OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
March 30, 1999

CC:EL:GL:Br2
GL-611268-98

UILC: 09.08.00-00

Number: **199921042**
Release Date: 5/28/1999

MEMORANDUM FOR DISTRICT COUNSEL, VIRGINIA-WEST VIRGINIA
DISTRICT COUNSEL, RICHMOND

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Voluntary Payments by Debtors for Prepetition Tax Liabilities - Does Acceptance Violate the Automatic Stay?

This is in response to your request for our advice as to whether a voluntary payment of a prepetition nondischargeable tax liability pursuant to an installment agreement, after the filing of a Chapter 7 petition by an individual debtor, violates the automatic stay of B.C. § 362(a). For the following reasons, we conclude that as a general rule the stay is not violated.

You state that this issue arises most frequently in Chapter 7 cases with respect to nondischargeable taxes for which an individual taxpayer is making payments under an installment agreement. In many cases, after filing the Chapter 7 petition the taxpayer wishes to continue to make payments under the installment agreement from the taxpayer's post-petition income.

Our office has previously given the advice at a training session that the automatic stay prohibits the acceptance by the Service of any payment of a prepetition tax liability, even a voluntary payment by the taxpayer/debtor, and that payments accepted in violation of the automatic stay should either be refunded or the Service must seek relief from the automatic stay in the bankruptcy court. This advice was based in part on prior advice we gave in a memorandum dated June 16, 1998, that the Service should not accept voluntary payments by third parties while the automatic stay is in effect.

You disagree with our advice regarding payments by the taxpayer/debtor on the ground that there is case law indicating that acceptance by a creditor of a truly voluntary payment does not violate the automatic stay. You also point out that the

advice concerning voluntary payments from third parties was premised on the fact that such payments will rarely occur, and, thus, it is not worthwhile to litigate the automatic stay issues which arise from third party payments. You state that in contrast voluntary payments from taxpayers/debtors are more routine. You estimate that returning such voluntary payments will require the issuance of 180 refunds per week in your district. You also note that issuing such refunds will cause several problems. First, significant resources will be required to identify the postpetition payments and generate refunds. Second, it will be bad practice from a customer service perspective to return voluntary payments to taxpayers which will result in the accrual of additional interest and penalties. Third, neither your office nor the Department of Justice is adequately staffed to routinely file motions for relief from the stay in these cases.

For purposes of the advice in this memorandum, we are presuming the following facts. An individual debtor filed a Chapter 7 petition. Prior to the petition, the debtor and the Service entered into an installment agreement pursuant to I.R.C. § 6159 to pay past-due taxes in monthly installment payments. Pursuant to this agreement, the debtor is required to make monthly payments by check to the Service. The taxes covered by the agreement are nondischargeable pursuant to B.C. § 523 (e.g., trust fund taxes). The debtor continues to make monthly payments pursuant to the installment agreement after the petition is filed and prior to the Chapter 7 discharge. The source of these monthly payments is the debtor's post-petition income. For the following reasons, we agree with your view that acceptance by the Service of voluntary payments under these circumstances does not violate the automatic stay.

We emphasize at the outset that we are presuming that the source of the voluntary payments is the debtor's post-petition earnings, and, thus, the payments do not come from funds which are property of the estate. 1/ Thus, we presume that B.C. § 362(a)(3), which prohibits any act to obtain possession of property of the estate or to exercise control over property of the estate, is not implicated.

We previously concluded in a prior memorandum dated February 5, 1999 (attached), that the filing of a bankruptcy petition does not automatically terminate an installment agreement and the Service does not have the authority to terminate the installment agreement due to the filing of the bankruptcy petition. Thus, if the taxpayer ceases making payments under the installment agreement after bankruptcy is filed, the agreement should be treated as "suspended" but no action should be taken to terminate the agreement. This memorandum addresses what

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1/ Property of the estate includes property of the debtor as of the commencement of the case. B.C. § 541(a)(1). Earnings from services performed by an individual debtor after the commencement of the case are expressly excluded from property of the estate. B.C. § 541(a)(6).

the Service should do in a Chapter 7 case if the taxpayer continues to make payments under the agreement after a bankruptcy petition is filed.

Section 362(a)(6) stays "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title...." B.C. § 362(a)(6). We conclude that acceptance of a voluntary payment made by a taxpayer in the situations described above does not violate this provision (nor any other provision of section 362), and, thus, the payment can be accepted by the Service during the pendency of the automatic stay during the Chapter 7 case.

The purpose of subsection (a)(6) is to assist the debtor in rehabilitation by protecting the debtor from collection and other harassing actions by creditors, and to provide for an orderly liquidation of the debtor's assets to ensure that all creditors are treated equally. Morgan Guaranty Trust Co. of New York, 804 F.2d 1487, 1491 (9th Cir. 1986), cert. denied 482 U.S. 929 (1987). The courts have indicated that certain actions with respect to prepetition debts do not violate subsection (a)(6) if such actions do not interfere with these purposes. For example, in Morgan Guaranty, the Ninth Circuit held that where a creditor presented a promissory note received from the debtor prepetition to a bank after the bankruptcy petition was filed, such presentment did not violate subsection (a)(6) because it did not interfere with the orderly administration of the estate and did not constitute harassment of the debtor.

The courts have similarly held that reaffirmation letters sent to debtors do not violate subsection (a)(6). Matter of Duke, 79 F.3d 43 (7th Cir. 1996); Brown v. Pennsylvania State Employees Credit Union, 851 F.2d 81 (3d Cir. 1988); Sears, Roebuck and Co. v. Epperson, 189 BR 195 (E.D. Mo 1995). The reaffirmation cases involve offers made by holders of dischargeable debt such as retailers or credit unions to continue to do business with the debtor if the debtor reaffirms the debt. Such reaffirmations are permitted by B.C. § 524(c). The courts hold that such offers do not violate subsection (a)(6) so long as they are nonthreatening and non-coercive. The Third Circuit explained that the respite afforded by the automatic stay "is not from communication with creditors, but from the threat of immediate action by creditors, such as foreclosure or a lawsuit." Brown, 851 F.2d 86. In Epperson, the court stated:

> Courts have uniformly refused to interpret section 362(a)(6) to prohibit a creditor from making any post-bankruptcy contact with a debtor. Despite the literal language of the statute, the general rule is that requests for voluntary payment or reaffirmation are not barred by the automatic stay absent coercion or harassment by the creditor.

189 B.R. 197.

The court in Henry v. United States, 213 BR 45 (1997), held that the Department of Health and Human Services (HHS) did not violate the automatic stay by continuing to accept payments in satisfaction of a court ordered restitution obligation after a Chapter 11 filing by a prisoner. The restitution payments were made pursuant to a voluntary program which afforded the prisoner certain benefits such as the opportunity for an early release. Pursuant to this program, the payments were automatically deducted from the prisoner's prison wages, but the prisoner's payments were voluntary and he could have terminated his participation in the program at any time. The court held that HHS did not engage in an "act to collect," stressing the voluntary nature of the program. The court stated:

> These results do not contravene the policies underlying the imposition of the automatic stay. The payments were initiated by the debtor without any 'pressure or harassment' from the government 'to collect.' The payments were not made from property of the chapter 11 estate and therefore did not 'dismember' estate assets. In addition, the payments were applied to reduce a debt which is not subject to discharge in this chapter 11 case.

213 B.R. 48.

Thus, the case law indicates that an action by a creditor such as acceptance of a voluntary payment from the debtor will not violate the automatic stay if the creditor's action does not interfere with the purposes of the stay. We conclude that the purposes of the stay are not interferred with by acceptance of tax payments in the factual scenario discussed above. Acceptance of voluntary payments from the debtor, where the debtor chooses to continue to pay under an installment agreement without any encouragement by the Service, does not constitute harassment or coercion. Assuming the payments are from the debtor's post-petition earnings, they are not being made from property of the estate and, therefore, other creditor's interests are not harmed. Additionally, so long as the tax being paid is nondischargeable, the debtor's interests are furthered by continuing to pay under the installment agreement since the debtor will continue to owe the tax after the discharge. The installment payments help reduce the tax owed and prevent the accrual of interest. We conclude that the receipt of voluntary payments made from post-petition earnings for a nondischargeable tax does not constitute an act to collect, assess or recover a claim within the meaning of subsection (a)(6), and, thus, does not violate the automatic stay. Such payments received during Chapter 7 cases do not have to be returned to the debtor.

Further support for this conclusion can be found in cases involving automatic payroll deductions. The courts have held that where a creditor is receiving payments on a dischargeable debt through automatic deductions from the debtor's pay, the creditor's continued acceptance of payments after the bankruptcy filing violates subsection (a)(6) unless the debtor formally and voluntarily agrees to the continuation of the automatic debits. Matter of Hellums, 772 F. 2d 379 (7th Cir.

1985); In re Raper, 177 BR 107 (Bankr. N.D. Fla. 1994); In re O'Neal, 165 BR 859 (Bankr. M.D. Tenn. 1994); In re Houseworth, 177 BR 557 (N.D. Ohio 1994). The Seventh Circuit in Hellums stated that it is consistent with congressional intent to require that a creditor "obtain some positive indication that debtors indeed intend to voluntarily assume their pre-petition debts. Such a requirement safeguards against inadvertent repayment yet preserves the right of a debtor to voluntarily re-affirm otherwise dischargeable obligations." 772 F.2d 382. These cases stress that debtors may not have the knowledge and experience to contact the creditor to request that the automatic debits be halted, and, thus, the payments cannot be considered voluntary.

These decisions, in permitting continuation of automatic debits where the debtor expressly and voluntarily agrees to the continuation, support the proposition that installment payments do not violate subsection (a)(6). When a debtor voluntarily sends a check to the Service, this is an express, positive indication which pursuant to the rationale of these cases results in no violation of the automatic stay. 2/

We emphasize that this advice applies only to nondischargeable debts which would survive the bankruptcy discharge under B.C. § 523(a)(1). The debtor has no obligation to pay discharged tax liabilities after the Chapter 7 discharge, and a debtor has no incentive to reaffirm dischargeable tax debt. We, thus, do not believe it is appropriate for the Service to continue to accept payments for such debt, after the bankruptcy petition is filed.

We also note that our advice is limited to individual Chapter 7 cases. In Chapter 13 cases, property of the estate includes property acquired post-petition. B.C. § 1306. Thus, acceptance of post-petition payments may violate section 362(a)(3). Additionally, to ensure the Service's right to payment it is critical that the Chapter 13 plan provide for payment of all priority and secured tax debts. Thus, any post-petition tax payments should be made through the Chapter 13 plan rather than the installment agreement.

In conclusion, where a taxpayer continues to make voluntary payments from post-petition earnings for nondischargeable taxes pursuant to a pre-existing installment agreement after filing a Chapter 7 petition, the Service can generally continue to

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2/ If instead of paying by check, a taxpayer was making installment payments by automatic debits, then the continuation of the automatic debits might violate the automatic stay in the absence of a written agreement by the debtor to continue the debits. Installment payments by automatic debits present difficult issues and we are not offering an opinion as to how to treat such payments in this memorandum. Cf. Henry (court approves of automatic debits with respect to a nondischargeable criminal restitution debt without an express agreement by the debtor.)

accept such payments without violating the automatic stay. Please contact Mitchel S. Hyman at (202) 622-3620 if you need any further assistance.

Attachment (1)