



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
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OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL RICHMOND

CC:SB:2:RCH
Attn: TBHeavner

FROM: Alan C. Levine,
Chief Branch 1 Collection, Bankruptcy & Summonses

SUBJECT: Liquidated Damages

This Chief Counsel Advice responds to your memorandum dated May 21, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

If the Internal Revenue Service ("Service") sells real property redeemed pursuant to I.R.C. § 7425 and the sales contract does not provide for liquidated damages for a defaulting purchaser, may the Service offset the bidder's deposit to recover its actual damages.

CONCLUSION

When the sales contract does not provide for "liquidated damages," the Service may offset the bidder's deposit against its actual damages arising from a defaulted sale.

FACTS

The Service redeemed real property following a nonjudicial sale and subsequently sold the property at public auction. The notice of sale stated that the property would be sold to the highest bidder, who would be required to pay 15% of the highest bid price at the time of sale and would be required to pay the balance within 30 days after the bid was accepted. The purchaser defaulted on the remainder of the bid price. The notice of sale made no mention of liquidated damages.

LAW AND ANALYSIS

Black's Law Dictionary defines liquidated damages as the sum which a party to a contract agrees to pay if he breaks some promise and, which having been arrived at by a good faith effort to estimate actual damage that will probably ensue from the breach, is recoverable as agreed damages if a breach occurs.

I.R.C. § 7506(a) provides, "The Secretary shall have charge of all real estate which is, or shall become the property of the United States . . . or which has been redeemed by the United States" Section 7506(b) provides, "The Secretary may, at public sale, and upon not less than 20 days notice, sell and dispose of any real estate owned or held by the United States as aforesaid."

Treas. Reg. § 301.7506-1(b)(5) states, "in the event of the sale of redeemed property . . . [a] notice of sale shall state whether, in the case of a default in payment of the bid price, any amount deposited . . . shall be retained as liquidated damages . . . not to exceed \$200." Treas. Reg. § 301.7506-1(b)(6) limits the recovery of liquidated damages to a maximum amount of \$200.00, as discussed below:

The district director may, before giving notice of sale, solicit offers from prospective bidders and enter into agreements with such persons that they will bid at least a specified amount in case the property is offered for sale. In such cases, the district director may also require such persons to make deposits to secure the performance of their agreements. Any such deposit, but not more than \$200, shall be retained as liquidated damages in case such person fails to bid the specified amount and the property is not sold for as much as the amount specified in such agreement.

Alternatively, the Service may choose not to insert a clause for liquidated damages. In that situation, we have taken the position that the Service may still recover its actual damages. Nothing in the regulations prohibit the Service from recovering its actual damages, and we see no reason why the Service should not have the same right as any other seller to recover actual damages from a defaulting purchaser. Moreover, it can be inferred from other sections of the Internal Revenue Code and regulations that Congress intended that the Service not bear the economic burden resulting from the defaulted sales of property. ^{1/}

^{1/} I.R.C. § 6335(e)(3) and the regulations thereunder, which concern the sale of seized property rather than the sale of property that the government has redeemed, provide that if the purchaser fails to pay the balance of the bid price, the Service can either (1) institute suit for the balance of the purchase price or (2) readvertise and resell the property again and consider the deposit forfeited.

Based upon the foregoing discussion, if the Service did not insert a liquidated damages clause, we think that the Service may recover its actual damages in full. Given that the Service has the defaulting purchaser's deposit, the Service may exercise its common law right of offset and recover its damages from the deposit.

In response to your inquiry concerning the discrepancy in pattern letters P-339 and P-637 referenced in IRM 5.10.7.3.5, we contacted the Office of Filing and Payment Compliance to ascertain why the letter used to give notice of sale of redeemed property, P-637, contains a liquidated damages provision but the pattern letter for the sale of other than redeemed property, P-339, does not. Apparently, there is no explanation for the discrepancy, and we were advised that it was probably just an oversight in drafting. However, to clarify matters, that office will revise pattern letter P-637 to delete any reference to liquidated damages. Likewise, they will revise pattern letter P-340, Notice of Sealed Bid Sale, (other than redeemed property) to delete any reference to liquidated damages so that it will comport with pattern letter P-1627 (redeemed property) which does not contain such a provision.

If you have any further questions, please do not hesitate to call us on 202-622-3610.

cc: Jeff Basalla, Director, Filing & Payment Compliance, S:C:CP:FP