Wadleigh v. Commissioner, 134 T. C. 280 (2010)

In Wadleigh v. Commissioner, the U. S. Tax Court ruled that the IRS could pursue a taxpayer's pension to collect a discharged tax debt, as the pension was excluded from the bankruptcy estate. This decision underscores the IRS's ability to levy on assets not included in the bankruptcy estate, even when personal liability for the tax is discharged, and highlights the importance of proper classification of assets in bankruptcy filings.

Parties

Vance L. Wadleigh, the petitioner, sought review of the Commissioner of Internal Revenue's determination to sustain a proposed levy on his pension. The Commissioner of Internal Revenue, the respondent, issued the notice of intent to levy on Wadleigh's pension income to collect his unpaid 2001 Federal income tax liability.

Facts

Vance L. Wadleigh had an unpaid Federal income tax liability for the year 2001. On September 16, 2002, the IRS assessed the tax shown on Wadleigh's 2001 Form 1040, along with additions for failure to pay timely and estimated tax, and interest. Wadleigh did not pay this liability. In 2005, Wadleigh and his wife filed for Chapter 7 bankruptcy, listing his interest in the Honeywell Pension Plan but claiming it as exempt property under 11 U. S. C. § 522(b)(2) and Cal. Civ. Proc. Code § 703. 140(b)(10)(E), or alternatively, as excluded from the bankruptcy estate under 11 U. S. C. § 541(c)(2). Wadleigh's pension was fully vested but not in payout status at the time of the bankruptcy filing, with monthly payments beginning on November 1, 2007. On January 29, 2007, the IRS mailed Wadleigh a notice of intent to levy on his pension to collect the 2001 tax liability.

Procedural History

After receiving the notice of intent to levy, Wadleigh timely requested a hearing under I. R. C. § 6330. The IRS Appeals Office conducted the hearing and determined that the proposed levy could proceed. Wadleigh then sought review of this determination in the U. S. Tax Court. The Tax Court reviewed the case for abuse of discretion, as Wadleigh did not challenge the underlying tax liability.

Issue(s)

Whether a tax lien under I. R. C. § 6321, which was not perfected by the filing of a valid notice of federal tax lien (NFTL), may be enforced by a levy on a taxpayer's pension income after the taxpayer's personal liability for the unpaid tax has been discharged in bankruptcy?

Whether the IRS's notice of intent to levy is invalid because it was mailed before the

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pension entered payout status?

Whether the release of a prior levy on the same pension releases the underlying I. R. C. § 6321 lien?

Rule(s) of Law

I. R. C. § 6321 provides that if any person liable to pay any tax neglects or refuses to do so, the amount of the tax, including costs, penalties, and interest, shall be a lien in favor of the United States on all property and rights to property belonging to the taxpayer.

11 U. S. C. § 541(c)(2) states that a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under the Bankruptcy Code.

I. R. C. § 6331(a) authorizes the Secretary to collect taxes by levy upon all property and rights to property belonging to the taxpayer or on which there is a lien, except property exempt under I. R. C. § 6334.

Holding

The Tax Court held that the I. R. C. § 6321 lien on Wadleigh's pension was not discharged by his 2005 bankruptcy because his interest in his pension was excluded from his bankruptcy estate under 11 U. S. C. § 541(c)(2). The court further held that although Wadleigh's personal liability for the 2001 tax was discharged in bankruptcy, the IRS could still collect the tax in rem by levying on the pension income. The notice of intent to levy was not invalid merely because it was mailed before the pension entered payout status. Finally, the release of a prior levy did not release the underlying I. R. C. § 6321 lien on Wadleigh's pension.

Reasoning

The court's reasoning focused on the distinction between exempt and excluded property in bankruptcy. Exempt property is initially part of the bankruptcy estate but removed for the debtor's benefit, whereas excluded property never becomes part of the estate and remains subject to pre-existing liens. The court relied on the Supreme Court's decision in Patterson v. Shumate, which held that a debtor may exclude an interest in an ERISA-qualified pension plan from the bankruptcy estate under 11 U. S. C. § 541(c)(2). The court concluded that Wadleigh's pension was properly excluded from his bankruptcy estate, and thus, the I. R. C. § 6321 lien remained attached to the pension despite the discharge of Wadleigh's personal liability for the tax.

The court also addressed the timing of the notice of intent to levy, stating that there is no authority requiring such a notice to be issued only after the pension enters payout status. The court distinguished between the notice of intent to levy and the

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actual levy, noting that the IRS could not levy on the pension until it entered payout status.

Finally, the court clarified that the release of a prior levy does not release the underlying I. R. C. § 6321 lien, as the lien arises automatically upon assessment and continues until the liability is satisfied or becomes unenforceable.

Disposition

The Tax Court remanded the case to the IRS Appeals Office for further proceedings, as the administrative record lacked information on Wadleigh's financial situation after his pension entered payout status, which was necessary to evaluate whether the levy would cause economic hardship.

Significance/Impact

The Wadleigh case clarifies the IRS's authority to enforce tax liens against assets excluded from a bankruptcy estate, even when the taxpayer's personal liability for the tax has been discharged. This decision emphasizes the importance of properly classifying assets in bankruptcy filings, as the treatment of exempt versus excluded property can significantly impact the IRS's ability to collect discharged tax debts. The case also highlights the need for clear procedures and communication between taxpayers and the IRS regarding financial information relevant to proposed levies, especially in cases involving retirement income.

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