TAXES AND BANKRUPTCY – A PRIMER

I. What are the issues and considerations when you think bankruptcy could be the answer?

A. Are the taxes dischargeable in Bankruptcy?

1. The pre-requisites to dischargeability of taxes in bankruptcy are:

a. The tax return must be DUE (with extensions) more than 3 years before the bankruptcy. §507(a)(8)(A)(i).

b. The tax must be ASSESSED at least 240 days before the bankruptcy. The 240 days is extended anytime an offer in compromise is in effect during the 240 days, plus 30 days, and any time the IRS was precluded from collection during the 240 days, plus 90 days. §507(a)(8)(A)(ii).

c. UNASSESSED taxes are not dischargeable. §507(a)(8)(A)(iii).

d. Trust fund taxes are not dischargeable. §507(a)(8)(C).

e. Taxes due from UNFILED returns are not discharged. §523(a)(1)(B)(i).

f. Late-filed returns must be filed at least 2 years before bankruptcy. §523(a)(1)(B)(ii).

g. Tax due to fraudulent returns, or unpaid as a result of evasion to pay. §523(a)(1)(C).

***All of the periods in §507(a)(8) are extended anytime the IRS is precluded from collection as a result of the debtor requesting a hearing and an appeal of collection action, plus 90 days, and during any time the automatic stay was in effect during a prior bankruptcy plus 90 days; and during any time collection was precluded because of a confirmed plan, plus 90 days. §507(a)(8) hanging paragraph.

B. Even if the taxes are discharged, can the IRS still collect? YES, IF

1. If the Debtor owns property prior to the bankruptcy and the IRS has filed a federal tax lien, or perfected their interest in the property:

a. The tax lien survives the bankruptcy because it continues to attach to the debtor's property. IRC §§ 6321, 6322.

b. The tax lien attaches to all pre-bankruptcy property, including exempt property.

Exempt property can include: homestead, life insurance, IRA's, 401(k)'s.

c. The IRS can seize this property, or demand payment of the value of the property.

d. IRC §6334 provides a list of property that is exempt from IRS levy certain items, including up to $6,250 of personal property. Presumably this Code section should prevent the IRS from levying pre-bankruptcy assets pursuant to an IRS lien after the taxes have been discharged.

C. If dischargeable, when are the taxes discharged in a bankruptcy?

1. Chapter 7 – when the court enters the discharge order, §727.

2. Chapter 13 – after the last plan payment is made, unless there is hardship. §1328.

3. Chapter 11 – after the last plan payment is made, unless the Debtor requests it earlier and has paid unsecured creditors more than they would get in a Chapter 7. §1141,

D. When does the statute of limitations on collection expire for the taxes?

1. The IRS generally has 10 years to collect taxes. IRC §6502(a).

2. This period can be extended for various events:

a. taxpayer is outside the US for at least 6 months. IRC §6503(c).

b. taxpayer is in bankruptcy. IRC §6503(h).

c. anytime the IRS is precluded from levy. IRC §6503(i)(5).

During OIC, IRC §6503(k)(1).

While an offer of an installment agreement is pending, IRC §6503(k)(2).

During CDP proceeding. IRC §6503(i)(5).

During innocent spouse claim.

3. Look at each of the tax periods at issue to determine if the statute of limitations for collection is about to expire.

4. The debtor makes payments from disposable income – as determined by the Court without application of the IRS national standards.

5. There is a separate taxable entity created upon the filing of the bankruptcy.

6. The debtor's post-petition income is an asset of the bankruptcy estate.

7. The debtor must pay quarterly fees to the US Trustee's office during the pendency of the bankruptcy.

8. The debtor must file monthly income and expense reports with the US Trustee until confirmation, then affidavits of expenses until the case is closed.

E. Chapter 12 – Payment of creditors of a family farmer/fisherman through a Chapter 12 Plan.

II. <u>What happens to the taxes in bankruptcy?</u>

A. Chapter 7 taxes.

1. Priority/Non-dischargeable taxes must be paid even after bankruptcy.

a. Due less than 3 years before bankruptcy, §507(a)(8)(A)(i).

b. Assessed within 240 days of bankruptcy, §507(a)(8)(A)(ii).

(Adding any extensions for pending OIC's)

c. Unassessed taxes. §507(a)(8)(A)(iii).

d. Trust fund taxes §507(a)(8)(C).

2. Non-priority/Non-dischargeable taxes must be paid even after bankruptcy.

a. Unfiled returns. §523(a)(1)(B)(i).

b. Late filed returns, filed within 2 years of bankruptcy. §523(a)(1)(B)(ii).

c. Fraudulent returns or unpaid tax due to evasion to pay. §523(a)(1)(C).

3. Non-priority/Dischargeable taxes may be discharged in bankruptcy.

BUT – the tax liens for these taxes would still attach to post-bankruptcy property.

AND – the IRS could still seize and sell that property or demand payment for the value of the property.

B. Chapter 13 taxes.

1. Secured taxes:

a. By surrendering the property to the IRS.

b. Selling the property and surrendering the proceeds to the IRS.

c. Paying the amount of the secured claim in full with interest through the Plan.

2. Priority taxes:

a. must be paid in full over the life of the Plan.

3. Unsecured – Dischargeable/Non-priority taxes:

a. a monthly payment in the plan equal to the disposable income for either 36 or 60 months. Disposable income doesn't include certain items, and is reduced by expenditures for secured payments, priority payments, IRS national standards, US trustee fees and other items.

b. These creditors must receive more than they would have in a Chapter 7.

4. Any non-dischargeable taxes which remain unpaid at the conclusion of the Plan would still be collectible by the IRS.

5. The discharge is not entered until the last payment is made.

C. Chapter 11 taxes:

1. Secured taxes:

a. same as Chapter 13

2. Priority taxes:

a. must be paid in full in regular installment payments over the life of the Plan, plus interest, within 5 years of the bankruptcy filing date. §1129(a)(9)(C) and (D).

3. Unsecured taxes:

a. monthly payment equal to the disposable income, which is determined to be reasonable by the court.

b. The IRS must receive more than it would have in a Chapter 7.

4. The discharge is not entered until the last payment is made, unless requested earlier and the unsecured creditors have received more than they would have in a Chapter 7.