although Y, as donee, is not the party who is contesting the notice of deficiency in the Tax Court, she is, nevertheless, pursuant to section 6324(b), personally liable for the gift tax but the amount of her liability generally should await the finality of the Tax Court's decision.

Based upon the foregoing discussion, we are of the view that Y, the donee, is liable, to the extent of the value of the gifts she received during for the amount of gift tax asserted as a deficiency for the gift tax return due for that year. Considering, as stated earlier, that the estate has challenged that deficiency in the pending Tax Court case, the extent of Y's liability will be determined by the outcome of the case, i.e., as prescribed by section 6324(b), she will be personally liable only to the extent of the value of the gifts she received assuming the Service's deficiency notice is upheld by the court.

ISSUE 2:

As a rule, the Service will not attempt to assert donee liability under section 6324(b) until all efforts to collect from the donor have been exhausted. IRM § 4582.21 states that "Except as provided . . . every effort should be made to assert the tax liability against the transferor within the period of limitation. However, if a deficiency in tax is determined in the case of the transferor and the period of limitation has expired, the deficiency should be asserted against the transferees (or fiduciary) within the statutory period of limitation applicable to them." Section 6324(b) renders the donee personally liable for the gift tax if it is not paid by the donor. Although there exist two separate methods for collecting gift tax liability against a donee, i.e., the foreclosure of the section 6324(b) lien or the assertion of transferee liability under section 6901, the collection procedures set forth in the statute are not exclusive and mandatory but are cumulative and alternative to other methods of tax collection recognized and used prior to enactment of that statute and its predecessors. United States v. Russell, 461 F.2d. 605 (10th Cir. 1972). (Note that although Russell involved estate tax liability, the result would be the same for gift tax liability since sections 6324(a) and 6324(b) are similar.

For example, in Ripley v. Commissioner, 102 T.C. 654 (1994), the Service attempted to collect the gift taxes owed from the donee pursuant to the liability established under section 6324(b). Simultaneously, the Service issued the donee a notice of transferee liability pursuant to section 6901 and the donee filed a petition with the Tax Court for redetermination of the liability. The donee filed a motion to restrain collection under section 6213(a). Section 6213(a) permits the Tax Court to restrain assessment and collection of a deficiency in cases where "a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition." According to the Ripley court, normally the Service's collection efforts will be enjoined where it is attempting prematurely to collect a deficiency that is the subject of a timely filed petition for redetermination. See Meyer v. Commissioner, 97 T.C. 555 (1991). However, citing Treas. Reg. § 301.6324-1(d) which provides that the general tax lien under section 6321 and the special gift tax lien under section 6324(b) are not exclusive of each other but are cumulative, the Tax Court in Ripley concluded that the Service could collect the gift tax from the transferee (donee) without having made a prior transferee assessment pursuant to section 6901.

In La Fortune v. Commissioner, 263 F.2d 186 (10th Cir. 1958), one of the issues concerned a question of transferee liability for gift taxes. It was agreed that the donors were solvent but that the statute of limitations barred collection against them. Although all of the gift tax cases had been consolidated, in four of the cases presented, the assessments were made against donees of gifts out of which none of the claimed deficiencies arose.

According to the Tenth Circuit, the liability of the donee as transferee for unpaid gift tax of his donor is clearly established by statute but such liability is limited to the value of the gift received. Such liability has been repeatedly upheld by the courts. Solvency or insolvency of the donor is immaterial and assertion of a deficiency against the donor is not required. The statute, i.e., present section 6324(b), clearly imposes the liability on any donee of a gift made during the year and the fact that a deficiency exists because of a gift to another makes no difference. In La Fortune, the donees claimed

that the notice of transferee liability did not prorate the liability. However, in the Tenth Circuit's view, that is of no concern since the statute makes each donee liable to the extent of his gift. See also, Tilton v. Commissioner, 88 T.C. 590 (1987).

The present situation is similar to that before the United States Claims Court (now Court of Federal Claims) in Murray v. United States, 687 F.2d 386 (Ct. Cl. 1982). In that case, the plaintiffs, who represented the estate of the donor, believed that because the transferees (donees) represented an available source of payment, somehow the estate was absolved of any responsibility for the delinquent gift taxes. According to the court, "the plaintiffs' argument fails to recognize that even though the transferee liability provision causes a donee to be immediately and directly liable for the gift tax should the donor fail to pay the tax when due, section 6901(a)(1)(A)(iii), this does not prevent the IRS from seeking payment from the donor." As further stated by the court, "There is nothing in the Code requiring the IRS to obtain recovery from the donees in lieu of attempting to secure payment directly from the assets of the donor's estate. For this reason, we find that the IRS acted completely within its prerogative in assessing and collecting the unpaid gift taxes from Oliver's estate." Id at 393. Thus, based upon the foregoing discussion, we conclude that a donor has no right to insist that the Service pursue collection against a donee for the donor's unpaid gift taxes.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS: