

**SUMMARY:** This document contains final regulations relating to civil causes of action for damages caused by unlawful collection actions of officers and employees of the IRS and the awarding of costs and certain fees. The regulations reflect amendments made by the Taxpayer Bill of Rights 2 and the Internal Revenue Service Restructuring and Reform Act of 1998. The regulations affect all persons who suffer damages caused by unlawful collection actions of officers or employees of the IRS.

**EFFECTIVE DATE:** These regulations are effective March 25, 2003.

**FOR FURTHER INFORMATION CONTACT:** Kevin B. Connelly, (202) 622-3630 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document contains final amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to civil actions for damages caused by unlawful collection actions of officers or employees of the IRS. The Taxpayer Bill of Rights 2 (TBOR2), Public Law 104-168 (110 Stat. 1465), amended section 7433 of the Internal Revenue Code of 1986 (Code) by increasing the maximum amount of damages a taxpayer may be awarded for unlawful collection actions from \$100,000 to \$1,000,000. TBOR2 also eliminated the jurisdictional requirement that administrative remedies be exhausted before a court may award damages; TBOR2 authorized the court, however, to reduce damages if it determined that the plaintiff did not exhaust administrative remedies. These TBOR2 provisions were effective for actions of IRS officers or employees after July 30, 1996. The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105-206 (112 Stat. 685), although retaining the pre-existing authorization for an award of damages in the case of reckless or intentional disregard of the Code or regulations, amended section 7433(a) by providing that taxpayers may file actions for damages caused by the negligent disregard of the Code or regulations. RRA 1998 also added subsection (e) to section 7433. This amendment provides that an action for damages could be brought for the IRS's willful violation of section 362 (relating to the automatic stay) or section 524 (relating to the effect of discharge) of the Bankruptcy Code. Actions for damages caused by the violation of section 362 or 524 of the Bankruptcy Code are limited to willful violations. The maximum amount of damages that may be awarded for negligent disregard under

section 7433(a) is \$100,000. The maximum amount of damages that may be awarded for reckless or intentional disregard under subsection (a) or for willful violations of section 362 or 524 of the Bankruptcy Code under subsection (e) is \$1,000,000. RRA 1998 also reinstated the requirement under section 7433 that the plaintiff must exhaust administrative remedies before a court may award damages. These RRA 1998 provisions apply to actions of IRS officers or employees after July 22, 1998.

RRA 1998 also added section 7426(h), which authorizes persons who bring wrongful levy actions under section 7426 to sue for damages caused by the reckless or intentional, or negligent, disregard of any provision of the Code, plus costs of the action. Consistent with section 7433, damages awarded under section 7426(h) are limited to \$1,000,000 for reckless or intentional disregard and \$100,000 for negligent disregard. In addition, a plaintiff must exhaust administrative remedies before a court may award damages under section 7426(h). The provisions of section 7433 relating to mitigation and the period for bringing an action also apply to actions brought under section 7426(h). IRS published a notice of proposed rulemaking reflecting these changes in the **Federal Register** on March 5, 2002. (67 FR 9929). No written comments on the proposed regulations were received. No public hearing was held.

**Explanation of Provisions**

*Section 301.7426-2*

RRA 1998 added subsection (h) to section 7426. Subsection (h) authorizes persons to sue the United States in Federal district court for damages due to a wrongful levy caused by the reckless or intentional, or negligent, disregard of a provision of the Code. Plaintiffs may recover the lesser of actual direct economic damages and costs of the action or \$1,000,000 (\$100,000 in the case of negligence). The amendment also provided that the rules of section 7433(d) relating to exhaustion of administrative remedies, mitigation of damages, and the period for bringing an action shall apply. The regulations thus adopt rules like those promulgated under section 7433. Plaintiffs must mitigate damages and no damages may be awarded unless the court determines that the plaintiff has exhausted administrative remedies available within the IRS, e.g., by filing an administrative claim for damages. The regulations provide that any action for damages under this section must be brought within two years after the date

the action accrues. This two-year limitations period is independent of the nine-month period following the wrongful levy during which the third party may make a claim for wrongfully levied property.

*Section 301.7430-8*

Section 7430 provides that reasonable administrative costs may be awarded to the prevailing party in an administrative proceeding brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under Title 26 of the United States Code. Prior to the amendments in RRA 1998, taxpayers generally were not entitled to recover costs for administrative proceedings in connection with collection matters. Accordingly, the current regulations exclude such collection matters, including proceedings under sections 7432 and 7433, from the definition of administrative proceedings. To reflect the RRA 1998 amendments, the regulations expand the definition of an administrative proceeding to include any administrative action for damages under section 7433(e) and any procedure or action brought before the IRS seeking relief with respect to a violation by the IRS of section 362 or 524 of the Bankruptcy Code.

The regulations provide that the prevailing party is a party who establishes that, in connection with the collection of his or her federal tax, the IRS has willfully violated a provision of section 362 or 524 of the Bankruptcy Code. The only administrative costs that may be awarded are those incurred after the date of the bankruptcy petition that gave rise to the section 362 stay or section 524 discharge injunction.

A claim with the IRS for administrative costs must be filed within 90 days after the date the IRS mails its decision on the taxpayer's administrative claim for damages under § 301.7433-2(e) or claim for relief from a violation of section 362 or 524 of the Bankruptcy Code.

*Section 301.7433-1*

Section 3102 of RRA 1998 amended section 7433(a) of the Code by providing that a taxpayer may sue the United States in a district court of the United States for damages caused by the negligent disregard of the Code or regulations in connection with the collection of the taxpayer's tax liability. Section 801 of TBOR2 amended section 7433(b) by increasing the maximum amount of damages that a taxpayer may recover for damages caused by the reckless or intentional disregard of the Code or regulations from \$100,000 to