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DISCHARGEABILITY TAX ISSUES: THREADING THE TAX MAN'S NEEDLE – WILL I HAVE TO PAY MY TAXES AFTER THIS BANKRUPTCY?

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Introduction

Few issues ignite the emotions of the parties to a bankruptcy like taxes.[1] For attorneys, it is a complicated area that leads to unnerving CLE programs and articles warning of "traps for the unwary" when dealing with clients with tax debts. For debtors, the rules rarely make sense, any legal advice seems filled with uncertainty and hedging, and unwanted surprises pop up all too often even after the case is long over.

Rarely, in the practice of bankruptcy, is a surprise a good thing. Particularly when it comes to taxes, clients want their cases to unfold according to plan. Understanding the impact of bankruptcy on tax liabilities and expressing the same clearly to the client will reduces stress and increase the client's overall sense of relief from the process. To that end, the overwhelming share of the work needed for a successful bankruptcy involving tax liabilities is done before the case is filed. Completing land record searches, pulling and reviewing tax account transcripts, and applying the rules of discharge, priority and tolling will permit an attorney to accurately set the expectations of the client. Understanding the tax discharge rules, however, must begin with a review of the applicable Bankruptcy Code sections.

Statutory Framework

The rules and tests for the discharge of income taxes in bankruptcy derive from a combination of Bankruptcy Code sections, including 11 USC § 523 (exceptions to discharge) and § 507 (priority claims).[2]

[1] As described by the Chapter 13 Trustee, Peter C. Fessenden, Esq., in his August 11, 2017, pleading, TRUSTEE'S COMMENTS ON CONFIRMATION OF DEBTOR'S PLAN, in the case of In re: F. Lee Bailey, Jr., 17-20323: "[This case] pits the powerful, petulant and vengeful IRS against an unrepentant and self-righteous tax scofflaw. There is substantial law supporting each side. There is little moral foundation for either."

[2] While this article focuses on the discharge of federal income taxes, the analysis and the "rules" described herein are the same for state income taxes.

Bankruptcy Code § 507(a)(8) assigns 8th priority to income taxes filed or assessed within specified timeframes. Taxes entitled to 8th priority would include: (1) taxes for which the return was last due within three years of the petition date, and (2) taxes assessed within 240 days before the date of the filing of the petition.

Section 523(a)(1)(A) excepts from discharge under 11 USC § 727, as well as the hardship discharge provisions of 11 USC § 1328(b), those priority tax claims under 11 USC § 507(a)(8).[3] In contrast, under the broad Chapter 13 discharge provisions of 11 USC § 1328(a), these same priority claims are dischargeable. As priority claims, though, they must be paid in full in order to receive the more expansive Chapter 13 discharge under 11 USC § 1328(a).

The remaining subsections of 11 USC § 523(a)(1) are not related to whether the claim is priority but describe other circumstances where the taxes would be excepted from discharge, regardless of whether the debtor is in a Chapter 7 or 13. Section 523(a)(1)(B) makes nondischargeable a tax for which the return was either not filed or was filed late and less than two years prior to the petition date. Section 523(a)(1)(C) makes a tax nondischargeable if the taxpayer made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

[3] Also, 11 USC § 523(a)(1(A) excepts from the Chapter 7 and hardship Chapter 13 discharges any tax under 11 USC § 507(a)(3).

The Key Dischargeability Questions

Based on these controlling Bankruptcy Code sections, any tax discharge analysis should start with these three key timing questions:

> The Three-Year Rule. Was the due date for filing the return that results in the tax claim more than three years prior to the date of the bankruptcy filing?
>
> The 240-Day Rule. Was the tax claim assessed at least 240 days prior to the bankruptcy filing?
>
> The Two-Year Rule. Was the tax return filed more than two years before the filing of the bankruptcy?

If the answers to all of these questions are "yes" for a particular tax year's liability and if the debtor neither fraudulently filed that year's tax return nor has willfully evaded the tax (for purposes of this article, the "fraud/evasion test"), then the tax liability would be dischargeable in either Chapter 7 or 13 as a general unsecured claim. While the answers to the tests themselves are simple enough – yes or no decisions – the application of the tests can be more challenging.

Determining Tax Return Due Date

The pivotal factor, with respect to the 3-Year Rule, is determining the due date for the tax return. The 3-year period does not start to run until the conclusion of any extension dates the taxpayer may have requested even if the actual tax return is filed before that final due date. Also, never assume the due date for dischargeability purposes is April 15th or October 15th of any given year because holidays and weekends often delay the actual due date.

Audits and Multiple Assessments Possible

Although a taxpayer will have only one tax return due date for each tax year, multiple tax assessments are possible. As will be described in more detail later in this article, the assessment dates are noted on a taxpayer's tax account transcript. Subsequent assessments trigger new 240-day tests for priority claim status. For example, if the IRS has made a second assessment, then two separate 240-day periods must be calculated to determine whether the tax resulting from each assessment will be a priority claim under 11 USC § 507(a)(8).

Reporting Federal Adjustments to the State

Taxes remain subject to audit and further assessment for three years from the day after the date on which the return was filed or is deemed filed.[4] Returns that are filed early are deemed to be filed on the last day when the return is due without penalty.[5] If an audit by the IRS results in an assessment, many state laws also require such assessments to be reported to the state.

Since 11 USC § 523(a)(1)(B) would make nondischargeable any tax arising from a required return that is not filed, or that is filed late and less than two years prior to the bankruptcy, the taxpayer that fails to report the results of an IRS audit to the state may find that state arguing that the resulting additional state assessment to be nondischargeable in a bankruptcy.[6] Arguably, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") strengthened the position of the state by the addition of language expanding the requirement of a return (that would start the two-year dischargeability clock) to include any

[4] 26 USC § 6501(a).
[5] 26 USC § 6501(b)(1).
[6] In re Ciotti, 638 F.3d 276, 279 (4th Cir. 2011) (Concluding that post-BAPCPA § 523(a)(1)(B) was sufficiently expansive to except from discharge not only tax debts for which no return is filed, but also tax obligations for which the debtor fails to file an amended return, report, or notice when one is required under the pertinent tax laws.).

required "equivalent report or notice" in determining nondischargeability under 11 USC § 523(a)(1)(B).

Defining a Return for Discharge Purposes

The two-year period initiates upon the filing of a return. A split among the circuits, however, has developed as to whether a late-filed return may be considered a tax return for purposes of dischargeability. The First,[7] Fifth[8] and Tenth[9] circuits have found that the tax determined from untimely returns is never dischargeable in bankruptcy. The rulings are based on the hanging paragraph to 11 USC § 523(a) added by BAPCPA and interpret the language to define "return" to exclude any taxpayer filing that does not strictly comply with all return filing requirements, including timeliness.

> For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.
>
> 11 USC § 523(a) (hanging paragraph).

The most well-known opinion in this developing area arises from the Sixth Circuit's case, In re McCoy.[10] The McCoy opinion actually involved the determination of the dischargeability of state taxes owed to the Mississippi State Tax Commission. The Chapter 7 debtor brought an adversary proceeding to request a declaration that the taxes shown on her late-filed state income

[7] In re Fahey, 779 F.3d 1 (1st Cir. 2015).
[8] In re McCoy, 666 F.3d 924 (5th Cir. 2012).
[9] In re Mallo, 774 F.3d 1313 (10th Cir. 2014).
[10] McCoy v. Mississippi State Tax Comm'n, 666 F.3d 924 (5th Cir., 2012).

tax returns, filed over two years prior to the commencement of her bankruptcy, were discharged under 11 USC 727.[11] The McCoy Court determined that the late-filed returns of the debtor did not qualify as tax returns for dischargeability purposes because the hanging paragraph of 11 USC § 523(a) defines a return as "a return that satisfies the requirements of applicable nonbankruptcy laws…." Having concluded that a late-filed return could not be a return for dischargeability purposes, the debtor could not show that such a return was filed in order to meet the dischargeability requirements of 11 USC § 523(a)(1)(B).[12] Courts and commentators often describe the ruling from McCoy and the cases that follow it as the "one-day-late" rule because it prohibits discharge of a tax debt with respect to which a return was filed even one day late.[13]

The Ninth Circuit BAP rejected this one-day-late rule in finding that a late-filed return may still otherwise qualify as a tax return for dischargeability purposes in the case of In re Martin.[14] The Eleventh Circuit agreed in *dicta* in In re Justice,[15] and both Courts instead followed the Beard test[16] for a return. Under the Beard test, a document must meet the following conditions to qualify as a tax return. The filing: (1) must purport to be a return; (2) must be executed under penalty of perjury; (3) must contain sufficient data to allow calculation of tax liability; and (4) must represent an honest and reasonable attempt to satisfy the requirements of the tax law.[17]

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[11] Id. at 925.
[12] The McCoy court did leave open the possibility of a return qualifying under the safe harbor provisions of 26 USC § 6020(a). See the language of the hanging paragraph of 11 USC § 523(a). Returns under 26 USC § 6020(a) are prepared by the IRS for the taxpayer's signature. The IRS, however, indicates that these § 6020(a) returns are only prepared in a "minute number of cases." See, IRS NOTICE CC-2020-016, September 2, 2010, Office of Chief Counsel, "Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-Filed Returns and Returns Filed After Assessment."
[13] In re Justice, 817 F3d 738, 743 (11th Cir. 2016).
[14] In re Martin, 542 B.R. 479 (B.A.P. 9th Cir. 2015).
[15] Justice at 743 ("[W]e can assume arguendo, although we do not expressly decide, that the one-day-late rule is incorrect.").
[16] The Beard test for what constitutes a return originates from the opinion, Beard v. Commissioner, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).
[17] Id.

Interestingly, the IRS does not appear to be following McCoy.[18] The IRS Office of Chief Counsel reported in its "Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-Filed Returns and Returns Filed After Assessment," that tax debts related to late-filed returns may be discharged. Explaining its rejection of the one-day-late rule, the IRS Notice states:

> Read as a whole, section 523(a) does not provide that every tax for which a return was filed late is nondischargeable. If the parenthetical "(including applicable filing requirements)" in the unnumbered paragraph created the rule that no late-filed return could qualify as a return, the provision in the same paragraph that returns made pursuant to section 6020(b) are not returns for discharge purposes would be entirely superfluous because a section 6020(b) return is always prepared after the due date. It is a cardinal principle of statutory construction that a statute should be construed so that no clause, sentence or word is rendered superfluous. Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998) (refusing to read one provision of the Bankruptcy Code to render another superfluous).[19]

Thereafter, in the In re Martin decision, the Ninth Circuit BAP acknowledged the position of the IRS against the one-day-rule.[20] The BAP noted, "neither side here advocates in favor of the literal construction of the 'return' definition that Congress added to the nondischargeability statute as part of the 2005 Bankruptcy Code amendments. Indeed, in this case and in other cases, the IRS expressly has rejected the literal construction and has stated that the literal construction leads to 'overly harsh' results."[21] Instead, the IRS advocated in the Martin case for "its less draconian approach" turning on whether the taxpayer filing occurred

[18] See, IRS NOTICE CC-2020-016, September 2, 2010, Office of Chief Counsel, "Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-filed Returns and Returns Filed After Assessment."
[19] Id.
[20] Martin at 483.
[21] Id.

before or after an assessment of tax from the preparation of a Substitute for Return (discussed in more detail below) by the IRS.[22]

Substitute for Return

A related issue involves the Substitute for Return (or "SFR") prepared by the IRS when the taxpayer has not timely filed a return.[23] Of course, from the taxpayer's perspective, the tax imposed by the SFR is typically worse than if the taxpayer prepared the return because the IRS has no information about exemptions, deductions, dependents, or other figures that may reduce the tax liability. More importantly, though, the SFR does not count as a return for bankruptcy discharge purposes. Further, even if the taxpayer files a return after the SFR, most cases hold that such a filing by the taxpayer after an SFR and assessment is not a return for purposes of discharge. The majority of Circuit Courts that have considered the issue have found that a belated return does not serve a legitimate tax purpose.[24] Accordingly, the subsequent return is not a return for discharge purposes and the related tax may never be discharged.[25]

Practitioners may identify an SFR by looking to the taxpayer's tax account transcript. Although an SFR does not count as a return for bankruptcy discharge purposes, the IRS will accept the taxpayer's subsequent return for purposes of recalculating the client's liability. The return is accepted for purposes of liability not dischargeability. However, to the extent that additional tax is reported by a return filed after an SFR and assessment, the additional tax would be subject to discharge if all other tests of dischargeability are met.[26]

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[22] Id.
[23] 26 USC § 6020(b).
[24] Justice v. United States (In re Justice), 817 F.3d 738 (11th Cir.2016); In re Payne, 431 F.3d 1055 (7th Cir.2005); In re Moroney, 352 F.3d 902 (4th Cir.2003).
[25] Id.
[26] See, IRS MEMORANDUM sbse-05-0911-078, August 1, 2012, Director, Collection Policy, "Determining Dischargeability of Late-filed Returns in Which a Substitute for Return was Prepared under 26 USC § 6020(b)."

Tolling

The time periods described in the dischargeability tests for tax debts may be tolled or extended in various circumstances. The hanging paragraph of 11 USC § 507(a)(8) operates to toll the 240-day and 3-year time periods related to the tests of priority.

> An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.
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> 11 USC § 507(a)(8) (hanging paragraph).

Requests for Collection Due Process hearings and appeals toll the 240-day and 3-year tests by the duration of the time the government is prohibited under nonbankruptcy law from collecting a tax as a result of the requested hearing and appeal plus 90 days.[27] Similarly, the 240-day and 3-year tests are also extended by the time the taxpayer's prior bankruptcy was pending with collection prohibited due to the existence of the automatic stay or confirmed plan of the debtor, plus 90 days.[28]

Under 11 USC § 507(a)(8)(ii), the 240-day test is tolled by a taxpayer's Offer in Compromise ("OIC") for the length that the OIC was pending or in effect, plus 30 days. Interestingly, the 3-year period is not extended by an OIC.

[27] 11 USC § 507(a)(8) (hanging paragraph).
[28] Id.

Technically, the 2-year test of dischargeability under 11 USC § 523(a)(1)(B) does not have a similar statutory tolling provision like those under 11 USC § 507. However, the IRS takes the position that a bankruptcy filing or collection due process hearing will toll the 2-year rule also.[29] Practitioners should also be aware that tax litigation typically postpones a tax assessment and under such circumstances would delay the start of the 240-day clock. The most useful nonbankruptcy tool for "buying time" by practitioners may be the initiation of an Installment Plan with the IRS as such action does not toll any of the time periods but typically does cease ongoing IRS collection efforts while the plan is in place.

Fraud and Willful Evasion Cases

Bankruptcy Code § 523(a)(1)(C) excepts from Chapter 7 and 13 discharges any debt for a tax "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." In determining whether the debtor filed a fraudulent return, courts consider badges of fraud, including (1) large understatements of income made consistently over time; (2) failure to keep adequate records; (3) failure to file tax returns; (4) implausible or inconsistent behavior by the taxpayer; (5) concealing assets; and (6) failure to cooperate with taxing authorities.[30]

Recently the U. S. Bankruptcy Court for the Eastern District of Virginia addressed the standards for willful evasion in a Chapter 7 case involving debtors with significant accumulated tax liability.[31] Judge Phillips surveyed the standards for nondischargeability and determined that willful evasion under the Code includes both a conduct requirement that the debtor sought to

[29] Putnam v. Internal Revenue Serv., 503 B.R. 656, 659 (Bankr.E.D.N.C., 2014) (Finding that the two year look-back period in § 523(a)(1)(B)(ii) is subject to equitable tolling under either Sections 105(a) or 108(c)).
[30] Berkery v. Commissioner, 192 B.R. 835, 841 (E.D.Pa.1996).
[31] Conard v. Internal Revenue Serv., AP No. 16-01121-KHK (Bankr. E.D.Va., December 14, 2017).

evade or defeat the tax liability and a mental state requirement that the debtor did so willfully.[32] In evaluating the conduct portion of the test for evasion, Judge Phillips explained that Courts have considered the failure to pay taxes combined with other factors, such as the failure to file timely returns, the concealment of assets, inadequate recordkeeping, intra-family or fraudulent transfers, a lavish or extravagant lifestyle during the tax years in which the debtor failed to pay or during later years while the tax obligation remained due. With respect to the mental state requirement, Judge Phillips agreed with those Courts that have required the government to prove that the debtor: "(1) had a duty to file income tax returns and pay taxes; (2) knew that he had such a duty; and (3) voluntarily and intentionally violated that duty."[33]

An Effective Bankruptcy Doesn't Necessarily Require All Tests to be Passed

Even if a debtor may not be able to discharge all tax liability in a Chapter 7, the bankruptcy may nonetheless be helpful to reduce the overall debt load and permit the debtor to focus on the remaining tax liabilities after the case concludes through the use of an Offer in Compromise or Installment Agreement. Other debtors may find that their tax liabilities only fail a Chapter 7 discharge because the debts are priority claims failing the 3-year or 240-day tests. In those situations, if a debtor needs to move forward with a bankruptcy without delay and has nonexempt assets he is willing to sacrifice, the debtor at least has the assurance that those assets will be used to reduce his otherwise nondischargeable tax burden and not be effectively wasted on simple credit card or other fully dischargeable debts. Finally, overwhelming tax debt may have the added benefit of helping a high-income debtor avoid possible dismissal under the income-triggering dismissal provisions of 11 USC § 707(b)(2) reserved for debtors with

[32] Id. at 13.
[33] Conard at 11, quoting United States v. Fretz (In re Fretz), 244 F.3d 1223, 1330 (11th Cir. 2001).

primarily consumer debts. Most Courts find tax claims to be nonconsumer debts,[34] and if a high-income debtor has a majority of nonconsumer debts his likelihood of success in reaching a Chapter 7 discharge would increase significantly as he would not need to complete a means test and would not face a 11 USC § 707(b)(2) motion for dismissal based on abuse.[35]

Under Chapter 13, even if a tax claim fails the 240-day or 3-year tests and is priority, it may still be discharged in Chapter 13 as long as it is otherwise dischargeable. Specifically, the tax claim would need to: (a) result from a tax return either filed timely or more than two years prepetition and (b) not involve fraud or willful evasion. This is because the Chapter 13 discharge provisions of 11 USC § 1328(a) do not except from discharge the priority taxes referenced in 11 USC § 523(a)(1)(A) but do except from discharge those taxes falling under 11 USC § 523(a)(1)(B) or (C) (the untimely return/2-year rule and fraud/evasion cases).[36] Of course, if the tax claim is, in fact, priority and an allowed claim is filed, the claim must be paid in full for the debtor to receive a discharge under 11 USC § 1328(a).

Interest

Interest always follows the tax for discharge purposes. If the underlying tax is dischargeable, so is the interest.[37] If a priority tax claim in a Chapter 13 does not involve the fraud or willful evasion of 11 USC § 523(a)(1)(C) and the applicable return was filed timely, then the interest on that claim would also be discharged upon the successful completion and discharge of the case under 11 USC § 1328(a). However, post-petition interest can accrue and

[34] IRS v. Westberry, 215 F.3d 589, 593 (6th Cir.2000) (income taxes are not consumer debt for the purpose of enforcing the co-debtor stay under 11 U.S.C. § 1301).
[35] See, STATEMENT OF THE U.S. TRUSTEE PROGRAM'S POSITION ON LEGAL ISSUES ARISING UNDER THE CHAPTER 7 MEANS TEST, April 23, 2010 ("Most tax debts are not typically consumer debt.")
[36] 11 USC § 1328(a) will also not discharge taxes under 11 USC § 507(a)(8)(C), that is, "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity…." In other words, trust fund taxes like withholding taxes. These tax liabilities will be priority and nondischargeable in 7 or 13.
[37] 26 U.S.C. § 6601(e)(1); See, IRS MEMORANDUM 202005029, October 21, 2009, Office of Chief Counsel, "Dischargeable Taxes, Penalties, and Interest under post-BAPCPA Chapter 13 Provisions."

not be discharged for priority tax claims that are based on returns filed late and within two years of the bankruptcy, even if the principal amount of the allowed priority claim is paid in full during the case.

Section 523 (a)(1)(B) excepts from discharge any tax "with respect to which a return, or equivalent report or notice, if required – (i) was not filed or given; or (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition…." In other words, if the debtor failed to file a required return, or filed it late and within two years of the petition date, the underlying debt is not discharged. Following the rule above that interest follows the tax for discharge purposes, the failure of the tax to be dischargeable results in the interest not being discharged notwithstanding the payment of the tax claim as filed in the Chapter 13.[38] Although BAPCPA added 11 USC § 1322(b)(10) to permit a Chapter 13 debtor to provide for the payment of post-petition interest on nondischargeable claims in a plan, such interest may be paid only to the extent that the debtor has disposable income available after making provision for full payment of all allowed claims.

Which "Tax Bucket" Applies to Your Debtor?

Processing all of the rules regarding the dischargeability of tax claims can be mind-numbing. Ultimately, though, all income tax claims should fall into one of the following categories or "buckets" which control the options the client has in bankruptcy.

[38] See, IRS NOTICE CC-2020-016, September 2, 2010, Office of Chief Counsel, "Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-Filed Returns and Returns Filed After Assessment." According to this IRS memorandum, because "BAPCPA created a number of tax debts that are now non-dischargeable, debtors will owe post-petition interest on the non-dischargeable tax obligations."

Nonpriority and Dischargeable Tax. Filing the petition when the timing tests indicate the tax is nonpriority and dischargeable will result in the discharge of the tax claim, regardless of whether filing a Chapter 7 or 13.[39]

CATEGORY	DESCRIPTION	STRATEGY
Nonpriority AND Dischargeable	All three tests of dischargeability have been met and the tax does not involve fraud or willful evasion.	Fully dischargeable in a 7 or 13. From a tax perspective, now is a good time to file the bankruptcy.

Nonpriority and Nondischargeable Tax. If the tests of discharge result in a nonpriority and nondischargeable tax, careful explanation to the client about the impact of moving forward with a bankruptcy filing is required. Consider the potential benefits, if any, of waiting to file a bankruptcy or nonbankruptcy alternatives.[40]

CATEGORY	DESCRIPTION	STRATEGY
Nonpriority AND Nondischargeable	The tax satisfies the 3-year and 240 day tests but it is not dischargeable under § 523(a)(1)(B) or (C). Examples would be older tax years (3+ years) where assessments have been made more than 240 days prior BUT either no return filed by the taxpayer or the return was filed late and within the last 2 years.	Give some thought to this case. Confer with the client. Document the file. In a 7 or 13, the tax claim and the post-petition interest are not discharged. Can you fix the problem? Maybe if the problem arises from a nonfiled return. If so, consider filing the return and wait out time if possible. Or, do you have an SFR issue?

[39] This analysis assumes the fraud/evasion test is also passed.
[40] Of course, delaying the bankruptcy will not help if the basis of the nondischargeability is the fraud/evasion test of 11 USC § 523(a)(1)(C).

Priority and Nondischargeable Tax. To limit surprises to the client, this is also an important area for memorializing warnings and advice in writing.

CATEGORY	DESCRIPTION	STRATEGY
Priority AND Nondischargeable Under § 523(a)(1)(A) ONLY (*because Priority*)	An example might be a tax that has not met the 3-year rule but the return was filed timely. These taxes are not dischargeable in a Chapter 7 pursuant § 523(a)(1)(A) [41] – BUT would be dischargeable in a Chapter 13 since § 523(a)(1)(A) is not an exception to the Chapter 13 discharge of § 1328(a).	Since dischargeable in a 13, the interest that would otherwise accrue during the plan is discharged upon plan completion. File Chapter 13 (and pay the priority tax) in the plan. Or consider delaying filing in order to turn this into a nonpriority and dischargeable tax. Then consider filing a Chapter 7 if possible (or perhaps a lower paying Chapter 13).

CATEGORY	DESCRIPTION	STRATEGY
Priority AND Nondischargeable Under § 523(a)(1)(B) or (C)	These taxes are priority because the bankruptcy is filed before the satisfaction of the 3-year or 240-day tests under § 507(a)(8). These taxes are also nondischargeable because return filed late and within the last 2 years or fraud/evasion issues.	These taxes are challenging. They are not discharged in a 7. Although the allowed priority tax claim will be paid under the plan in the 13, the post-petition will accumulate and not be discharged. File Chapter 13 (and pay the priority tax) with clear warnings to the client of the post-petition interest. Or, if there are no fraud/evasion issues, consider delaying filing in order to get to a nonpriority and dischargeable tax and file a 7 or low paying 13.

[41] The tax in this example would also not be dischargeable under a hardship discharge of 11 USC § 1328(b), but the claim may have received some distributions as a priority claim during the pendency of the case.

Nonbankruptcy IRS Collection Statute of Limitations.

Even if bankruptcy does not prove to be a viable option, the statute of limitations may provide some hope for clients with older tax liabilities. The statute of limitations for the collection of income taxes by the IRS, defined by the Collection Statute Expiration Date ("CSED"), is independent of the Bankruptcy Code and runs 10 years from the date a tax was assessed.[42] However, several tolling events are applicable to the IRS statute of limitation, and those tolling periods for purposes of collection under the Internal Revenue Code's statute of limitations are not the same as the tolling periods in the Bankruptcy Code related to discharge issues. The CSED tolling periods are more complicated and very broad covering similar tolling events related to bankruptcy discharge time periods but also include, for example, circumstances such as when the taxpayer is outside of the country continuously for 6 months or more or when the taxpayer formally requests an Installment Agreement.[43]

Tax Liens

For practical purposes, a tax lien may limit the benefits of a discharge in bankruptcy. Discharged debts may not be collected from debtors personally but recorded tax liens not otherwise avoided are enforceable even after the bankruptcy against property owned by the debtor prior to the bankruptcy.[44] In the case of nondischargeable tax claims secured by a federal tax lien, such liens remain enforceable to collect those nondischargeable taxes after the bankruptcy filing even from after acquired property.

The federal tax lien attaches to the bankruptcy debtor's property, regardless of whether exempt or not. To be valid against real property in bankruptcy, the federal tax lien must be

[42] 26 USC § 6502.
[43] IRM 8.21.5.4.1 – 14.
[44] 11 USC § 524.

recorded in the county in which the real property is located.[45] For the IRS to have a secured claim in bankruptcy against the debtor's personal property, the lien must be recorded where the debtor resides, and once filed, the lien follows the taxpayer and his personal property even if he moves.[46]

The enforceable duration of the lien is the same as the statute of limitations for collections of the underlying IRS tax, that is, 10 years from date of the original assessment of the tax, plus any time added by applicable tolling provisions.[47] However, if the IRS reduces the claim to a judgment, the IRS may continue collection of the judgment lien according to state law.

A tax lien is a statutory lien and therefore cannot be avoided under 11 USC §§ 522(f) or 547. However, cramming down the lien is permitted in Chapter 13. The limitation on cramming down a lien under BPACPA applies only to PMSI claims, and a tax lien is not a PMSI.[48]

Setoff of Tax Refunds

Under 11 USC § 362(b)(26), the automatic stay does not apply to an effort by a taxing authority to setoff a tax refund for prepetition tax refunds against liabilities arising from prepetition tax years.

Obtaining Tax Account Transcripts[49]

To obtain tax account transcripts, the client should complete and sign a FORM 8821 Tax Information Authorization or the FORM 2848 IRS Power of Attorney. "Fill-able" forms are located at: http://www.irs.gov. Include the specific years and types of tax that the client is

[45] 26 USC § 6323(f)(1)(A)(i).
[46] 26 USC §§ 6323(f)(1)(A)(ii) and 6323(f)(2)(B).
[47] 26 USC §§ 6322 and 6502.
[48] 11 USC § 1325(a)(9)
[49] The critical document for tax discharge analysis is the Tax Account Transcript, not to be confused with a Tax Return Transcript

authorizing the IRS to discuss or share with you. Note that the Service does not accept general grants of authority such as "all tax years on record."

Once the taxpayer has signed the authorization form, you may either call the IRS or utilize the "self-help" options through e-Services. If you want information the same day, call the Practitioner Priority phone line at 1-866-860-4259 and be prepared to fax over the signed authorization. This method can be frustrating, however, due to wait times and disconnections. A less time-consuming approach is available online. If you take the time to register for the IRS e-Services at https://www.irs.gov/tax-professionals/e-services-online-tools-for-tax-professionals, the e-Services program allows tax professionals to complete transactions, such as downloading tax transcripts, online with the IRS. However, this approach is not without drawbacks either, which include: (1) delay (access to a particular account is typically not available until several days after the IRS authorization form is faxed in for the taxpayer), and (2) reauthentication (the IRS regularly requires re-registration of the tax professional and such authentication procedures can be frustrating).

Through these services, the IRS will ultimately provide Tax Account Transcripts by fax for each tax year requested, as well as transcripts of a return, and reports of wage and income information, such as W-2 and 1099 forms attached to a taxpayer's record for a particular tax year. These documents are critical in analyzing the impact of a bankruptcy on a client with tax liabilities.

Interpreting the Tax Account Transcripts

The Tax Account Transcript includes important data for analyzing the dischargeability of tax debt. An exhaustive list of the potential IRS codes is beyond the scope of this article; however, some of the most significant codes are described below.

Code 150 shows the date of assessment; the amount of tax assessed is shown inside of parenthesis. A common indication of the preparation of a Substitute for Return is when the figure in the parenthesis is shown as $0.00.

Codes 290 and 300 indicate that additional tax has been assessed, so attorneys should be mindful of the start of a new 240-day time period.

The receipt of an Offer in Compromise is shown by Code 480, and Code 780 reflects the acceptance of the OIC by the IRS. Code 481 signifies the rejection or withdrawal of that OIC.

Bankruptcy filings, litigation and requests for due process hearings are indicated by Code 520, and Code 521 is used to show the conclusion of the 520 event.

Although the location of the filing is not shown, Code 582 identifies that a tax lien has been recorded.

Conclusion

With practice and study, the rules of tax debt dischargeability become easier to apply to individual client circumstances. Getting comfortable with the interplay between tax and bankruptcy law will not only grow the scope of an attorney's practice, but will improve the advice and options that are provided to clients. Armed with the knowledge of the tax discharge rules in bankruptcy, an attorney may dramatically improve the client's situation by determining the best time to file a case and how to offer the most protection for a client that may be delaying such a filing. Most importantly, though, the attorney will be able to set better and more accurate expectations for a client facing the stress of overwhelming tax debt.

Form **8821**

(Rev. January 2018)

Department of the Treasury
Internal Revenue Service

Tax Information Authorization

► **Go to *www.irs.gov/Form8821* for instructions and the latest information.**

► **Don't sign this form unless all applicable lines have been completed.**

► **Don't use Form 8821 to request copies of your tax returns or to authorize someone to represent you.**

OMB No. 1545-1165

For IRS Use Only

Received by:

Name

Telephone

Function

Date

1 Taxpayer information. Taxpayer must sign and date this form on line 7.

Taxpayer name and address	Taxpayer identification number(s)	
	Daytime telephone number	Plan number (if applicable)

2 Appointee. If you wish to name more than one appointee, attach a list to this form. **Check here if a list of additional appointees is attached** ► ☐

Name and address	CAF No.
	PTIN
	Telephone No.
	Fax No.
	Check if new: Address ☐ Telephone No. ☐ Fax No. ☐

3 Tax Information. Appointee is authorized to inspect and/or receive confidential tax information for the type of tax, forms, periods, and specific matters you list below. See the line 3 instructions.

☐ By checking here, I authorize access to my IRS records via an Intermediate Service Provider.

(a) Type of Tax Information (Income, Employment, Payroll, Excise, Estate, Gift, Civil Penalty, Sec. 4980H Payments, etc.)	**(b)** Tax Form Number (1040, 941, 720, etc.)	**(c)** Year(s) or Period(s)	**(d)** Specific Tax Matters

4 Specific use not recorded on Centralized Authorization File (CAF). If the tax information authorization is for a specific use not recorded on CAF, check this box. See the instructions. If you check this box, skip lines 5 and 6 . . . . . ► ☐

5 Disclosure of tax information (you **must** check a box on line 5a or 5b unless the box on line 4 is checked):

a If you want copies of tax information, notices, and other written communications sent to the appointee on an ongoing basis, check this box . . . . . ► ☐

Note. Appointees will no longer receive forms, publications, and other related materials with the notices.

b If you don't want any copies of notices or communications sent to your appointee, check this box . . . . . ► ☐

6 Retention/revocation of prior tax information authorizations. If the line 4 box is checked, skip this line. If the line 4 box isn't checked, the IRS will automatically revoke all prior Tax Information Authorizations on file unless you check the line 6 box and attach a copy of the Tax Information Authorization(s) that you want to retain. . . . . ► ☐

To revoke a prior tax information authorization(s) without submitting a new authorization, see the line 6 instructions.

7 Signature of taxpayer. If signed by a corporate officer, partner, guardian, partnership representative, executor, receiver, administrator, trustee, or party other than the taxpayer, I certify that I have the authority to execute this form with respect to the tax matters and tax periods shown on line 3 above.

► **IF NOT COMPLETE, SIGNED, AND DATED, THIS TAX INFORMATION AUTHORIZATION WILL BE RETURNED.**

► **DON'T SIGN THIS FORM IF IT IS BLANK OR INCOMPLETE.**

Signature | Date

Print Name | Title (if applicable)