

CC-2005-003

January 19, 2005

Subject: Administrative Collection of a Partnership's Employment Taxes from the Partners
Cancel Date: Until incorporated into the CCDM

Purpose

This Notice confirms that United States v. Galletti, 124 S. Ct. 1548 (2004), does not alter the Service's longstanding position that it may administratively collect a partnership's employment taxes from general partners based on their derivative liability under state law. This Notice also discusses the proper wording of Notices of Federal Tax Lien and whether general partners are entitled to Collection Due Process rights.

Background

On March 23, 2004, the Supreme Court in Galletti held that a timely assessment of a partnership's employment tax liability permits the Service to collect the liability in a bankruptcy case filed by the general partners who were derivatively liable for the taxes under state law. Pursuant to section 6501(a), the Service must assess a tax liability within 3 years from the filing date of the return. If a timely assessment is made, pursuant to section 6502(a), the Service has an additional 10 years to collect by levy or a proceeding in court. In Galletti, the debtor-partners argued that it was too late for the Service to collect the tax in the bankruptcy case, because the Service assessed only the partnership, and not the general partners, within the 3-year period. The Supreme Court rejected the partners' argument, reasoning that after the Service assessed the employment taxes for the employer-partnership, the Service was not required to separately assess the same tax against the general partners to take advantage of the additional 10-year collection period of section 6502(a) in the partners' bankruptcy case.

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The Court did not address administrative collection in the Galletti opinion, stating in footnote 1, “Because the Government is attempting to enforce the Partnership’s tax liabilities against respondents in a judicial proceeding, we do not address whether an assessment only against the Partnership is sufficient for the IRS to commence administrative collection of the Partnership’s tax debts by lien or levy against respondent’s property.” Galletti, 124 S. Ct. at 1552 n.1.

Discussion

Although the Court did not address administrative collection, Galletti does not change the Service’s long-established legal position that it can enforce the tax lien and take administrative levy action against a general partner based on the assessment, notice and demand directed to the partnership. The following questions and answers explain the legal analysis for the Service’s long-established legal position.

For purposes of the Q&A’s, assume that the Service has timely assessed the employment taxes for the partnership, the collection period has not expired, and under state law the general partners are liable for the debts of the partnership.

Q1. After the Service gives statutory notice and demand to the partnership under section 6303, does a federal tax lien attach to the general partners’ property and rights to property?

A1. After assessment of the partnership tax, notice and demand to the partnership gives rise to a tax lien both on the property of the partnership and the general partners. Section 6321 provides that if any person liable to pay the tax neglects or refuses to pay the same after demand, a federal tax lien shall arise on that person’s property and rights to property. Because state law makes a general partner derivatively liable for the debts of the partnership, the general partner is a “person liable to pay [the partnership’s] tax” under section 6321. After making an assessment against the partnership, the Service gives notice and demand for payment to the partnership pursuant to section 6303. This notice and demand is imputed to all of the general partners. Adams v. United States, 328 F. Supp. 228 (D. Neb. 1971); American Surety Co. v. Sundberg, 363 P.2d 99 (Wash. 1961), cert denied, 368 U.S. 989 (1962); Underwood v. United States, 37 F. Supp. 824 (E.D. Tex. 1939), aff’d, 118 F.2d 760 (5th Cir. 1941); Bauer v. United States, 408 F.2d 1331, 1332 (2d Cir. 1969) (dicta). Contra El Paso Refining, Inc. v. United States, 205 B.R. 497 (W.D. Tex. 1996). The rationale for imputing the notice and demand to all general partners is that notice to one partner is deemed to be notice to all general partners. See, e.g., Zimmerman v. Dan Kamphausen Co., 971 P.2d 236 (Col. Ct. App. 1999); Prisco v. Westgate Entertainment, Inc. 799 F. Supp. 266 (D. Conn. 1992); Manufacturers Hanover Trust Co. v. Jayhawk Associates, 766 F. Supp. 124 (S.D.N.Y. 1991). See generally 68 C.J.S. Partnership § 139 (2001) (notice to or demand upon the partnership or to one partner constitutes notice or demand to all partners). The property of general partners, as persons liable to pay the tax, is subject to the tax lien arising from assessment of the partnership tax when the partners neglect

or refuse to pay the same after notice and demand for payment. Adams, 328 F. Supp. at 232; Sundberg, 363 P.2d at 103; Underwood, 118 F.2d at 760; David A. Schmudde, Federal Tax Liens at 23 (4th ed. 2001) ("In those situations where the partnership is made liable for a specific tax, . . . the added effect of state law, making the partners individually liable for the partnership debts, serves to bring a lien to bear on the properties of both the partnership and the general partners.").

Q2. May the Service levy on a general partner's property and rights to property to collect the employment tax liability?

A2. The Service may levy on a general partner's property and rights to property to collect the employment tax liability. Section 6331(a) provides, in part, that "if any person liable to pay any tax neglects or refuses to pay" after notice and demand, the Service may levy upon the person's property and rights to property. The general partner is a "person liable to pay [the partnership's] tax." See, e.g., United States v. Remington, 210 F.3d 281 (5th Cir. 2000) (levy on general partner's property to collect employment taxes incurred by partnership was valid). Also, notice and demand to the partnership constitutes notice and demand to the general partners.

Q3. Should the Notice of Federal Tax Lien list both the partnership's name and the general partners' names in order for the NFTL to be valid as to those general partners?

A3. As a general matter, when filing a NFTL, the Service should list the names of the partnership and of all known general partners who are derivatively liable for the partnership's employment taxes. This fulfills the purpose of a NFTL, which is to provide public notice to third parties that a federal tax lien encumbers a person's property and rights to property. If the NFTL does not identify a general partner, there is a risk that a court may find that notice has not been provided to the public. Focht v. United States, 243 B.R. 263 (W.D. Pa. 1999) (NFTL identifying only one spouse-partner was not constructive notice for the employment tax liability of the unidentified spouse-partner). But see Tony Thornton Auction Service, Inc. v. United States, 791 F.2d 635, 639 (8th Cir. 1986) (NFTL provided constructive notice as to a general partner not identified in the NFTL).

Q4. After the Service files a NFTL identifying a general partner as being liable for the partnership's employment taxes, must a Collection Due Process notice be given to the partner?

A4. A CDP Notice must be given to the partner. Section 6320(a)(1) requires that written notice of the right to a CDP hearing be given to the person described in section 6321; that is, any person liable to pay the tax who is described in the NFTL. Treas. Reg. § 301.6320-1(a)(2)Q-A1. Because general partners are liable to pay the partnership tax liabilities, separate CDP notices should be given to the partnership and to all general partners listed on the NFTL.

