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Attached is an article about bankruptcy discharges for the next E-News. Our apologies for the delay in completing this article -- it had to undergo some revisions.

Please let me know if you have any questions about the article or if you need anything further for this edition.

ATTACHMENT 1

Bankruptcy Not Always the End for Tax Collection for the Individual Taxpayer

The purpose of bankruptcy is to allow a person to reduce, reorganize, or eliminate his debts and have a fresh financial start – but this does not always mean that the person's tax debts go away. Most individual debtors who file for bankruptcy do so under either Chapter 7 or 13 of the Bankruptcy Code. Each chapter has different treatments of the person's debts, but when it comes to the treatment of an individual's taxes, they are mostly the same. Neither Chapter 7 nor Chapter 13 allows an individual debtor to get rid of three types of tax obligations: (1) priority taxes, (2) taxes from non-filed or delinquent returns, and (3) taxes from fraudulent returns or willful tax evasion attempts.

For taxes incurred pre-bankruptcy, their dischargeability depends upon the type of tax and when the tax was assessed or the return was filed. Priority status is given to any income tax liability for which a return was due (including extensions) within three years before the bankruptcy filing. Income taxes are also not dischargeable in bankruptcy if the assessment was made within 240 days before the bankruptcy petition was filed (with additional time provided for any periods when an OIC was pending or during which the debtor was previously in bankruptcy). Trust fund taxes are considered priority in

bankruptcy regardless of the timing of the assessment. Priority taxes also include income taxes that were not assessed, but were assessable, after the start of the bankruptcy, so long as the taxes do not fall within one of the other categories described below.

The second category of taxes that are not discharged in bankruptcy are those stemming from tax periods in which a return was due, but not filed. Changes made to the Bankruptcy Code in 2006 make it so a substitute for return (SFR) prepared by IRS under IRC § 6020(b) is a return for purposes of discharge, so if the IRS created an SFR for the tax period, the debt can only be exempt from discharge if it falls within one of the other exceptions. This category of non-dischargeable taxes also includes those reported on late-filed returns, if the returns were filed within two years of the bankruptcy petition date.

Finally, the Bankruptcy Code punishes tax fraud by preventing discharge of any taxes that the debtor makes a fraudulent return or willfully attempts to evade taxes. While willful tax evasion is not defined by bankruptcy law, it is similar to the standard the IRS uses to define civil fraud. Failure to pay taxes is generally not enough. A debtor's voluntary, conscious, and intentional failure to file returns for an extended period of time, and a failure to pay taxes when the debtor has the ability to do so, may qualify as a willful evasion. Some courts require the IRS prove some affirmative misconduct to support a claim of will evasion, such as concealed or fraudulently transferred assets.

A debtor may also still have to pay penalties and interest on tax liabilities after going through bankruptcy. If a tax period is given priority status in bankruptcy, then the pre-petition interest on the liability is also nondischargeable. Postpetition interest on nondischargeable debts is also nondischargeable. The treatment of penalties is more complicated. Unlike interest, penalties do not follow the priority determination of the related tax. Penalties are only excepted from discharge if they relate to a transaction or event that occurs within two years before the bankruptcy petition date.

According to the American Bankruptcy Institute, the number of consumer bankruptcy filings increased over 41% between March 2008 and March 2009. This increase has likewise increased the work for SB/SE Insolvency. SB/SE Counsel is available to work with Insolvency and other affected divisions of the IRS to help represent the IRS's interests in bankruptcy proceedings and maximize the collection potential on non-dischargeable taxes.