



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

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MEMORANDUM FOR

FROM: Mitchel S. Hyman  
Senior Technician Reviewer, Branch 1  
(Collection, Bankruptcy & Summonses)  
CC:PA:CBS:Br1

SUBJECT: Tax Court Jurisdiction in a Collection Due Process  
Case to Determine Dischargeability of Taxes

This memorandum responds to your request for advice dated August 31, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

**QUESTIONS PRESENTED**

- I. Whether the Tax Court has jurisdiction in a collection due process case to decide whether the taxpayers' tax liability was excepted from discharge under the fraud exception of Bankruptcy Code § 523(a)(1)(C).
- II. If the Tax Court has jurisdiction, whether the correct burden of proof for determining that the fraud exception applies is a preponderance of the evidence or clear and convincing evidence.

**CONCLUSIONS**

- I. In the context of collection due process litigation, we take the position that the Tax Court has jurisdiction to determine whether a tax liability was dischargeable in a prior bankruptcy court proceeding.

II. The standard of proof for establishing before the Tax Court in a collection due process case that a tax liability was excepted from discharge under 11 U.S.C. 523(a)(1)(C) is a preponderance of the evidence.

### **FACTS**

The taxpayers filed a petition under Chapter 7 of the Bankruptcy Code on \_\_\_\_\_, and received a discharge. The taxpayers have unpaid tax liabilities for \_\_\_\_\_ and \_\_\_\_\_, of approximately \$ \_\_\_\_\_ total.

The Service issued a Notice of Intent to Levy and Notice of Right to a Collection Due Process Hearing with regard to the taxpayers' liability. The taxpayers timely filed a request for a collection due process hearing during which they claimed that their income tax liabilities were discharged in the Chapter 7 proceeding.

The Appeals Officer who conducted the collection due process hearing issued a Notice of Determination finding that the taxpayers' tax liability was excepted from discharge under the fraud exception of section 523(a)(1)(C). The taxpayers petitioned the Tax Court for a review of the Notice of Determination.

### **ANALYSIS**

#### **I. Tax Court Jurisdiction**

I.R.C. § 6330 generally provides that the Commissioner cannot proceed with the collection of taxes by way of a levy on a taxpayer's property until the taxpayer has been given notice of the matter and the opportunity for administrative review in the form of an Appeals Office due process hearing. If dissatisfied with the hearing results, the taxpayers can seek judicial review of the administrative determination. I.R.C. § 6330(d).

In a collection due process hearing, a taxpayer can raise any relevant issue relating to the unpaid tax or the proposed levy I.R.C. § 6330(c)(2); Treas. Reg. § 301.6330-1T, Q&A E1. In a judicial proceeding to review the Service's determination after a collection due process hearing, the taxpayer can raise any issue that was properly raised during the hearing. Treas. Reg. § 301.6330-1T, Q&A, F5.

A discharge order in bankruptcy court relieves a debtor from personal obligations and creates an injunction barring creditors from collecting discharged obligations. 11 U.S.C. § 524(a)(1) and (2).

The Tax Court is a court of limited jurisdiction. I.R.C. § 7442; Judge v. Commissioner, 88 T.C. 1175, 1180-1181 (1987); Naftel v. Commissioner, 85 T.C. 527, 529 (1985). The Tax Court holds that it lacks subject matter jurisdiction in

deficiency proceedings to determine whether or not a tax was discharged in bankruptcy. Neilson v. Commissioner, 94 T.C. 1, 16 (1990); Moody v. Commissioner, 95 T.C. 655, 658 (1990); Graham v. Commissioner, 75 T.C. 389, 399 (1980); Swanson v. Commissioner, 65 T.C. 1180, 1184 (1976); Fotochrome, Inc. v. Commissioner, 57 T.C. 842, 847 (1972). Generally, a taxpayer who wishes a ruling on dischargeability must seek the jurisdiction of the bankruptcy court. Neilson, *supra*.

I.R.C. § 6330(d)(1), however, provides for judicial review of an Appeals Officer's collection due process determination and confers jurisdiction on the Tax Court to hear the matter if the Tax Court has jurisdiction over the underlying tax. The Tax Court has jurisdiction to determine deficiencies in income tax. I.R.C. §§ 6211, 6213(a), 6214(a); Goza v. Commissioner, 114 T.C. 176, 182 (2000). The Tax Court, therefore, has jurisdiction to hear a taxpayer's challenge to the Service's determination to pursue collection of unpaid income taxes.

I.R.C. § 6630(c)(2) provides a listing of matters that a taxpayer can raise in a collection due process hearing: spousal defenses; challenges to the appropriateness of collection actions; and offers of collection alternatives. The listing is not all-inclusive.

Whether the Service is barred by law from collecting a tax because it was discharged is relevant to the unpaid tax, and more specifically, to the proposed levy. Moreover, dischargeability of the tax calls into question the appropriateness of collection action as well.

Discharge in bankruptcy, like innocent spouse relief, relieves a taxpayer of the obligation to pay the tax notwithstanding the validity of the underlying assessment; both measures effectively forestall the Service from collecting the liability from the taxpayer. The Tax Court can hear an appeal with respect to a collection due process determination of innocent spouse relief. I.R.C. § 6330(c)(2)(A); *see, also* King v. Commissioner, 115 T.C. 118 (2000).

In addition, state and federal courts may determine dischargeability in post-bankruptcy litigation. *See* Murphy v. Wheatley, 360 F.2d 180, 182 (5<sup>th</sup> Cir. 1966); In re Zitzmann, 46 F. Supp. 314, 315 (E.D.N.Y. 1942); Unemployment Compensation Fund v. Peters, 18 Pa. Commw. 448, 452 (1975); Ersparn v. Badgett, 647 F.2d 550, 556 (5<sup>th</sup> Cir. 1981), *cert. denied*, 455 U.S. 945 (1982).

Ideally, collection due process resolves in one administrative and judicial proceeding all matters with respect to collection of the tax in question. Legal issues that bear directly on the collectibility of tax should, therefore, be addressed as part of the process.

The taxpayers properly raised the discharge of their taxes in their collection due process hearing. Accordingly, we conclude that for collection due process purposes the Tax Court has jurisdiction to determine whether the tax debt was excepted from discharge.<sup>1</sup>

## II. Burden of Proof

Except as provided in 11 U.S.C. § 523, 11 U.S.C. § 727 provides for a discharge for individual debtors from all debts that arose before the date of the order for relief in Chapter 7 proceedings. Section 523(a)(1)(C) excepts from discharge any tax when the taxpayers either made a fraudulent return with respect to the tax or willfully attempted to evade or defeat the tax.

The burden is on the creditor to prove by a preponderance of the evidence that a debt is nondischargeable under section 523(a). Grogan v. Garner, 498 U.S. 279 (1991); see also United States v. Fegeley, 118 F.3d 979, 983 (3d Cir. 1997). This burden of proof places upon the party who bears it the duty to show that that which it alleges to be true is more probably true than not. In re Winship, 397 U.S. 358, 371 (1970) (Harlan, J., concurring).

The Grogan Court rejected a requirement that a party seeking to establish that a debt was not dischargeable because of fraud prove its case by clear and convincing evidence. The Court reasoned that because the preponderance of evidence standard results in a roughly equal allocation of the risk of error between litigants, “[W]e presume that this standard is applicable in civil actions between private litigants unless ‘particularly important individual interests or rights are at stake.’” Herman & MacLean v. Huddleston, 459 U.S. 375, 389-390.” Grogan, 498 U.S. at 285.

Accordingly, to prove in bankruptcy court that taxes are not dischargeable under section 523(a)(1)(C), the Service must prove by a preponderance of the evidence that the taxpayer filed a fraudulent return or willfully evaded taxes.

I.R.C. § 6663 provides that “[i]f any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.” In Tax Court, the Service must prove fraud under I.R.C. § 6663 by clear and convincing evidence. I.R.C. § 7454(a); Sadler v. Commissioner, 113 T.C. 99, 102 (1999); T.C.

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<sup>1</sup> We note that if the Tax Court were to find that it lacks jurisdiction over the dischargeability of the taxes in this case, as it does in deficiency proceedings, the taxpayers would not be left without remedy. They could either reopen their case in bankruptcy court to determine the dischargeability of their tax debt or bring a contempt proceeding for violation of the discharge order in the bankruptcy court that issued it.

Rule 142(b). Clear and convincing evidence requires a showing of more than a preponderance of the evidence. Kellett v. Commissioner, 5 T.C. 608, 616 (1954).

The issue of nondischargeability, however, is a matter of federal law governed by the terms of the Bankruptcy Code. Brown v. Felsen, 442 U.S. 127, 129-130 (1979). The Service in the instant case does not seek to impose the fraud penalty under I.R.C. § 6663; fraud under the tax law is not at issue. Rather, the Service must prove that the taxpayers' liability was not discharged under bankruptcy law. In brief, it is bankruptcy law, not tax law, that governs dischargeability.

Where the validity of the underlying tax liability is properly at issue in a collection due process case, a court reviews the Service's determination de novo; where the validity of the underlying tax liability is not properly at issue, the general rule is that the standard is abuse of discretion. H. REP. NO. 105-599, at 266 (1998); Goza v. Commissioner, 114 T.C. 176 (2000). Although the validity of the underlying taxes is not at issue in this case, however, we do not believe that the proper standard of review is abuse of discretion.

In general, abuse of discretion is the proper standard where the court is reviewing an administrative action. 5 U.S.C. § 706(a)(2)(A). The collection due process determination that the taxpayers' taxes were excepted from discharge, however, entails a conclusion of law. As in cases where a court decision on a question of law is under review by a higher court, we believe that the determination that the taxpayers' taxes were excepted from discharge merits de novo review. See, e.g., Agathos v. Starlight Motel, 977 F.2d 1500, 1504 (3d Cir. 1992).

Given the Supreme Court's holding in Grogan, that one standard of proof—a preponderance of the evidence—applies to exceptions to discharge, we take the position that the Tax Court must use that standard when determining de novo whether taxes were dischargeable.

Please call the attorney assigned to this case at 202-622-3610 with any questions.