VOLUNTARY PAYMENT OF TRUST FUND TAXES UNDER A BANKRUPTCY PLAN OF REORGANIZATION

Gary L. Fletcher

The Internal Revenue Service (IRS) is perhaps the most feared of all government agencies. Why is it that so many people become terrified by the thought of even the most minimal contact with the IRS? Perhaps the reason is that when it comes to the collection of outstanding debts, the IRS has many tools at its disposal.[1]

Unfortunately, most taxpayers do not know just what the IRS can or cannot do in order to collect an outstanding tax liability. This lack of knowledge operates to transform very effective IRS collection techniques into powerful weapons. The 100% penalty,[2] because it is widely misunderstood, exemplifies just such a weapon.

This Note explains the 100% penalty and examines those situations in which the penalty is usually imposed. The importance of a taxpayer's ability to designate application of voluntary payments to specified liabilities is discussed. Finally, this Note focuses on the issue of whether payments made to the IRS pursuant to a plan of reorganization in bankruptcy can be characterized as voluntary, so as to allow the taxpayer to direct application of those payments to employer withheld trust fund taxes.

MISUSE OF WITHHELD TAXES BY EMPLOYERS

The Internal Revenue Code requires an employer to deduct and withhold income and social security taxes from wages paid to employees.[3] The employer is then liable to pay the withheld amount to the IRS.[4] From the

1. Internal Revenue Code of 1986 (hereinafter I.R.C.) §§ 6671 through 6709 provide penalties which may be assessed by the IRS.

2. I.R.C. § 6672 (1986) provides that any person, as defined in § 6671(b), required to collect, truthfully account for, and pay over withholding taxes, who willfully fails to collect such tax, or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The term "100% penalty" is derived from the fact that the penalty is equal to 100% of the amount of the outstanding liability. The 100% penalty is actually considered a collection device, rather than a true "penalty," because it is designed to encourage payment of taxes rather than to punish the taxpayer. United States v. Sotelo, 436 U.S. 268, 278 (1978).

3. I.R.C. §§ 3402(a) and 3102(a) (1986) require employers to deduct and withhold social security and income taxes upon the wages of employees.

4. I.R.C. § 3403 (1986).

time that the taxes are initially withheld until the time they are paid to the IRS, the employer holds the funds in "trust" for the IRS. Thus, the IRS refers to withheld taxes as "trust fund taxes."[5] Because of this trust relationship, the IRS considers use of these funds for any purpose other than tax payment as a violation of the trust.[6] In fact, the IRS considers violations, such as using the "trust" funds to pay other creditors, tantamount to embezzlement.[7] The fact that the employee receives a credit against his or her individual income tax liability even if the employer does not pay the taxes to the government further intensifies the IRS's concern regarding an employer's failure to pay over trust fund taxes.[8] In light of this credit given to the individual employee, collection of the trust fund taxes from the employer is a high priority for the IRS.[9]

A corporate employer is most likely to use withheld taxes for operating capital or other impermissible purposes when it experiences cash flow difficulties.[10] When this happens, the trust fund portion of the corporation's tax liability is often one of the first items that is left unpaid.[11] There are several reasons why this occurs. First, the government is one of the very few creditors that will not knock at the debtor's door as soon as a payment is late.[12] Also, many corporate debtors prefer to use the company's last remaining assets to pay employees or other creditors, rather than turning funds over to the IRS. Finally, and perhaps most importantly, most corporate officers simply do not realize that failure to pay over withheld taxes subjects them to potential personal liability.[13]

IMPOSITION OF THE 100% PENALTY: THE IRS CRACKS DOWN ON NONCOMPLYING EMPLOYERS

The Internal Revenue Code imposes a penalty on "responsible" parties who "willfully" fail to pay over withheld taxes.[14] Although a person does not have to be an officer of a corporation to be considered a "responsible party," the penalty is most commonly assessed against officers.[15] The penalty is called the 100% penalty because the amount of the penalty is equal to

5. I.R.C. § 7501(a) (1986) provides that withheld taxes are held in trust for the United States.

6. Portney & Culp, *Who's Responsible? The Government's Weapon Against Unpaid Withholding Taxes*, 10 REV. OF TAX'N OF INDIVIDUALS 169, 170 (1986).

7. *Id.*

8. *Id.*

9. Internal Revenue Manual § 57(13)2.61(3)(b) (1986).

10. A corporation facing cash flow difficulties forces the corporate officer in control of disbursement of funds to make a difficult decision. He must decide whether to use the corporation's limited funds to pay employees and other creditors or to pay the IRS the withholding tax.

11. Robison & Mark, *Techniques to Avoid the Imposition of the Section 6672 Penalty on Officers of Bankrupt Corporations*, 65 TAXES 110, 110 (1987).

12. Although the IRS has many tools at its disposal to collect outstanding liabilities, they are not likely to discover a delinquent payment as rapidly as other creditors, such as suppliers. Suppliers will recognize a delinquency as soon as it occurs. The choice between paying a supplier and paying the IRS is not difficult to make since the officer of the corporate debtor knows that failure to pay the supplier may render the corporate debtor unable to continue operations.

13. Robison & Mark, *supra* note 11, at 110.

14. I.R.C. § 6672(a) (1986).

15. *See* Robison & Mark, *supra* note 11, at 111 n.1.

the full amount of the taxes withheld from employee wages.[16] Essentially, the 100% penalty is a collection device rather than a true penalty: the IRS seeks nothing more than collection of the amount of tax which was withheld yet never paid.[17] Even though it may have an assessment against the corporation as well as against one or more responsible officers, the IRS does not seek to collect this unpaid amount more than once.[18]

Upon assessment of the penalty, an individual may appeal on the basis that he or she is not a "responsible" party or did not "willfully" fail to pay over the trust fund taxes.[19] Yet, simply appealing on this basis does not stop collection proceedings. In fact, the only way to halt collection proceedings is if within thirty days of receipt of notice and demand for payment, the person charged with the penalty: (1) pays an amount equal to the amount of withholding due on one employee for one month, (2) files a claim for refund of the amount so paid, and (3) furnishes a bond in the amount of 1.5 times the amount of the assessed penalty less the amount paid to institute the refund suit.[20] The impracticality of obtaining a bond within thirty days of receipt of notice and demand makes this alternative for stopping collection procedures somewhat mythical.[21]

The IRS has no obligation to pursue collection from the corporation prior to assessment of the penalty against a responsible party.[22] It is the stated policy of the IRS to impose the 100% penalty whenever the trust fund taxes cannot be *immediately* collected from the corporation itself.[23] Corporate officers should realize that assessment of the penalty is the rule and forbearance is the exception.[24]

The IRS seeks to collect the unpaid taxes only once so that any pay-

16. I.R.C. § 6672(a) (1986). This section provides for the collection of the amount of taxes previously withheld from wages which were not paid to the government. The IRS does not assess an additional penalty.

17. IRS Policy Statement P-5-60 (1984), *reprinted in* Internal Revenue Manual § 1305-15 (1986). This policy statement provides that the IRS seeks to collect nothing more than the amount of withheld tax which was not paid to the government.

18. United States v. Sotelo, 436 U.S. 268, 279 n.12 (1978). If the tax liability is collected from the corporation or one or more of the responsible parties, no further collection action is taken on the remaining 100% penalties.

19. I.R.C. § 6672 (1986). For further explanation of the appeal process, see M. SALTZMAN, IRS PRACTICE & PROCEDURE ¶ 17.10[3] (1981).

20. I.R.C. § 6672(b) (1986).

21. Even if the taxpayer is able to find an insurer who is willing to write a bond in this situation, it is not likely that the bond could be obtained within the prescribed 30 day period. The most likely source from which a taxpayer would obtain a bond is an insurance company. The bonding and surety requirements described in Treas. Reg. § 301.7101-1 (as amended in 1972) apply to situations involving stay of collection of the 100% penalty. Rev. Rul. 79-170, 1979-1 C.B. 437. Generally, the administrative process of obtaining a bond would require more than 30 days. In addition, an insurance company is not likely to issue a bond to a corporate officer faced with a 100% penalty.

Given the financial situation of the corporate officer, the insurance company cannot be assured of repayment. An insurance company is not likely to issue the bond if there is much chance of default. The taxpayer is then left supplying a cash bond out of his personal funds. Taxpayers who find themselves in this position do not normally have adequate funds available to post the bond.

22. Calderone v. United States, 799 F.2d 254, 258 (6th Cir. 1986).

23. Robison & Mark, *supra* note 11, at 111. Once a deficiency is found in corporate withholding payments, the assessment of a 100% penalty on a corporate officer is likely to follow.

24. Internal Revenue Manual § 57(13)2.61(3)(b) (1986). Following this policy statement of the IRS, a corporate officer of a corporation which has had a deficiency assessed against it for delinquent payment of withheld taxes should anticipate the imposition of the 100% penalty.

ments made by the corporation will reduce the amount of the penalty imposed against any responsible party.[25] It is important to note, however, that when a responsible party remits payment of the tax, there is no right of contribution against other possible responsible parties.[26] Additionally, any payment made by a responsible person may not be treated as a deduction on that person's individual income tax return.[27] Given these facts, it is clearly beneficial to a responsible party to have the corporation or another responsible person pay as much of the tax liability as possible.[28]

CORPORATE ATTEMPTS TO SAVE THE RESPONSIBLE PARTY

Usually, at the time of payment, a taxpayer making a voluntary tax payment to the IRS may designate whether the payment should be allocated to tax, penalties, interest, or any combination thereof.[29] Unless the taxpayer designates how the payment is to be apportioned, the IRS is free to apply the payment however it sees fit.[30] In addition, if the payment is characterized as involuntary, the IRS has discretion in applying the payment.[31] Thus, if a corporation makes a voluntary payment to the IRS and directs application of the payment to the trust fund portion of its tax liability, a responsible party's liability for the 100% penalty is proportionately reduced.[32]

It is reasonable to assume that the IRS will first apply the payment to outstanding interest, penalties and non-trust fund taxes in order to insure that it maximizes the collection of the outstanding taxes, penalties and interest.[33] Additionally, application of payments to interest, penalties and non-trust fund taxes serves to maintain an outstanding tax liability that will continue to accrue additional interest on behalf of the IRS.[34] Given the fact that

25. It makes no difference to the IRS who makes the payment. All that matters is that the entire liability is paid. Therefore, a payment made by the corporation (or by another responsible party) reduces the corporate officer's liability for the 100% penalty. Portney & Culp, *supra* note 6, at 175.

26. Rebelle v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9717 (M.D. La. 1984). Thus, if a responsible party is forced to pay the 100% penalty, he will not be able to seek contribution from responsible parties, even if the IRS had imposed the 100% penalty on these other parties. This puts a premium on being the last responsible party to resolve a 100% penalty dispute with the IRS.

27. In this sense, one can view the 100% penalty as a "penalty" rather than a mere collection device. The penalty imposes personal liability on the corporate officer for a debt of the corporation. When the officer pays the penalty, he cannot deduct the payment on his individual return, thus penalizing the corporate officer. Treas. Reg. § 1.162-21 (1975).

28. A payment on the tax liability by either the corporation or a responsible party proportionately reduces the 100% penalty liability. Portney & Culp, *supra* note 6, at 175.

29. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983); O'Dell v. United States, 326 F.2d 451, 456 (10th Cir. 1964). The courts in both cases held, in part, that a taxpayer making a voluntary payment of federal taxes may designate whether the payment is to be allocated to tax, penalties, or interest.

30. Liddon v. United States, 448 F.2d 509, 513 (5th Cir. 1971), *cert. denied*, 406 U.S. 918 (1972) (a taxpayer must designate allocation at the time of payment).

31. *Muntwyler*, 703 F.2d at 1032. A taxpayer has the power to designate how a payment is to be allocated if the payment is characterized as voluntary.

32. Portney & Culp, *supra* note 6, at 175. The IRS seeks only to collect the entire liability once. It does not matter who makes the payment. Thus, the liability paid by the corporation reduces the responsible party's liability.

33. By collecting non-trust fund taxes, interest and penalties first, the IRS leaves an outstanding liability for trust fund taxes. Interest will continue to accrue on this liability until payment is made. I.R.C. § 6601 (1986).

34. *Id.*

a responsible party has an incentive to have the corporation's payments applied to the trust fund portion of the tax liability, and the IRS has a conflicting incentive to apply payments to interest, penalties and non-trust fund taxes, the determination of whether the payments are voluntary or involuntary is critical.

The question of whether or not a payment is voluntary would not be difficult to determine under ordinary circumstances.[35] Unfortunately, a 100% penalty situation most often arises when a corporation has financial difficulties or the corporation files for bankruptcy before a payment is made to the IRS.[36] As a result, the issue of voluntariness becomes more complex.

PAYMENTS MADE BY A BANKRUPT CORPORATE DEBTOR

When a corporation seeks relief from creditors under Chapter 11 of the Bankruptcy Act, the Bankruptcy Code permits the corporation to propose a plan to satisfy its liabilities.[37] This plan of reorganization must address any unpaid tax liabilities.[38] Such a plan must provide for full payment of all priority tax liabilities, including interest, over a period of no more than six years from the date of assessment.[39] Confirmation of the plan of reorganization forces the IRS to decide whether it will be satisfied receiving payments including interest, over an extended period of time, or whether it should impose a 100% penalty against one or more responsible parties so as to pursue immediate collection.[40]

Even if a corporation's plan of reorganization includes a reasonable schedule of payment of trust fund taxes, the IRS is under no obligation to wait for payments from the corporation.[41] Instead, the IRS will usually assess the 100% penalty even though the reorganization plan includes payment of the trust fund taxes. The Internal Revenue Manual indicates that forbearance from assessment may be considered only where it is certain that all taxes will be paid in full.[42] Accordingly, the IRS is likely to assess the penalty against one or more responsible parties and then argue that payments made under a Chapter 11 plan of reorganization are involuntary.[43] This allows the IRS to first apply payments made under the plan to interest, penalties and non-trust fund taxes. Interest continues to accrue on the remaining tax liability, thus maximizing the amount owed to the Service.[44]

35. "Ordinary circumstances" refers to situations in which payments are simply rendered directly from the taxpayer to the IRS with no bankruptcy proceedings present.

36. When a corporation is not facing financial difficulties, a delinquency in withholding tax payments is not likely to occur. If a delinquency does occur, funds are available in the corporation to remedy the situation, and there is no need for imposition of the 100% penalty.

37. 11 U.S.C. § 1129(a) (1986).

38. 11 U.S.C. § 1129(a)(9)(C) (1986).

39. *Id.*

40. Robison & Mark, *supra* note 11, at 111.

41. In fact, it is the stated policy of the IRS to impose the penalty whenever the trust fund taxes cannot be immediately collected from the corporation. *See supra* note 24.

42. Internal Revenue Manual § 57(13)2.61(3)(b) (1986).

43. In the following cases, the 100% penalty was assessed against two or more officers: M.C. Marker, Sr., 73-2 U.S. Tax Cas. (CCH) ¶ 9688 (E.D. Pa. 1973); M. Schlauch, 84-1 U.S. Tax Cas. (CCH) ¶ 9431 (N.D. Ohio 1984); C. Latimer, 84-2 U.S. Tax Cas. (CCH) ¶ 9769 (N.D. Ill. 1984).

44. I.R.C. § 6601 (1986).

Amos v. Commissioner[45] was the first case to address the issue of voluntariness of federal tax payments. In *Amos*, the Tax Court stated that payments are involuntary if received by the United States as a result of distraint, levy or legal proceeding in which the government sought or filed a claim for delinquent taxes.[46] The *Amos* definition of involuntary payments is widely accepted by many courts.[47] However, the *Amos* case did not address whether bankruptcy proceedings constitute sufficient judicial involvement so as to characterize payments made during bankruptcy as involuntary.

The court in *Muntwyler v. United States*[48] noted that the *Amos* distinction between voluntary and involuntary payments was not made solely on the basis of the presence of administrative action, but rather, the *Amos* court considered such factors as the presence of court action and actual seizure of property or money, as in a levy, as well.[49] The *Muntwyler* court further stated that there is no support for the proposition that a payment is involuntary whenever an agency takes even the slightest administrative action to collect taxes.[50] It is important to recognize that the *Muntwyler* case did not involve payments made in bankruptcy.[51] Actually, the court left open the possibility of an involuntary payment made in bankruptcy.[52] The ambiguity regarding the type of legal proceeding necessary to render a payment involuntary contributes to the conflicting case law concerning whether or not tax payments made pursuant to a bankruptcy proceeding are involuntary.[53]

The issue of voluntariness of payments made in bankruptcy is relatively new.[54] Several courts agree that merely filing a claim under Chapter 11 of the Bankruptcy Act and obtaining court approval of a plan of reorganization does not constitute sufficient judicial involvement so as to render involuntary any payments made pursuant to the plan.[55] The contention of the IRS that an act should be considered involuntary simply because it occurs in a bankruptcy proceeding is contrary to congressional concern for the rehabilitation of bankrupts. The IRS contention also conflicts with the dictionary defini-

45. 47 T.C. 65 (1966).

46. *Id.* at 69.

47. In recent cases regarding the voluntariness issue, courts use the *Amos* definition of voluntary as a starting point. *See, e.g., In re* Energy Resources, Inc., 59 Bankr. 702, 704 (Bankr. D. Mass. 1986); *In re* Lifescape, Inc., 54 Bankr. 526, 527 (Bankr. D. Colo. 1985); *In re* Jerry V. Herald, d/b/a Townhouse Restaurant, Debtor, 86-2 U.S. Tax Cas. (CCH) ¶ 9651 (E.D.N.C. 1986).

48. 703 F.2d 1030, 1033 (7th Cir. 1983).

49. *Id.* at 1032.

50. *Id.* at 1033.

51. *Id.* at 1034 n.2.

52. *Id.*

53. While the *Amos* definition of voluntariness may be widely accepted, there is considerable disagreement regarding the type of legal proceeding sufficient to render payments involuntary.

54. The great majority of the cases which have addressed the issue of voluntariness of tax payments made in bankruptcy arose after 1984.

55. *In re* Ducharmes & Company, Inc., 75 Bankr. 71 (Bankr. E.D. Mich. 1987); *In re* Energy Resources Co., Inc., 59 Bankr. 702 (Bankr. D. Mass. 1986); *In re* Lifescape, Inc., 54 Bankr. 526 (Bankr. D. Colo. 1985); *In re* A & B Heating & Air Conditioning, Inc., 53 Bankr. 54 (Bankr. M.D. Fla. 1985); *In re* Franklin Press, Inc., 52 Bankr. 151 (Bankr. S.D. Fla. 1985). Each of these cases supports the position that the mere filing of a claim in a Chapter 11 proceeding along with the confirmation of a plan of reorganization does not constitute sufficient judicial action to render payment made pursuant to a Chapter 11 plan involuntary. In support of the finding of voluntariness, the courts rely on the many options available to the debtor in developing its plan of reorganization under section 1129(a) of the Bankruptcy Act.

tion and common use of the word voluntary.[56] *In re Energy Resources, Inc.*[57] involved an attempt by a corporate debtor to apply payments made pursuant to a Chapter 11 plan of reorganization to the trust fund portion of its tax liability.[58] The IRS argued that the payments were involuntary and the manner of their application should be left to the discretion of the Service.[59] Apparently, the IRS relied on the court involvement associated with the filing of a Chapter 11 petition as support for its contention that the payments were involuntary.[60] At the confirmation hearing, the IRS had an opportunity to voice its concerns regarding allocation of the payments to trust fund taxes, yet the Service failed to do so and simply allowed the plan to be confirmed.[61] The court rejected the reasoning of the Service and held that the payments were voluntary.[62] Thus, if a debtor in possession in a Chapter 11 proceeding requested application of payments to the trust fund tax liability of the corporation, the IRS must comply.[63]

The reasoning introduced in *Muntwyler* and followed by the court in *Energy Resources* established a foundation for other courts to follow.[64] Essentially, this position supports the view that a court proceeding is insufficient to render a payment involuntary unless there is an actual seizure of property or money as in a levy.[65] For example, the Bankruptcy Court in *In re A & B Heating & Air Conditioning, Inc.*[66] specifically stated that the court involvement in a Chapter 11 reorganization is not the type of court involvement associated with seizure of property or money as in a levy.[67] The court noted the considerable latitude afforded to a taxpayer undergoing a Chapter 11 reorganization plan.[68] Unlike a taxpayer faced with a government-instituted collection proceeding, which may ultimately lead to a levy upon the taxpayer's assets, a taxpayer under a Chapter 11 reorganization plan not only controls whether or not a plan is proposed, but also how and when the IRS will be paid.[69] The only restriction on the debtor in developing a reorganization plan is that the plan must provide for full payment of pre-petition priority taxes over a period of not more than six years from the date of assessment.[70] As long as the plan provides for payment within the six-year period, the plan may be confirmed by the court.[71] It is the debtor's freedom of choice that forms the basis for the court's conclusion that payments made

56. *In re* Energy Resources, Inc., 59 Bankr. 702, 706 (Bankr. D. Mass. 1986).
57. 59 Bankr. 702 (Bankr. D. Mass. 1986).
58. *Id.* at 706.
59. *Id.* at 704.
60. *Id.* at 706.
61. *Id.* at 707.
62. *Id.* at 706.
63. *Id.* at 707.
64. The position that a bankruptcy proceeding alone is not sufficient to render payment involuntary has been followed in several cases. *See In re* Franklin Press Inc., 52 Bankr. 151 (Bankr. S.D. Fla. 1985); *In re* Lifescape, Inc., 54 Bankr. 526 (Bankr. D. Colo. 1985); *In re* A & B Heating & Air Conditioning, Inc., 53 Bankr. 54 (Bankr. M.D. Fla. 1985).
65. *Muntwyler*, 703 F.2d at 1033.
66. 53 Bankr. 54 (Bankr. M.D. Fla. 1985).
67. *Id.* at 57.
68. *Id.* at 57.
69. *Id.*
70. 11 U.S.C. § 1129(a) (1986).
71. *Id.*

to the IRS pursuant to a Chapter 11 plan of reorganization are voluntary.[72]

Similarly, in *In re Lifescape, Inc.*,[73] the court characterized payments as voluntary due to the great latitude afforded a debtor regarding the timing and nature of the IRS payments.[74] The fact that payments are made pursuant to a plan which must comply with the requirements of the Bankruptcy Code does not rise to a level of judicial action equivalent to a levy or judicial sale.[75]

Although a number of courts support the view that Chapter 11 payments are voluntary, other courts question this position or reject it outright.[76] For example, in *In re Herald*,[77] the court recognized payments made pursuant to a Chapter 11 plan as involuntary.[78] The *Herald* court strictly interpreted the definition of "voluntary" as set forth by the court in *Amos* and expressed a willingness to accept even the slightest court involvement as sufficient to render a payment involuntary.[79] However, the *Herald* court failed to recognize that a Chapter 11 debtor has many options available in making payments to the IRS.[80]

The availability of such options is inconsistent with the term involuntary. The more reasonable view is that payments made under a Chapter 11 plan are voluntary;[81] the debtor makes the payments in a voluntary proceed-

72. *In re A & B Heating & Air Conditioning, Inc.*, 53 Bankr. at 57.

73. 54 Bankr. 526 (Bankr. D. Colo. 1985).

74. *Id.* at 529.

75. *Id.* at 529. The *Lifescape* court recognized the possibility of a different outcome if the government had filed an involuntary petition for bankruptcy against the debtor. Because the case involved a Chapter 11 reorganization, the court concluded that the payments made pursuant to the plan were voluntary.

76. In *In re* B & P Enterprises, Inc., 67 Bankr. 179 (Bankr. W.D. Tenn. 1986), the court held that the payments were involuntary even though it did not apply the rigid *In re Herald* standard. The *In re Herald* standard automatically characterizes payments as involuntary if bankruptcy proceedings are involved. In *B & P Enterprises*, the court purposefully did not adopt a per se or inflexible rule regarding a Chapter 11 case. The mere filing for Chapter 11 does not automatically render payments involuntary. Instead, the decision as to voluntariness of payments in a Chapter 11 case should be decided on a case-by-case basis. The debtor must demonstrate exceptional or special circumstances which warrant allocating the payments to the trust fund portion of the tax liability. The court concluded that the debtor in *B & P Enterprises* had not demonstrated such special circumstances. The court did not address the possibility that payments made under a reorganization plan could be considered voluntary and that the mere presence of the bankruptcy proceedings does not automatically eliminate the possibility of voluntary payments. In *In re* Mister Marvins, Inc., 48 Bankr. 279 (Bankr. E.D. Mich. 1984), the court found payments to be involuntary, but stressed the fact that court proceedings other than bankruptcy were involved. It is unclear whether the court would have reached a different decision if the only court involvement was the bankruptcy proceedings. Alternatively, in *In re* Avildsen Tools & Machine, Inc., 794 F.2d 1248 (7th Cir. 1986), the court established that bankruptcy proceedings constitute sufficient court involvement to render payments involuntary. However, the court of appeals specifically stated that it did not need to decide the voluntariness issue. The court granted the government the choice in applying payments due to a breach of an alleged contract between the IRS and the taxpayer.

77. 66 Bankr. 169 (Bankr. E.D.N.C. 1986).

78. *Id.*

79. Amos v. Commissioner, 47 T.C. 65, 70 (1966). It is important to note that in *Herald*, the court cited the *Muntwyler* case for the proposition that the bankruptcy court's involvement in the distribution of funds to the IRS is sufficient to make the payments involuntary. The *Muntwyler* court did acknowledge the possibility that bankruptcy proceedings could render payments involuntary in dicta within a footnote. *Muntwyler*, 703 F.2d at 1034 n.2.

80. As long as the Chapter 11 plan of reorganization provides for payment in full of tax liabilities, the timing of tax payments is at the discretion of the taxpayer.

81. It is true that under section 1129 of the Bankruptcy Code, the debtor must provide for

ing and the payments are made pursuant to a reorganization plan developed by the debtor.[82] To a great extent, the debtor controls the method and timing of these payments. Accordingly, courts should adopt the view that payments made pursuant to a Chapter 11 reorganization plan are voluntary.

In two recent decisions, *In re Technical Knockout Graphics, Inc.*[83] and *In re The Venice Printing Co.*,[84] the Ninth Circuit bankruptcy appellate panel held that the debtor can direct that payments made pursuant to a Chapter 11 plan be applied to trust fund taxes.[85] The IRS appealed these decisions to the Ninth Circuit Court of Appeals. The court of appeals has not yet heard *Venice*, but has reversed the decision of the bankruptcy appellate panel in *Technical Knockout*. In that case, the court held that payments made by a debtor after filing a petition for reorganization under Chapter 11 of the Bankruptcy Code, *but before confirmation of a reorganization plan*, are involuntary and may be allocated by the IRS to unpaid non-trust fund taxes.[86]

PAYMENTS MADE PURSUANT TO A REORGANIZATION V. PAYMENTS MADE IN A LIQUIDATION

When determining whether payments made in bankruptcy are voluntary, the type of bankruptcy proceedings involved is important.[87] While a debtor undergoing a reorganization is afforded a great deal of latitude in developing a payment plan, a debtor in liquidation may have few options available.[88]

A debtor may file for liquidation voluntarily, or it may be forced to file involuntarily.[89] If the debtor is forced into liquidation involuntarily, latitude

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payment of tax liabilities as part of the plan of reorganization. However, as long as this requirement is met, the debtor is afforded great latitude in determining how and when the IRS will be paid.

82. Under section 1129 of the Bankruptcy Code, the plan of reorganization is developed by the debtor. The plan is subject to the confirmation of the court.

83. 68 Bankr. 463 (Bankr. 9th Cir. 1986).

84. BAP No. CC86-1421 (Bankr. 9th Cir. Apr. 15, 1987).

85. *In re* The Venice Printing Co., BAP No. CC86-1421 (Bankr. 9th Cir. Apr. 15, 1987); *In re* Technical Knockout Graphics, Inc., 68 Bankr. 463 (Bankr. 9th Cir. 1986). In each of these decisions, the bankruptcy appellate panel avoided the issue of voluntariness. The panel noted that under 11 U.S.C. § 505, the bankruptcy court has an obligation to determine the amount of tax owing from the debtor. The panel then stated that such a determination included the authority to allocate the various payments made to creditors. The bankruptcy court's decision to allow allocation of payments to trust fund taxes can be overruled only if it was clearly erroneous or if the court abused its discretion. The panel decided that the bankruptcy court had not abused its discretion in either of those cases, and thus upheld allocation of the payments to trust fund taxes.

86. *In re* Technical Knockout Graphics, Inc., 87-2 U.S. Tax Cas. ¶ 9645 (9th Cir. 1987).

87. It may seem unreasonable for a taxpayer to expect to have payments characterized as voluntary in the case of involuntary bankruptcy proceedings. There is a much stronger argument for characterization of the payments as voluntary when a taxpayer voluntarily files for bankruptcy. Given the vast differences in the types of bankruptcy proceedings, a blanket rule on the voluntariness determination is inappropriate when bankruptcy is involved.

88. In a liquidation proceeding, a distribution of debtor's assets by a trustee satisfies the debtor's liabilities. Clearly, this reduces the debtor's freedom in determining a schedule of payments. However, it is important to note that if the debtor files for liquidation voluntarily, the proceedings can be dismissed at any time without notice to creditors. Thus, the proceedings maintain their voluntary character.

89. 11 U.S.C. § 301 (1986); 11 U.S.C. § 303 (1986).

in determining a payment schedule does not exist.[90] A voluntary Chapter 11 reorganization is quite a different procedure. The debtor develops the plan of reorganization and the court confirms the plan.[91]

It may be unreasonable for a debtor forced into an involuntary liquidation to expect the court to characterize payments made to the IRS as voluntary. Yet, neither does the mere existence of any type of bankruptcy proceeding render those same payments involuntary. Critical to the determination of voluntariness is the degree of freedom afforded a debtor in the different types of bankruptcy situations.[92] The definition of voluntary as set forth in *Amos* must not be read so strictly as to construe the existence of any bankruptcy proceeding as determinative.[93] Thus, a per se rule rendering payments involuntary in any type of bankruptcy proceeding should not be adopted. Instead, the voluntariness determination should be flexible enough to take variances, such as the debtor's degree of freedom, into consideration. Moreover, the decision must be made on a case-by-case basis.[94] This enables a court to consider the type of bankruptcy proceeding before it determines whether a payment is voluntary.

DECISIONS OF THE CIRCUIT COURTS OF APPEAL

Although the voluntariness issue is relatively new, the number of cases involving the voluntariness issue is steadily increasing. As a result, opinions on this issue are no longer limited to the bankruptcy courts.[95]

The Eleventh Circuit Court of Appeals recently affirmed the lower court's decision in *In re A & B Heating & Air Conditioning, Inc.*[96] The court declined to accept a blanket rule that all payments made under a Chapter 11 reorganization were involuntary.[97] Instead, the court held that this determination should be decided on a case-by-case basis.[98]

The Third Circuit Court of Appeals in *In re Ribs-R-Us, Inc.*[99] recently held that payments made under a Chapter 11 reorganization are involuntary.[100] The court stated that the determination of whether payments are voluntary is a matter of law which should not be left to the exercise of discretion.[101] The court favored the establishment of a uniform federal rule to the effect that any payments made pursuant to any type of bankruptcy proceeding would be involuntary.[102]

Considering the effect of these recent conflicting decisions among the circuits, and given the growing number of suits involving the voluntariness

90. 11 U.S.C. § 303 (1986).
91. 11 U.S.C. § 1129 (1986).
92. As the debtor's freedom decreases, the justification for characterizing payments as voluntary also decreases.
93. *In re* B & P Enterprises, Inc., 67 Bankr. 169, 183 (Bankr. W.D. Tenn. 1986).
94. *Id.*
95. Until 1987, the only decisions on the voluntariness issue were at the bankruptcy court level.
96. 823 F.2d 462 (11th Cir. 1987).
97. *In re* A & B Heating & Air Conditioning, 823 F.2d 462 (11th Cir. 1987).
98. *Id.* at 465.
99. 87-2 U.S. Tax Cas. (CCH) ¶ 9528 (3rd Cir. 1987).
100. *Id.*
101. *Id.* at 89,532.
102. *Id.*

issue and the importance of this determination to both the government and the taxpayer, the United States Supreme Court may soon be forced to address this issue.[103]

CONCLUSION

If an officer of a corporate debtor in bankruptcy is faced with the imposition of the 100% penalty, the voluntariness determination is crucial.[104] Until the Supreme Court decides this issue, a responsible party, when faced with an assessed 100% penalty, should always attempt to have the bankrupt corporation direct a voluntary payment under its plan of reorganization.[105]

The 100% penalty serves as a powerful collection device for the IRS in pursuing unpaid withholding taxes. By imposition of the 100% penalty, the IRS is able to pursue collection at the corporate and individual levels simultaneously. The strength of this penalty is further enhanced by the fact that the 100% penalty is an area which is widely misunderstood. It is likely that this lack of understanding is the reason that many corporate officers are exposed to potential personal liability. Given knowledge of the fact that imposition of the 100% penalty results in personal liability for 100% of the unpaid corporate liability, most corporate officers would probably not place themselves in a position of such risk. An attorney practicing in the tax area has a responsibility to inform the client of the potential liability and take steps to see that it is avoided.

103. The only case to reach the United States Supreme Court thus far is United States v. A & B Heating & Air Conditioning, Inc., 88-1 U.S. Tax Cas. (CCH) ¶ 9343 (1988). In that case, the Court vacated the decision of the Eleventh Circuit Court of Appeals without issuing an opinion. The Court remanded the case to the court of appeals for a determination of whether a live dispute still existed between the parties. Thus, the Supreme Court has yet to render an opinion on the substantive issue of voluntariness.

104. The corporate officer can reduce his liability if corporate payments can be applied to trust fund taxes. This will be possible only if the corporation's payments are considered voluntary. *See supra* note 31.

105. Nothing is lost by attempting to apply a payment made by the corporation to trust fund taxes. It should always be attempted. Robison & Mark, *supra* note 11, at 115.