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Internal Revenue Service
Memorandum

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subject: Suspension of I.R.C. § 6502(a) Collection Period in Chapter 7

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

(1) May the Service retain and apply a payment received as a distribution from a Chapter 7 trustee that relates to a tax liability for which the I.R.C. § 6502(a) collection period, including suspensions provided in I.R.C. § 6503, has expired?

(2) After a debtor in a Chapter 7 case receives a discharge, does I.R.C. § 6503(h) continue to suspend the I.R.C. § 6502(a) collection period with respect to a claim for tax that is not excepted from discharge until the stay of any act against property of the estate, pursuant to B.C. § 362(a), is lifted?

(3) After a debtor in a Chapter 7 case receives a discharge, does I.R.C. § 6503(b) continue to suspend the I.R.C. § 6502(a) collection period with respect to a claim for tax until the stay of any act against property of the estate, pursuant to B.C. § 362(a), is lifted?

CONCLUSIONS

(1) If the Service receives a distribution from a Chapter 7 trustee as payment on an allowed claim that the government filed with the bankruptcy court within the

I.R.C. § 6502(a) collection period, including suspensions provided in I.R.C. § 6503, then the Service may retain and apply the payment, notwithstanding that at the time of payment, the collection period as suspended had expired.
(2) After a debtor in a Chapter 7 case receives a discharge, the I.R.C. § 6502(a) collection period is not suspended by I.R.C. § 6503(h), because the Service is no longer prohibited by reason of the bankruptcy case from collecting any claim for tax that was not excepted from discharge. Rather, independently of the case, B.C. § 524 provides a continuing injunction against the commencement or continuation of any action to collect a discharged claim for tax as a personal liability of the debtor.

(3) After a debtor in a Chapter 7 case receives a discharge, the I.R.C. § 6502(a) collection period might be suspended by I.R.C. § 6503(b), depending on whether substantially all of the taxpayer's assets remain in the control or custody of the bankruptcy court.

FACTS

Your question involves the government's receipt of a distribution from a Chapter 7 trustee after the collection statute expiration date ("CSED"). The pertinent facts are as follows: An individual debtor filed an asset Chapter 7 petition on July 1, 2002. At the time of filing, the debtor owed individual income tax for his 1992 tax year, which had been assessed on June 1, 1993. No exception to discharge applied to the claim for the debtor's 1992 income tax liability. The debtor received a discharge on October 1, 2002. The Service timely filed its claim for the outstanding balance on the 1992 liability. The trustee administered the assets of the estate and sent the Service a check on August 1, 2004, satisfying sixty-percent of the Service's general unsecured claim as part of the overall distribution of estate assets.

You set forth three situations involving asset Chapter 7 cases where: (1) the Service had not filed a notice of federal tax lien before the filing of the bankruptcy petition; (2) the Service had filed a notice of federal tax lien, but there was no exempt, abandoned, or excluded property subject to the tax lien; and (3) the Service had filed a notice of federal tax lien and the lien attached to property that is outside of the debtor's bankruptcy estate.

LAW AND ANALYSIS

I.R.C. Section 6502(a) Collection Period

Generally, I.R.C. § 6502(a) provides a ten-year period within which the Service can collect a properly assessed tax by levy or by a proceeding in court. What constitutes "a proceeding in court" is a question of federal law. See U.S. v. Silverman, 621 F.2d 961,964 (9th Cir. 1980). The Service's position is that the filing of a proof of claim is the commencement of a proceeding in court within the meaning of I.R.C. § 6502(a). Rev. Rul. 70-555, 1970-2 C.B. 296. Accordingly, when a taxpayer files a bankruptcy petition, if the Service files a proof of claim within ten years from the date of assessment, then the Service's ability to collect the amount reflected in the claim from the bankruptcy

estate is adequately protected against the running of the I.R.C. § 6502(a) collection period.

The Service may Accept and Apply the Chapter 7 Distribution

Under the facts presented, the CSED for the 1992 tax liability, which was assessed on June 1, 1993, would have been June 1, 2003, barring any suspension. See I.R.C. § 6502(a). However, the debtor commenced a voluntary case under Chapter 7 by filing an asset Chapter 7 petition on July 1, 2002. See B.C. § 301. This would have operated as an automatic stay pursuant to B.C. § 362(a). The stay of any act other than an act against property of the estate would have lifted ninety-two days later, on October 1, 2002, when the debtor received a discharge. See B.C. § 362(c)(2)(C). During that time, as discussed more fully below, the collection period would have been suspended because the Secretary was prohibited by reason of the case from collecting.[1] I.R.C. § 6503(h). Further, the collection period would have been suspended an additional six months. I.R.C. § 6503(h)(2). As a result, the collection period including suspension would have expired March 2, 2004.[2]

Though the facts state that the Service "timely filed" a proof of claim for the outstanding balance on the 1992 liability, they do not disclose the specific date that the claim was filed. Generally, a proof of claim is timely in a Chapter 7 liquidation if it is filed not later than ninety days after the first date set for the B.C. § 341 meeting of creditors. Bnkr. R. Proc. 3002(c). However, a proof of claim filed by a governmental unit is timely if it is filed not later than 180 days after the order for relief. B.C. § 502(b)(9); Bnkr. R. Proc. 3002(c)(1). If the claim was timely because it was filed not later than 180 days after the order for relief, then it would have been filed not later than December 28, 2003 and before the March 2, 2004 CSED. Therefore, the Service does not need to rely on any suspension of the collection period beyond the date of discharge. The filing of a proof of claim in bankruptcy is treated under the revenue ruling as the filing of a proceeding in court for purposes of I.R.C. § 6502(a). Rev. Rul. 70-555. Because the proof of claim was filed before the CSED, the Service would be entitled to receive any distribution from the bankruptcy estate based on that claim regardless of when the distribution was made.

If, on the other hand, the Service had timely filed its proof of claim after the expiration of the collection period, as suspended by I.R.C. § 6503(h) until six months after the date of discharge, then any distribution received with respect to such claim likely would be an overpayment, unless there were a further suspension of the collection period beyond the date of discharge so that the proof of claim was not filed after the CSED.[3]

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[1] I.R.C. § 6503(b) might provide the same suspension, if substantially all of the debtor's assets were under the control or custody of the court.

[2] Ninety-two days beyond the June 1, 2003 collection statute expiration date, plus six months.

[3] Similarly, if the Service's proof of claim had been filed tardily pursuant to B.C. § 501(a), then the Service only could accept and apply a distribution received

I.R.C. Section 6503 Suspension Provisions

The I.R.C. § 6502(a) collection period elapses by operation of law, unless a suspension affirmatively applies. As relevant herein, I.R.C. § 6503(h), which was enacted in 1980,[4] provides that the I.R.C. § 6502(a) collection period is suspended, in a case under Title 11, for the period during which the Secretary is prohibited by reason of such case from collecting, and for six months thereafter. In this case, as discussed above, the I.R.C. § 6503(h) suspension was triggered on the date of the order for relief, because on that date the Service was prohibited by reason of the case from collecting its pre-petition claim from the debtor due to the automatic stay provided in B.C. § 362(a). Specifically: (1) B.C. § 362(a)(1) stayed the commencement or continuation of any action against the debtor to recover any pre-petition claim; (2) B.C. § 362(a)(5) stayed any act to create, perfect, or enforce a lien against the debtor's property to the extent that such lien secured a pre-petition claim; and (3) B.C. § 362(a)(6) stayed any act to collect, assess, or recover any pre-petition claim against the debtor. Additionally, B.C. § 362(a) prohibited the Service from collecting its pre-petition claim from the property of the estate. See, e.g., B.C. § 362(a)(3).

Generally, the B.C. § 362(a) automatic stay lifts in two stages. The stay of any act against property of the estate continues until such property is no longer property of the estate. B.C. § 362(c)(1). The stay of any other act under B.C. § 362(a) continues in an individual's Chapter 7 case until the earliest of the time that the case is closed, dismissed, or the time a discharge is granted or denied. B.C. § 362(c)(2). Most courts that have examined the I.R.C. § 6503(h) suspension provision agree that it runs from the date that a bankruptcy petition is filed *at least* until a discharge order is issued, because generally the automatic stay against collection is then lifted pursuant to B.C. § 362(c)(2). See, e.g., Clark v. Commissioner, 90 T.C. 68, 73 (1988); In re Klingshirn, 147 F.3d 526 (6th Cir. 1998); Wekell v. United States, 144 B.R. 503 (W.D. Wash. 1992). Indeed, the legislative history to I.R.C. § 6503(h) supports this position.[5] In this case, B.C. § 362(c)(2) would have lifted the automatic stay, except as to acts against property of the estate, on October 1, 2002, the date of discharge. At that time, none of the B.C. § 362(a) paragraphs would have been implicated, except as to acts against property of the estate. As a result, the Service no longer would have been prohibited *by reason of B.C. § 362(a)* from collecting its pre-petition claim, even though it might have been impaired in its collection efforts because of the continued automatic stay against property of the estate. Specifically, the automatic stay under I.R.C.

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pursuant to B.C. § 726(a)(1), (a)(2)(C) or (a)(3) if the claim, though late, nonetheless was filed before the CSED.

[4] See The Bankruptcy Tax Act of 1980, P.L. 96-598, § 6(a), 94 Stat. 3389.

[5] The Senate report provides that the statute of limitation on collection is suspended if "the Internal Revenue Service is prohibited for a period of time by reason of a bankruptcy case from . . . collection of tax (for example, because of the automatic stay under new 11 U.S. Code sec. 362(a)(6))." S. Rept. No. 1035, 96th Cong., 2d Sess. 50 (1980). Accord, H.R. Conf. Rep. No. 833, 96th Cong., 2d Sess. 45 (1980).

§ 362(a)(6), which prohibits any act to collect a pre-petition claim, would have lifted

when the discharge was granted. Thus, after the date of discharge, B.C. § 362(a) no longer would have prohibited the Service from *in rem* collection outside of the estate. In re Isom, 901 F.2d 744 (9th Cir. 1990).

Moreover, the B.C. § 524 discharge injunction is not a prohibition by reason of the case against the Service's ability to collect a tax liability pursuant to I.R.C. § 6503(h).[6] Although the discharge is granted by reason of the case, once it is granted, the B.C. § 524 discharge injunction exists independently. It provides a continuing injunction against commencing or continuing any action to collect a discharged claim for tax as a personal liability of the debtor. Also, the discharge injunction does not prohibit *in rem* collection against exempt, abandoned, or excluded property and therefore does not represent the "prohibition" contemplated by Congress in I.R.C. § 6503(h). If the injunction consistently were interpreted to be a "[prohibition] by reason of such case," then often when a tax claim is discharged, the I.R.C. § 6502(a) collection period would be suspended *ad infinitem*, which we think is an untenable result.

We do not believe that the prohibition required by I.R.C. § 6503(h) necessarily must derive from the statute. For example, in the Chapter 11 context, the Service argues that it is prohibited by reason of the case from collecting beyond the date of discharge in situations in which (1) the Service's claim is allowed, (2) the confirmed plan provides for full payment of the tax debt, and (3) the plan is not in substantial default. In these situations, the binding plan provisions prohibit the Service from collecting pre-confirmation taxes (outside the plan) from both the debtor and the debtor's property, thereby triggering the I.R.C. § 6503(h) suspension, unless and until the taxpayer defaults under the plan. The Service asserts this position notwithstanding that the Bankruptcy Code otherwise would allow collection of non-dischargeable tax debts. However, there are no analogous binding plan provisions in the Chapter 7 context that would effect a complete prohibition against collection similar to those in the

Therefore, in the Chapter 7 context, even if there is a dischargeable tax and no *in rem* interest to pursue outside of bankruptcy, the automatic stay with respect to property of the estate is not a prohibition against the collection of tax sufficient to trigger the I.R.C. § 6503(h) suspension. The fact that the Service is not able to collect the tax in this situation is due to the dischargeability of the tax claim, not the automatic stay, and the B.C. § 524 discharge injunction is a prohibition that exists independent of the case.

There is another suspension provision, however, that might suspend the collection period in a Chapter 7 case beyond the date of discharge. Under I.R.C. § 6503(b), which was last amended in 1966, the period of limitations on collection after assessment is

[6] But See Nelson v. U.S., 94-1 U.S.T.C. ¶ 50,206 (E.D. Mich. 1994) (although the court held that the I.R.C. § 6503(h) suspension was triggered by the B.C. § 524 discharge injunction, the case involved the revocation of a discharge order after the CSED).

suspended for the period that the taxpayer's assets are in the control or custody of a court of the United States, and for six months thereafter.[7] There are no explicit statements in the Internal Revenue Code, regulations, case law, or legislative history to the Bankruptcy Tax Act of 1980 that suggest that I.R.C. § 6503(h) is the exclusive provision capable of effecting a tolling in a case under Title 11. While it is true that I.R.C. § 6503(h) was enacted more recently than subsection (b), in cases where the two subsections do not overlap, we believe that either could trigger a suspension.

The Treasury regulations interpret I.R.C. § 6503(b) to suspend the I.R.C. § 6502(a) collection period when "*all or substantially all* of the assets of a taxpayer are in the control or custody of the court." (Emphasis added). However, case law interpreting the breadth of the I.R.C. § 6503(b) suspension period is not uniform. See United States v. Tomasello, 569 F.Supp 1, 3 (W.D.N.Y. 1983) ("Judicial interpretation of section 6503(b) has produced a substantial split of authority concerning the duration of the suspension of the limitations period set by section 6502 which arises when the taxpayer files a petition in bankruptcy.").

The government has argued under the Bankruptcy Act that I.R.C. § 6503(b) suspends the I.R.C. § 6502(a) collection period from the time that a Chapter 7 petition is filed until the final closing of the estate.[8] The Fifth Circuit has disagreed, holding that it only suspends the collection period from the time that a Chapter 7 petition is filed until the time that the debtor receives a discharge. U.S. v. Verlinsky, 459 F.2d 1085 (5th Cir. 1972).[9] The opinion explained that a debtor becomes a new economic person upon discharge, in part because title to the debtor's property has actually passed to the trustee. Id. at 1088 (citing Bankruptcy Act section 110(a)). In an action on decision disagreeing with Verlinsky, the Service has reiterated its position that the suspension period under I.R.C. § 6503(b) continues until the termination of the bankruptcy proceeding. AOD 1972-387.

The Ninth Circuit also has disagreed with the government, holding that I.R.C. § 6503(b) suspends the I.R.C. § 6502(a) collection period for one year after the first creditors' meeting. McAuley v. United States, 525 F.2d 1108 (9th Cir. 1975). Although the court

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[7] See Federal Tax Lien Act of 1966, P.L. 89-719, § 106(b), 80 Stat. 1125 (1967). The senate report explains that I.R.C. § 6503(b) suspends the running of the I.R.C. § 6502(a) collection period "where assets are in the control or custody of a court because during this time they are not subject to administrative collection procedures." S. Rep. No. 1708, 89th Cong., 2d Sess. 24-25.

[8] See, e.g., U.S. v. Malkin, 317 F.Supp. 612 (D.C.N.Y. 1970) (holding that the assets of the taxpayer are 'in control or custody of the court' from the date the petition is filed to the date the referee signs the order closing the estate).

[9] The In re Verlinsky decision is also binding in the Eleventh Circuit. See Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc) (the Eleventh Circuit adopted as binding precedent all decisions of the former Fifth Circuit that were handed down prior to October 1, 1981); Gonzalez-Sanchez, et. al v. International Paper Company, et. al., 346 F.3d 1017 (11th Cir. 2003).

recognized that a literal construction of the statute required a factual determination regarding the control of the bankruptcy court over a taxpayer's assets, it refused to undertake a factual inquiry. Id. at 1112. Instead, the court held that the primary limitation on collection rights of the United States relates to the uncertainty of whether claims will be satisfied. Id. at 1113. The court found that the government would not know if its claim was in jeopardy until the time for filing claims had elapsed, which, under the Bankruptcy Act, was usually six months after the first creditors' meeting. Id. at 1114 (citing Bankruptcy Act section 57n). Therefore, the Ninth Circuit held that I.R.C. § 6503(b) suspended the I.R.C. § 6502(a) collection period until the date that is six months after the first creditors' meeting, plus the additional six months provided for in I.R.C. § 6503(b) (or one year from the first creditors' meeting). In an action on decision disagreeing with McAuley, the Service reiterated that it disagreed with the Ninth Circuit and that its position was consistent with other provisions of the Internal Revenue Code and the Bankruptcy Act. AOD 1976-55.

The government may not be bound by either Verlinsky or McAuley, each of which were decided under the Bankruptcy Act. In 1978, the Bankruptcy Reform Act substantively changed the bankruptcy laws by repealing the Bankruptcy Act and replacing it with the Bankruptcy Code. P.L. 95-598. Importantly, some of the Bankruptcy Act provisions relied upon by the Fifth and Ninth Circuits do not have successor provisions in the Bankruptcy Code. In particular, under the Bankruptcy Code, title to a debtor's property does not pass to a Chapter 7 trustee, unlike Bankruptcy Act section 110(a), which was relied upon in Verlinsky. Further, under the Bankruptcy Code, the time for filing claims is not usually six months from the first creditors' meeting, unlike Bankruptcy Act section 57n, which was relied upon in McAuley. Moreover, the Verlinsky decision did not address the impact of the Treasury regulation, which recently had been enacted.[10] Therefore, we believe that the Service may assert that the collection period would be suspended in a Chapter 7 case beyond the date of discharge in situations where, based on the facts and circumstances, substantially all of the taxpayer's assets were under the control or custody of the bankruptcy court.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[10] See T.D. 7121, 1971-1 C.B. 411 (approved May 28, 1971).

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