INTERNAL REVENUE SERVICE

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MEMORANDUM FOR NEW JERSEY DISTRICT COUNSEL
Attention: Wendy Gardner

FROM: Joseph W. Clark
Acting Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Request for Technical Advice
Taxpayers:

This constitutes our response to your June 14, 2000, request for an opinion on whether the Service can argue that the running of the three-year "look-back" period for determining priority status of a claim in bankruptcy is tolled during the period of an earlier bankruptcy when the debtor was making payments pursuant to a confirmed Chapter 11 plan, as an extension of the holding in In re Taylor, 81 F.3d 20 (3d Cir. 1996). We believe that Taylor provides authority for arguing that the look-back period is tolled in this context, but we advocate advancing this position only in circuits where controlling precedent such as Taylor exists.

LEGEND

Taxpayer X
Taxpayer Y
Date A
Date B
Date C
Date D
Date E
Date F

ISSUE: Whether the running of the three-year look-back period for determining that a claim is entitled to priority status, as set forth at B.C. § 507(a)(8)(A)(i), is suspended for the time the debtor was making payments pursuant to the terms of a confirmed Chapter 11 plan.

CONCLUSION: Yes. Based on the reasoning of In re Taylor, 81 F.3d 20 (3d Cir. 1996), the running of the period for determining priority status can be viewed as tolled during any time the Service is precluded from engaging in collection action during bankruptcy, including while the debtor is making payments under a confirmed Chapter 11 plan. However, since the Service no longer advances the

reasoning which is the basis of Taylor in circuits which have not addressed the issue, this view is limited to those circuits which have addressed the specific tolling issue addressed in Taylor and which have reached the same conclusion on the same rationale.

BACKGROUND: Your memorandum requesting advice assumes a situation as follows. A married couple owes federal income taxes for various unspecified years which include Date A. On Date B, Taxpayer X files a petition under Chapter 11 of the Bankruptcy Code. The Chapter 11 plan, which fully provides for the couple's income taxes for Date A, a post-petition year, is confirmed on Date C. Taxpayer X makes some payments under the plan in Date D, but then stops making payments until Date E, when Taxpayer X makes several additional payments. On Date F, Taxpayer Y files a petition under Chapter 13. At this point, part of the claim for taxes filed in the second bankruptcy cannot be classified as priority unless the running of the three-year look-back period set forth at B.C. § 507(a)(8)(A)(i) is viewed as suspended during the period between confirmation of the Chapter 11 plan and the time of "substantial default."

LAW AND ANALYSIS: In Taylor, supra, the specific issue presented was whether the period for determining priority status set forth in what is now B.C. § 507(a)(8)(A)(i) 1/ should be viewed as having stopped running during the pendency of the debtor's earlier bankruptcy. In that case, the two bankruptcies involved were both Chapter 13 cases. Since the Service's claim was based on taxes for which a return was filed within three years of the filing of the first bankruptcy petition, but more than three years before the filing of the second bankruptcy petition, its claim would have had to have been classified as unsecured general, rather than unsecured priority, in the second bankruptcy if tolling were not applied.

The Third Circuit Court of Appeals, upholding the determinations of both the bankruptcy and district courts, viewed tolling as warranted in this context. The court essentially reasoned as follows. I.R.C. § 6502(a), a provision of

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1/ Section 507(a)(8)(A) of the Bankruptcy Code affords unsecured claims of governmental units an eighth-level "priority" in order of payment where the claims are for prepetition taxable years and are for taxes

> (i) ... for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; [or]
>
> (ii) assessed within 240 days ... before the date of the filing of the petition ... .

B.C. § 507(a)(8)(A)(1999). Prior to 1995, this provision was numbered B.C. § 507(a)(7)(A).

"nonbankruptcy law," sets a ten-year period for collection of taxes following assessment. The running of the section 6502(a) period is suspended during bankruptcy by another "nonbankruptcy" provision, I.R.C. § 6503(h). Therefore, under B.C. §108(c) 2/, the running of the period for collection is suspended, as is the running of the period for determining whether a claim is entitled to priority status, during the pendency of any bankruptcy. The Third Circuit held that these provisions of the Bankruptcy Code and Internal Revenue Code, taken together, reflect intent on the part of Congress that the Service be afforded additional time to effect tax collection where collection previously could not be pursued due to the pendency of a bankruptcy, relying in part on the fact that the Service cannot collect taxes during the imposition of the automatic stay. See 81 F.3d at 23.

In rendering its decision in Taylor, the Third Circuit did not explicitly address the issue you raise, whether tolling should apply not only when the automatic stay is in effect, but during periods in bankruptcy when the Service is precluded for other reasons from effecting collection. However, the court did make certain comments indicating that its application of tolling might not be limited to periods during which the automatic stay was in effect. For example, the court stated:

> The time limitations within § 507 merely reflect the existing limitation periods in income tax cases under 26 U.S.C. §§ 6501 and 6502, which are suspended during bankruptcy proceedings by § 6503(h).
> ...
>
> We deem it obvious that [the relevant Internal Revenue Code and Bankruptcy Code] sections, read together, evidence a congressional concern to preserve the collectability of tax claims.

2/ Section 108(c) of the Bankruptcy Code states, in pertinent part, that

> ... if applicable nonbankruptcy law ... fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor ... and such period has not expired before the date of the filing of the [bankruptcy] petition, then such period does not expire until the later of –
>
> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 30 days after notice of the termination or expiration of the stay under section 362 ... with respect to such claim.

B.C. § 108(c).

> Section 507(a)(7)(A)(i) simply provides priority as to those taxes which fall within the three-year limitation period. The extension of time provided within § 108(c) of the Bankruptcy Code and § 6503(h) of the Internal Revenue Code would be meaningless if debtors could discharge their tax liability by filing successive bankruptcies.

81 F.3d at 24.

Given the Third Circuit's general reasoning in Taylor and the above-cited specific language, we believe that this decision provides authority for arguing that tolling may be warranted for all periods in bankruptcy when the Service is precluded for any reason from taking collection action, including during the type of scenario you present. This makes sense because the Service normally is precluded from collecting taxes while a debtor is adhering to the terms of a confirmed Chapter 11 plan, even though the automatic stay generally is not in effect at this point. See, e.g., B.C. §§ 362(c)(2), 1141 (indicating that automatic stay terminates upon confirmation of plan); United States v. Wright, 57 F.3d 561 (7th Cir. 1995)(in dictum, court summarily agrees that Service was precluded from collecting taxes while payments were being made under reorganization plan). Moreover, this argument, while not squarely addressed by any court, has been at least implicitly approved in several instances. See, e.g., In re Montoya, 965 F.2d 554 (7th Cir. 1992)(finding it unnecessary to address lower court's determination that tolling applies for all periods post-confirmation, but ruling that tolling applies for period Service's claims were initially disallowed); Mouradian v. United States, 1998 U.S. Dist. LEXIS 13900 (M.D. Fla. 1998)((suggesting that tolling should apply whenever assets are within bankruptcy court's protection); United States v. Colvin, 203 B.R. 930 (N.D. Tex. 1996)(in general discussion of tolling, notes existence of Wright, supra, and Montoya, supra, as supporting application of tolling even while automatic stay is not in effect).

Despite our agreement that this argument is viable, we do not recommend that the argument be advanced in all circuits. We recognize that three circuits in addition to the Third have issued decisions in which tolling was applied based on reasoning similar to that contained in Taylor. See Waugh v. Internal Revenue Service, 109 F.3d 489 (8th Cir. 1997), cert. denied, 118 S. Ct. 80 (1997); In re West, 5 F.3d 423 (9th Cir. 1993), cert. denied, 511 U.S. 1081 (1994); In re Montoya, supra. However, three others have explicitly rejected this reasoning. See In re Palmer, 2000 U.S. App. LEXIS 16115 (6th Cir., July 14, 2000); Morgan v. United States, 182 F.3d 775 (11th Cir. 1999); In re Quenzer, 19 F.3d 163 (5th Cir. 1995). 3/ As a result, the Office of Chief Counsel now recognizes the

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3/ Of the three decisions in which the analysis based on sections 108(c) and 6503(h) was rejected, all except Palmer left the door open for tolling to potentially apply on a different basis. Another decision, In re Richards, 994 F.2d 763 (10th Cir. 1993), applied tolling based on the bankruptcy court's equitable authority afforded by B.C. § 105(a), without addressing the analysis based on sections

infirmities of the argument that the "look-back" periods contained in the Bankruptcy Code should be deemed tolled pursuant to B.C. § 108(c) and I.R.C. § 6503(h), and the Office no longer advances this argument in circuits where no controlling precedent based on these provisions already exists. 4/

In summary, we believe that Taylor provides authority for arguing, at least in cases arising within the Third Circuit, that the running of the three-year "look-back" period for determining priority status contained in B.C. § 507(a)(8)(A)(i) should be viewed as tolled during not just periods of prior bankruptcies when the automatic stay was in place, but periods when the Service was precluded from effecting collection because the debtor was making payments pursuant to the provisions of a confirmed Chapter 11 plan. Because the Office of Chief Counsel no longer advances the reasoning adopted in Taylor except in circuits where this reasoning has already been adopted, however, we do not urge that the extension of the Taylor holding discussed herein be advocated in all circuits.

If you have further questions, please call 202/622-3620.

108(c) and 6503(h).

4/ Instead, the Office now argues that tolling applies based on the legislative intent underlying the look-back periods themselves. In addition, we argue that the bankruptcy court is authorized to apply tolling if the court believes equitable factors so warrant, pursuant to B.C. § 105(a).