

Department  
of the  
Treasury

Internal  
Revenue  
Service

Office of  
Chief Counsel

# Notice

[ CC-2006-007 ]

December 22, 2005

**Subject:** Administrative Expense Claims for Pension Underfunding Penalties in Bankruptcy Cases  
**Cancel Date:** Upon incorporation into CCDM

---

## Purpose

This Notice provides guidance regarding the Service's position that pension underfunding taxes set forth under section 4971(a) and (b) of the Internal Revenue Code that relate to postpetition pension obligations of the bankruptcy estate are entitled to administrative expense priority under section 503 of the Bankruptcy Code. This Notice also requires coordination with the National Office concerning any bankruptcy case with section 4971 tax issues.

## Background

Section 4971(a) imposes a tax of 10 percent on the amount of an accumulated funding deficiency under a pension plan to which section 412 applies for each taxable year an employer maintains the plan. Section 4971(b) imposes an additional tax equal to 100 percent of the accumulated funding deficiency if the deficiency is not corrected before the mailing of a notice of deficiency with respect to the 10 percent tax, or the time the 10 percent tax is assessed. While liabilities imposed under section 4971 are termed "taxes" under the Internal Revenue Code, they are considered penalties for bankruptcy purposes. United States v. Reorganized CF&I Fabricators of Utah, Inc., 518 U.S. 213, 225-26 (1996).

Section 503 of the Bankruptcy Code governs the payment of "administrative expenses" of the bankruptcy estate. Section 503(b) lists a number of specific categories of expenses that "shall be allowed [as] administrative expenses . . . , including . . . the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A). Administrative expenses are accorded priority of payment above most prepetition claims. 11 U.S.C. § 507(a)(2), as amended by the Bankruptcy Abuse

---

Filing Instructions: Binder \_\_\_\_\_

NO: Circulate \_\_\_ Distribute \_\_\_ to: All Personnel \_\_\_ Attorneys \_\_\_ In: \_\_\_\_\_  
Other \_\_\_\_\_

Electronic Filename: \_\_\_\_\_ Original signed copy in: CC:FM:PM:P \_\_\_\_\_

Prevention and Consumer Protection Act of 2005, effective for cases filed on or after October 17, 2005.

In Reading Co. v. Brown, 391 U.S. 471, 483 (1968), the Supreme Court held that actual and necessary costs of preserving the bankruptcy estate include costs ordinarily incident to the operation of a business. Rejecting the argument that “necessary” expenses include only those expenditures without which operation of the business would be impossible, the Court held that tort claims arising from a bankruptcy trustee’s negligence while he operated the debtor’s business were administrative expenses of the bankruptcy estate. 391 U.S. at 477, 485.

Non-compensatory penalties imposed under a state’s environmental laws also have been allowed as administrative expenses of the Chapter 11 bankruptcy estate. In re N.P. Mining Co., Inc., 963 F.2d 1449 (11<sup>th</sup> Cir. 1992). In N.P. Mining, the Eleventh Circuit held that penalties assessed under state law as a consequence of the operation of the debtor’s mining business were “actual, necessary costs and expenses of preserving the estate” under section 503(b)(1)(A). 963 F.2d at 1458-59; see also Cumberland Farms, Inc. v. Florida Department of Environmental Protection, 116 F.3d 16 (1<sup>st</sup> Cir. 1997). Similarly, in In re Hemingway Transp., Inc., 993 F.2d 915, 935 (1<sup>st</sup> Cir. 1993), the court held that costs incurred by a purchaser of contaminated property from the debtor-in-possession for which the debtor-in-possession was liable under federal environmental law could be administrative expenses under section 503(b)(1)(A). See Yorke v. NLRB, 709 F.2d 1138, 1143 (7<sup>th</sup> Cir. 1983) (damages incurred based on a trustee’s failure to bargain with the union over the effects of his decision to terminate operations, as required by federal law, are administrative expenses under section 503(b)(1)(A)).

Section 4971(a) and (b) taxes also should be allowed as administrative expenses if they relate to postpetition pension obligations of the bankruptcy estate. The debtor-in-possession has an obligation to operate its business in accordance with federal pension laws that require the timely funding of its pension plans. Because a bankruptcy debtor remains responsible for operating its business in accordance with federal nonbankruptcy law, it remains liable for penalties that are the result of its failure to do so. Like penalties arising under other nonbankruptcy laws from the operation of the debtor’s business, the section 4971 taxes are allowable expenses of administration. See also 28 U.S.C. § 960(a) (officers conducting business under the authority of a United States court shall be subject to federal taxes).

Two bankruptcy courts have held that section 4971 taxes are not administrative expenses of the bankruptcy estate under section 503(b)(1)(C). In re Unitcast, 219 B.R. 741 (B.A.P. 6<sup>th</sup> Cir. 1998); In re CF&I Fabricators of Utah, Inc., 148 B.R. 332, 341 (Bankr.D.Utah 1992), appealed on other grounds and affirmed 53 F.3d 1155 (10<sup>th</sup> Cir. 1995), affirmed on other grounds 518 U.S. 213 (1996). Section 503(b)(1)(C) provides that a penalty relating to a tax that is entitled to be paid as an administrative expense of the bankruptcy estate must also be paid as an administrative expense of the estate. The courts reasoned, by negative inference, that any penalty that does not relate to a

