**INTERNAL REVENUE SERVICE**

October 2, 2001

Number: **200146058** CC:PA:CBS:Br2
Release Date: 11/16/2001 POSTS-152644-01
UIL # 09.11.05-00
9999.98-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
(SMALL BUSINESS / SELF-EMPLOYED) CC:SB:2:RCH

FROM: MITCHEL S. HYMAN
Acting Senior Technician Reviewer, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Default of Chapter 11 Plan -- Your Request for Our Comments

This Chief Counsel Advice responds to your request for our review of a memorandum prepared by your office. 1/ The memorandum, dated March 26, 2001, concludes, in reliance on Virginia state law, that upon a corporate taxpayer's default on making payments under a confirmed Chapter 11 plan, the Service is entitled to use administrative collection procedures to collect the amount for which the taxpayer is in default, but not the entire amount due under the plan. This position, which is based on law controlling in Virginia cases, is contrary to the position which has been expressed by this office. Accordingly, you asked for our comments on the position expressed in the March 26 memorandum.

ISSUE: Where a corporate Chapter 11 plan has been confirmed and the taxpayer-debtor fails to make one or more scheduled payments under the plan, is the Service entitled to collect the entire amount due under the plan or only the amount in default?

CONCLUSION: Upon a substantial default, where the debtor has ceased making any plan payments, the Service is entitled to employ administrative mechanisms for collection, and to use those mechanisms to collect the entire amount still due under the plan.

LAW AND ANALYSIS: Section 1141 of the Bankruptcy Code states, in pertinent part:

> ... the provisions of a confirmed plan bind the debtor ... and any creditor, ... whether or not the claim or interest of such creditor ... is impaired under the plan and whether or not such creditor ... has accepted the plan.

B.C. § 1141(a).

---

1/ This Chief Counsel Advice should not be cited as precedent.

This provision generally has been construed as replacing preexisting obligations on the debtor's part with whatever obligations are imposed by the plan, giving the plan a binding effect. See, e.g., In re Barton Industries, Inc., 159 B.R. 954 (Bankr. W.D. Okla. 1993). However, the Service's position is that it retains its ability to employ administrative collection mechanisms to collect a tax liability even after a given liability is dealt with in a confirmed Chapter 11 plan, at least upon the taxpayer-debtor's default. This position is supported by the analysis in In the Matter of Official Committee of Unsecured Creditors of White Farm Equipment, 943 F.2d 752 (7th Cir. 1991), cert. denied, 503 U.S. 919 (1992). In White Farm, a case involving serial Chapter 11 cases, the court held that even after confirmation, the priority tax liabilities at issue were not discharged and accordingly maintained their status as priority tax claims in a subsequent bankruptcy case. Pursuant to White Farm, where a tax is provided for by the plan, the tax retains its status as a tax liability.

This office's position that the Service may employ administrative collection mechanisms upon the debtor's default is also supported by cases holding that once a Chapter 11 plan is confirmed, a creditor aggrieved in some way may not seek redress through the bankruptcy court, but must instead pursue any available remedies without resort to the bankruptcy process. For example, in a local bankruptcy court decision cited in your memorandum, In re Jankins, 184 B.R. 488 (Bankr. E.D. Va. 1995), the taxpayer-debtor, an individual, defaulted on making payments under a confirmed Chapter 11 plan. The taxpayer-debtor and the Service differed as to what, if anything, was required to be paid under the terms of the plan. The bankruptcy court held that the plan required the taxpayer-debtor to pay post-confirmation interest on the Service's claim and that his failure to do so constituted a "material" default, but noted that the taxpayer-debtor had substantially complied with the plan terms. In denying the United States's motion to dismiss the case based on the taxpayer-debtor's default, essentially on the grounds that the Service failed to pursue its remedies in a timely fashion, the court characterized a confirmed Chapter 11 plan as "in the nature of a novation," and stated that where a debtor defaults on such a plan, "the creditor ... is not required to seek relief in the bankruptcy court but may pursue its normal remedies with respect to the restructured debt." 184 B.R. at 494. The court went on to specifically hold that the Service, "to the extent it has not received the payments promised by the plan, ... may enforce payment of the restructured liability through its own administrative processes." Id. 2/ See also In

---

2/ In an individual case, some tax liabilities may be nondischargeable; there is no question that such liabilities may be collected by administrative means after default. See, e.g., In re Gurwitch, 794 F.2d 584, 585 (11th Cir. 1986); In re Amigoni, 109 B.R. 341, 345 (Bankr. N.D. Ill. 1989). The decision in Jankins does not indicate whether the liabilities at issue are nondischargeable. In any case, we interpret Jankins as standing for the broader proposition that the Service may use its administrative tax collection authority to collect any tax liability provided for by the plan after default. We also note, in this regard, that unless the plan provides otherwise, any tax liabilities not provided for by a corporate Chapter 11 plan are discharged under B.C. § 1141(d) and cannot be collected even after default.

re Seminole Motors, Inc., 1989 U.S. Dist. LEXIS 15634 (E.D. Okla. 1989)(obligations imposed by plan are enforceable in forum other than bankruptcy court).

Although it is clear that the Service can use its administrative remedies to collect plan liabilities after default, it has been less than clear whether the Service can only collect plan amounts as they come due. Our position is that where the debtor has defaulted on a series of plan payments and has ceased making any payments under the plan, and after notice of the default from the Service it is clear that the debtor will not attempt to cure the default and satisfy its plan obligations, it is appropriate for the Service to attempt to collect the full amount of the tax liability provided for by the plan. In such a case of substantial default, the debtor is in essence treating the plan as no longer in effect and has opted out of participation in the bankruptcy process. The Service should accordingly be permitted to use its full administrative collection authority to collect the plan amounts. Where the debtor, however, has only missed some payments and is still actively making some payments under the plan, we believe that since the debtor is still trying to participate in the bankruptcy process, the Service should limit any administrative collection to the plan payments then due.

Our position that the Service can collect the entire plan amount upon a substantial default is consistent with the fact that the statute of limitations on collection resumes running once default occurs. The running of the collection statute is clearly suspended during the period the automatic stay is in effect. I.R.C. § 6503(h). Moreover, the suspension continues during the post-confirmation period when a Chapter 11 plan is in effect and payments are being made under the plan, since prior to default the Service is bound by the plan and is, thus, prohibited from collecting. See, e.g., In re Montoya, 965 F.2d 554, 557 (7th Cir. 1992). However, upon substantial default, the Service can once again commence administrative collection. The collection statute is, accordingly, no longer suspended, and collection of the full amount of the plan liability may be necessary in order to ensure collection within the period of limitations.

Your view is that, assuming the Chapter 11 plan does not contain language explicitly allowing the Service to collect the full amount due under the plan if the debtor defaults, the Service may collect only the actual amount in default, at least in cases arising in Virginia. This position is based on controlling case law addressing remedies upon breach of an installment contract.

The controlling case which you cite as limiting the Service's ability to collect the entire plan amount upon default is City of Hampton, Virginia v. United States of America, 218 F.2d 401 (4th Cir. 1955), which holds that upon breach of an installment contract, a creditor with no remaining duties left to perform under the contract may recover only the installments due at the time the creditor institutes the action for breach. In accord, Parker v. Moitzfield, 733 F. Supp. 1023, 1025 (E.D. Va. 1990). These decisions may be representative of the general rule on this issue. See, e.g., Restatement (Second) of Contracts § 243 (1979). However, we do not view this rule as dispositive of the issue of the Service's remedies upon the taxpayer-debtor's default. These decisions contemplate the existence of contracts between consenting parties. A taxpayer is

subject to a given tax liability not as a result of a consensual relationship, but because a federal statutory scheme exists which requires him to pay that liability. While a party to an installment contract is only obligated to pay each installment according to the contractual payment schedule, a delinquent taxpayer is obligated under the Internal Revenue Code to pay his or her taxes in full immediately or risk accrual of interest and penalties as well as administrative collection action. Even though the Chapter 11 plan modifies this statutory obligation to permit installment payments over an extended period of time, the underlying statutory obligation is one of immediate payment of the amount due. Accordingly, when the obligation to pay in installments under the plan is breached, thus permitting the Service to employ its normal administrative remedies available outside of bankruptcy, the Service should be able to collect the full amount as permitted under nonbankruptcy law. Given both the peculiarities of the bankruptcy process and the nature of the debtor-creditor relationship specific to taxpayers and the Service, we do not believe rules governing remedies upon breach of installment contracts should apply to situations where debtors who are also taxpayers have stopped making payments under confirmed plans in bankruptcy.

LITIGATING HAZARDS:

[redacted]

In summary, our position is that the Service may legally use administrative collection mechanisms to collect the full amount due under a plan once the taxpayer-debtor defaults on making plan payments, in cases where the debtor has ceased making all payments under the plan and will no longer attempt to comply with the plan. We see no reason, based on the case law noted in your memorandum, why this remedy would not be available in Virginia as well as in other jurisdictions. [redacted]

Thank you for requesting our comments on this matter. If you require further assistance, please contact Debbie Kohn, the attorney assigned to this file, at 202-622-3620.

Note: This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.