
Tax Issues in Bankruptcy[©]

**For the Tax Controversy Group of the
Maryland Bar Association Tax Section**

Burton J. Haynes, MBA, JD, CPA

USING BANKRUPTCY TO RESOLVE TAX PROBLEMS

Prepared for the Tax Controversy Group
of the Maryland State Bar Association Tax Section

March 1, 2005

Burton J. Haynes, MBA, CPA, JD
Phone 703-913-7500
Email bj@bjhaynes.com

Preview of topics to be covered.

1. Types of Bankruptcies
 - Chapter 7
 - Chapter 13
2. Contesting Tax Liabilities
 - U.S. Tax Court (pre-assessment)
 - Federal District Court (refund claims)
 - Bankruptcy Court
3. Effect on IRS Collection Action
4. Classifying Tax Debts
 - Secured vs. Unsecured
 - Priority vs. Nonpriority

 - Three years from due date
 - Two years from date filed
 - 240 days from date of assessment
5. Interest and Penalties
6. Nondischargeable Taxes
7. Equitable Considerations
8. Chapter 7 vs. Chapter 13
9. After the Discharge.
10. Bankruptcy Reform Legislation
11. Bankruptcy vs. Offer in Compromise

1. Types of Bankruptcies.

Chapter 7 -- liquidating bankruptcy.

Trustee is appointed to protect the unsecured creditors (secureds are already protected).

Trustee identifies, marshals and sells debtor's nonexempt, unsecured assets.

Trustee abandons encumbered assets.

No payments from future income are required.

Chapter 13 -- Small debtors with regular income who can make monthly payments against debts, and whose debts are under the statutory limits:

Unsecured debts less than \$307,675.

Secured debts less than \$922,975.

Debtor makes monthly payments to trustee for distribution to creditors (less commission).

Plan must provide full payment of priority debts.

2. Contesting Tax Liabilities.

U.S. Tax Court.

No jurisdiction unless Petition filed within 90 days of Statutory Notice of Deficiency.

Lacks jurisdiction over some kinds of taxes.

Deals only with federal taxes.

U.S. District Court or Claims Court.

Prerequisite is full payment (Flora).

Deals only with federal taxes.

U.S. Bankruptcy Court.

Court has authority to determine any tax. Taxes are put at issue by filing an objection to IRS proof of claim, or an adversary proceeding to determine amount and dischargeability of tax.

Objection to claim.

Motion filed by debtor, creditor, or trustee to object to all or part of a claim; hearing held to resolve the dispute.

Claims by federal and state tax authorities are assumed valid *prima facie*, and will be allowed absent objection.

Debtor's objection may go to the liability for the tax, amount of the tax, applicability of penalties, whether the tax is priority or nonpriority, or whether it is secured or unsecured.

Adversary proceeding.

Lawsuit within a bankruptcy case seeking affirmative relief, including a proceeding to recover money or property, to determine the validity, priority, or extent of a lien, and to determine dischargeability of a debt.

A motion to determine the correct amount of a debtor's unpaid tax liability is often treated as a "contested matter," rather than an adversary proceeding.

In some cases, bankruptcy may be the taxpayer's only opportunity to litigate a tax dispute.

Access to Tax Court requires that a petition be filed within 90 days of the statutory notice of deficiency. If petition is not timely filed, the Court has no jurisdiction to hear the matter.

Access to Federal District Court or the Claims Court requires that the tax first be paid in full.

3. Effect of Bankruptcy on IRS Collection Action.

Automatic stay arises under BC §362(a) -- all IRS collection action must cease, except:

Demanding delinquent (unfiled) tax returns.

Auditing prepetition or postpetition returns.

Issuing a statutory notice of deficiency.

Assessing uncontested prepetition liabilities and taxes shown on filed tax returns.

Refiling a previous notice of federal tax lien.

Issuing a summons to determine a tax liability.

Property levied upon but not transferred to the IRS prepetition is property of the estate and subject to turnover.

Any tangible property seized prepetition but not sold prepetition is property of the estate subject to turnover.

When IRS has received payment prepetition, ownership has transferred to the IRS and the asset is not property of the estate (but may be subject to recovery as a preference).

Specific IRS collection actions prohibited:

Starting or continuing an administrative or judicial proceeding (including a CDP hearing).

Issuing a levy or instituting a seizure.

Verbally requesting payment or sending written notices demanding payment.

Making a setoff against a postpetition refund to accomplish collection of a prepetition tax.

Filing, perfecting or enforcing a tax lien for prepetition tax periods (a refiling is permitted).

Violations of the automatic stay or permanent injunction by the IRS:

IRC §7433(e)(1) permits action against the IRS for willful or negligent violations of the stay or the permanent injunction arising on discharge.

Taxpayer may recover actual damages, costs of litigation, and additional statutory damages.

4. Classifying Tax Debts.

The two crucial determinations must be made:

Secured vs. unsecured.

Priority vs. nonpriority.

Secured vs. Unsecured.

In bankruptcy, IRS is just another creditor.

IRS can be (see BC §506):

A secured creditor, if a NFTL was filed; or

An unsecured creditor, if no lien was filed; or

Partially secured and partially unsecured, if a lien was filed but the tax exceeds taxpayer's equity in property covered by the lien.

A tax claim is unsecured if:

no tax lien was filed;

a tax lien was filed but the debtor has no equity in assets to which the lien may attach;

a tax lien was filed but other creditors had recorded liens prior to the tax lien, consuming all available equity in the property.

Priority vs. Nonpriority:

Taxes are priority debts if the tax return was due (with extensions) less than 3 years prior to the filing of the bankruptcy petition. BC §507(a)(8)(A)(i)

3-year period is extended for the time a prior bankruptcy case was open (see U.S. v. Young, 122 S.Ct. 1036 (2002); IRS Notice CC-2202-023).

Taxes are priority debts if assessment was made less than 240 days prior to filing of the bankruptcy petition. BC §507(a)(8)(A)(ii)

240-day period is extended for time an offer in compromise is pending, plus 30 days.

Although self-assessment starts filing a return, the filing date is NOT the assessment date.

240-day period is tolled during an prior bankruptcy. (Richmond v. U.S., 79 AFTR 97-359).

Relation back:

For purposes of the BC §507(a)(8)(A)(ii) 240-day rule, interest and penalties relate back to the assessment date of the tax.

Thus, each incremental assessment of penalty or interest is not protected from discharge by a separate 240-day priority period.

Taxes are priority debts if tax return was not filed, or if it was filed less than 2 years prior to the filing of the bankruptcy petition. BC §523(a)(1)(B)

Applies in Chapter 7, but not in Chapter 13.

2-year period is extended for the time a prior bankruptcy case was pending.

Return for Discharge Purposes.

To constitute a tax return under BC §523, a document must contain enough information for the IRS to compute the tax liability, and must evidence an honest attempt to comply with the tax laws.

A frivolous return is not a "return" for this purpose. The tax protestor community is constantly dreaming up new return variants, and discharge of the taxes later assessed because what was filed is deemed not to constitute a return for purposes of §523.

Substitute for Return (SFR) Assessments.

IRS can compute a tax liability if the taxpayer fails or refuses to file a return and assess with or without the taxpayer's consent. IRC §6020(b).

Some courts (now including the 4th Circuit) hold that once an SFR assessment is made, a late filed return is ineffective. Since the taxpayer can then never satisfy the "two-year-from-date-of-filing" rule of BC §523(a)(1)(B), a tax assessed by SFR is a priority debt in a Chapter 7.

Cases on dischargeability of SFR assessments.

- Beard v. Commissioner, 82 TC 766, 777-78 (1984)
- In re Hatton, 220 F.3d 139 (6th Cir. 1989)
- In re Hindenlang, 164 F.3rd 1029 (6th Cir. 1999)
- In re Nunez, 232 BR 778 (B.A.P. 9th Cir. 1999)

- In re Moroney, 352 F.3d 902, 907 (4th Cir. 2003)
- Swanson v. Commissioner, 121 TC 7 (2003)
- U.S. v. Klein, 94 AFTR 2d 5103 (S.D. Fla. 2004)

States can and do make SFR assessments, often based on information received from the IRS.

The Virginia Department of Taxation asserts (too broadly) that even an audit adjustment made to a timely return is a "substitute for return assessment," and thus a priority debt not subject to dischargeable in Chapter 7.

5. Interest and Penalties.

Prepetition interest.

Interest follows the underlying tax. So if the pre-petition tax is discharged, the related interest will also be discharged. Debtor is thus no longer personally liable for the interest. But if the tax survives the discharge, so too does the pre-petition interest.

Postpetition interest on nondischargeable tax.

In Chapter 7, interest accrues after petition date on prepetition tax, and like the underlying tax is not dischargeable. See In re Hanna (8th Cir. 1989) and In re Burns (11th Cir. 1989).

Even if priority claim with penalties and interest is paid in full by estate, postpetition interest is not a debt of the estate and can't be paid from estate's assets. Debtor remains liable after the discharge.

Interest accrues postpetition if the claim is secured. See Ron Pair Enterprises (S. Ct. 1989).

On undersecured priority claim, interest accrues on secured portion (except in Chapter 13).

On unsecured priority claim, postpetition interest accrues (except in Chapter 13). However, no postpetition interest accrues if tax is dischargeable (it would be discharged in any event).

Penalties.

BC §523(a)(7) disjunctive test for penalties: Penalties are dischargeable to the extent they --

(A) relate to a dischargeable tax claim, OR

(B) where the event giving rise to the penalty occurred more than three years prior to the filing of the bankruptcy petition.

See In re Burns (11th Cir 1989) and In re Allen, 272 B.R. 913 (E.D. Va 2002) following majority rule, contra In re Putnam 131 B.R. 52 (W.D. Va 1991).

Pecuniary loss penalties are priority claims and not dischargeable (e.g. the 100% penalty or "trust fund recovery penalty").

But punitive penalties are not priority claims, even if the underlying tax is entitled to priority, and such penalties are dischargeable if they meet either prong of the disjunctive test of BC §523(a)(7).

Punitive penalties include those for late filing, late payment, negligence and fraud.

6. Nondischargeable Taxes.

BC §507(a)(8)(C) gives priority to "a tax required to be collected or withheld and for which the debtor is liable in any capacity," thereby making such taxes nondischargeable.

Withheld portion of payroll taxes.

Trust fund recovery penalty.

Sales taxes collected from customers.

Employer's share of payroll taxes: While the withheld portions of the payroll tax are nondischargeable, those portions imposed directly on the employer (50% of FICA and Medicare), plus penalties and interest thereon, are separately dischargeable if the underlying wages were paid and the related return was due more than three years prior to the bankruptcy. See BC §507(a)(8)(D).

FUTA taxes are not "trust fund" taxes and are similarly dischargeable.

Debt incurred to pay a nondischargeable tax.

BC §523(a)(14) bars discharge of a debt incurred to pay a nondischargeable federal tax. This prevents debtors from using credit card advances to pay priority taxes before bankruptcy, and then discharging the credit card debt. Applies only to Chapter 7, not Chapter 13.

BC §523(a)(1)(C) bars discharge if the taxpayer "made a fraudulent return or willfully attempted in any manner to evade or defeat such tax."

Circuits are split on whether mere nonpayment, without more, constitutes willful attempt to evade or defeat tax. Compare Haas (11th), Toti (6th), Dalton (10th) and Fegely (3rd). Does civil or criminal definition of "evasion" apply?

Doesn't apply in Chapter 13, so taxes resulting from fraud can be discharged ("superdischarge").

BC §523(a)(1)(C) does not require that the taxpayer be criminally prosecuted for the taxes to be found nondischargeable (in Chapter 7).

Meyers v. IRS (6th Cir. 1999). Tax protestor did not file returns and claimed excessive withholding exemptions to reduce tax withheld by his employer.

Or see U.S. v. Schmidt (4th Cir. 1991). Taxpayer assigned wages, yet maintained dominion and control over the funds.

Chapter 7 -- Nondischargeable taxes survive the discharge, and must be addressed later.

Chapter 13 -- To be confirmable, a Chapter 13 plan must provide for the full payment of all priority debts.

7. Equitable Considerations.

Court can deny the discharge if the debtor is acting unjustly and could in fact pay a portion of the debts.

In re Zuercher. Extravagant lifestyle, previous bankruptcy discharge, concealment of assets and other actions to thwart creditors.

In re Paulson. Tax protestor.

In re Crayton. Refusal to file income tax returns.

In re Hammonds. Bankruptcy directed at a single creditor (like the IRS).

8. Chapter 7 vs. Chapter 13.

Superdischarge. Some taxes that have priority in Chapter 7 enjoy no priority in Chapter 13 (§523 is inapplicable).

SFR assessments.

Taxes based on returns filed less than two years before petition date.

Taxes arising due to fraud.

Taxes assessable but not assessed.

Nonpecuniary loss penalties, even if related to a priority tax or accrued within 3 years of petition.

Other advantages of Chapter 13.

Ability to pay priority taxes with monthly payments under the protection of the Court.

No post-petition penalties, and no interest on unsecured, priority tax debts.

Non-pecuniary loss penalties dischargeable in Chapter 13 even if incurred within three years of the filing of the petition.

Disadvantages of Chapter 13.

Who may be a debtor: Only someone with regular income; and with debts less than \$307,675 unsecured, \$922,975 secured.

Monthly payments (based on income and living expenses over 36 to 60 months).

Requirement to provide for full payment of priority debts for the plan to be confirmable. (In contrast, in Chapter 7 you can still be a debtor and get some debts discharged; the priority debts simply survive the discharge.)

"Chapter 20" (7 + 13 = 20)

Where debts exceed Chapter 13 limits (\$307,675 unsecured and \$922,975 secured), first reduce unsecured debts in Chapter 7 so client can then use Chapter 13.

Chapter 13 may be needed to discharge taxes not dischargeable in Chapter 7 ("superdischarge" provision, e.g. taxes arising due to fraud, SFR assessments, returns filed less than 2 years ago, or taxes "assessable" but not yet assessed).

Majority rule appears to be that a Chapter 13 plan providing for the discharge of a debt that was not dischargeable in an earlier Chapter 7 is not *per se* bad faith. In re Doersam, 849 F.2d 237 (6th Cir. 1988).

Nevertheless, the Court gives closer scrutiny to cases in which the primary debts were priority debts in a prior Chapter 7. See In re Diego, 6 B.R. 468 (1980).

9. After the Discharge.

Tax problems often remaining after bankruptcy.

Some taxes may survive the discharge (the "*in personam*" liability remains).

Some taxes may have been secured by the prepetition filing of tax liens (the "*in rem*" liability remains).

A valid federal tax lien survives a discharge.

If the Service has properly filed a prepetition Notice of Federal Tax Lien and such lien is still valid (i.e., refiled correctly, if applicable), the lien survives the discharge. See BC §522(C)(2)(B).

Thus, the IRS may collect discharged taxes from property that is exempt from the estate, excluded from the estate, or abandoned by the trustee.

Lien stripping.

Distinguish strip down from strip off.

The decisions are unclear as to whether a lien which reaches nothing at all can be eliminated or "stripped off" in a Chapter 7.

Yes: In re Payne, 179 B.R. 486 (W.D. Va 1995).

No: In re Yi, 219 B.R. 394 (E.D. Va 1998), held a third deed of trust to be a nullity where all equity in property was absorbed by prior liens.

Debtor would like to strip down undersecured lien to the amount reached by lien. Dewsnup v. Timm, 502 U.S. 410 (1992), appears to bar lien stripping in Chapter 7.

However, lien stripping may be permitted in Chapter 13. See In re Dever, 164 B.R. 132 (C.D. Calif. 1994).

IRS processing of case after discharge.

Accounts remaining unpaid are reactivated, abated or reported as currently not collectible.

Discharge relieves taxpayer of personal liability. But tax may still be collected from property (including exempt property) encumbered by lien. SPf reviews collection potential and determines whether accounts should be abated. If there are no encumbered assets, taxes are abated and liens released.

A result similar to a lien strip down or a lien strip off can be accomplished after the discharge.

Release.

Removes and extinguishes the lien.

IRC §6325(a) requires the IRS issue a certificate of release within 30 days after the tax liability is satisfied, expires under the statute of limitations, or a bond is accepted.

Systemic releases are automatically generated when all modules listed on NFTL are satisfied.

Systemic releases will not be generated on NMF (non-master file) accounts.

Discharge.

A certificate of discharge removes specified real or personal property from the lien. But the lien continues as to all other property of the TP. See IRC §6325(b)(2):

TP divested of all interest in the property.

Property has no value to the government.

Proceeds of sale have same priority.

Subordination.

Relegates the FTL to a lower priority position than some other specified lien.

Possible solutions for taxes surviving discharge.

Second bankruptcy -- a Chapter 7 can be followed by a Chapter 13 (under present law).

Installment agreement.

Offer in compromise.

Wait out the statute of limitations (ten years from date of assessment, extended by OIC, time in bankruptcy, CDP requests, etc.).

10. Bankruptcy Reform Act:

Would impose complex "means tested" bankruptcy, forcing debtors with ability to pay at least \$6,000 over 5 years to make payments against debts through Chapter 13 plans.

Would use IRS's national and local standards, with various questionable modifications.

Penalty on attorney if case is converted due to a finding of ability to make payments on debts.

Would eliminate Chapter 13 "superdischarge" provision for debts arising due to fraud.

Would bar "Chapter 20" -- imposes 5-year delay, and extends time between Chapter 7 cases to 8 years.

Would codify U.S. v. Young for all periods collection is barred (including CDP hearing, appeal, and the time an installment agreement is in effect), thus resolving the conflict as to whether a prior bankruptcy extends all the time periods.

Would require filing of any unfiled tax returns for the past 4 years before a Chapter 13 plan can be confirmed.

Would authorize postpetition refund to be offset against prepetition tax debts (which IRS often does anyway, in violation of the automatic stay).

11. Bankruptcy vs. Offer in Compromise.

Treatment of Assets.

Offer in compromise: Retain assets. Pay 20% quick sale discount on hard assets, 100% of value of cash assets (special rules for IRAs, etc.).

Chapter 7: Assets in excess of exemptions sold by trustee. Tax liens survive on pre-petition assets.

Chapter 13: Retain assets. Must pay at least the value of non-exempt assets, plus the equity in property encumbered by the FTL. Three to five years to pay.

Payment Options.

Offer in Compromise: Three options -- payable in 90 days, or over 2 years, or deferred offer over remaining life of collection statute.

Chapter 7: Paid from and to the extent of the debtor's assets. Unpaid priority taxes survive.

Chapter 13: Trustee determines ability to pay. Pay value of non-exempt assets, plus equity in property encumbered by FTL, over three to five years.

Substitute for Return (SFR).

Offer in Compromise: May compromise -- (but IRS will often require filing of unfiled returns so that taxpayer is in "full compliance").

Chapter 7: Nondischargeable in some circuits (2 years from never is a long time from now).

Chapter 13: Dischargeable (2-year from date of filing rule does not apply).

Late Filed Returns.

Offer in Compromise: May compromise.

Chapter 7: Dischargeable if petition filed 2 years after late return is filed, 240 days after assessment, and 3 years after due date.

Chapter 13: Dischargeable if petition filed 240 days after assessment and 3 years after due date (2 year from filing rule inapplicable).

Non-filed Returns.

Offer in Compromise: May not compromise until tax returns are filed and tax assessed.

Chapter 7: Nondischargeable.

Chapter 13: Dischargeable at least 3 years after due date (IRS may object to discharge, arguing that nonfiling is "affirmative attempt to evade").

Fraudulent Returns.

Offer in Compromise: May compromise (in some cases IRS may raise public policy argument).

Chapter 7: Nondischargeable.

Chapter 13: Dischargeable ("superdischarge" rule). Reason is that BC §523 doesn't apply to Chapter 13 (except for hardship discharges).

Trust Fund Taxes (100% Penalty).

Offer in compromise: May compromise (but note special rules discouraging acceptance of offers in compromise from "in business" taxpayers).

Chapter 7: Nondischargeable.

Chapter 13: Dischargeable only if IRS files its claim late, and the Court finds that the taxpayer did not act in bad faith.

Impact of State Exemptions.

Offer in Compromise: None (but IRS will ignore up to \$6,890 in clothing and household effects based on exemption from levy provisions of IRC).

Chapter 7: Trustee may only take nonexempt property, but IRS may pursue pre-petition lien and nondischargeable taxes after the discharge.

Chapter 13: Impacts amount to be paid on dischargeable taxes not secured by lien; taxpayers in states like Florida pay less.

Enforced Collection Action.

Offer in Compromise: IRS may not levy or seize while offer is under consideration.

Chapter 7: BC §362 prevents enforcement action by IRS and other creditors.

Chapter 13: BC §362 prevents enforcement action by IRS and other creditors.

Taxpayer's Other Debts.

Offer in Compromise: Not resolved.

Chapter 7: Discharges all unsecured, non-priority debts not excepted from discharge.

Chapter 13: Discharges all unsecured, non-priority debts not excepted from discharge.

State Tax Obligations.

Offer in Compromise: Not settled (but separate offer in compromise with state may be available).

Chapter 7: Same rules as federal taxes, so that bankruptcy may resolve some or all state taxes along with federal liabilities. (But see Seminole Tribes v. Florida and In re Young dealing with difficult state sovereign immunity issues.)

Chapter 13: Same rules as above.

Penalties.

Offer in Compromise: Included in offer and resolved upon acceptance and payment.

Chapter 7: Dischargeable if over 3 years old.

Chapter 13: Dischargeable if over 3 years old.

Limitation on Amount of Debt.

Offer in Compromise: None.

Chapter 7: None.

Chapter 13: Debts cannot exceed statutory limits (\$307,675 unsecured debt; \$922,975 secured debt).

Ideal Client for Each Approach.

Offer in Compromise: Taxpayer with large nondischargeable taxes, modest present income and future earning potential, few assets (on an individual and household basis), and a source of "new" cash with which to fund the offer.

Chapter 7: Taxpayer with high income, few assets that would be includible in bankruptcy estate, and large dischargeable tax and non-tax debts, and who has met all relevant BC §507(a)(8) and §523(a)(1)(B) dischargeability date tests.

Chapter 13: Taxpayer with steady income who owes income tax obligations arising due to fraud, or with late filed returns who can't wait until two years after filing to resolve the liabilities, and with assets that would be excluded in bankruptcy but included in IRS's computation of ability to pay for purposes of an OIC.

DEALING WITH THE IRS COLLECTION DIVISION

DISCHARGING TAX LIABILITIES IN BANKRUPTCY

by Burton J. Haynes, CPA and Attorney at Law

This is the fourth in a series of articles about dealing with the IRS Collection Division. In previous articles we discussed innocent spouse relief, installment agreements, and offers in compromise. All of these are useful techniques for dealing with tax liabilities which should not be collected from your client, or which exceed your client's ability to pay. But there are situations in which these devices are unavailable, inappropriate or inadequate. And in these cases, relief can sometimes be obtained through bankruptcy. Bankruptcy can be useful in contesting the amount or validity of a tax liability when other judicial forum cannot be used. And most importantly, a properly timed and structured bankruptcy can discharge many tax liabilities, thus giving a financially distressed individual a "fresh start."

Right up front we need to address a common misconception. More than a few otherwise knowledgeable accountants and lawyers will vigorously assert that taxes are not subject to discharge in bankruptcy. For certain tax debts which enjoy a "priority" status under the Bankruptcy Code, this is true. But under the proper circumstances, many tax liabilities lose their priority status, and enjoy no greater protection from discharge than debts owed to any other creditor. In the pages below we will discuss the statutory provisions differentiating priority from nonpriority taxes so that you will be able to tell which tax liabilities are potentially subject to discharge and which are not. And while no article of this length can possibly make you an expert in the tax aspects of bankruptcy, it is hoped that you will come away with an increased sensitivity for those situations in which bankruptcy might present a useful alternative worthy of further exploration.²

¹ Mr. Haynes is a tax lawyer with offices in Burke, Virginia, and Burtonsville, Maryland. From 1973 to 1981 he served as a Special Agent with the IRS Criminal Investigation Division, and in 1980 was named "Criminal Investigator of the Year" by the Association of Federal Investigators. He specializes in civil and criminal tax disputes and litigation, and the tax aspects of bankruptcy and divorce.

² Bankruptcy in general, and the impact of bankruptcy on taxes in particular, are exceedingly complex matters. This article will necessarily present only broad outlines of concepts and rules which are laced with exceptions and caveats. Before any bankruptcy is filed, extensive consultation with an experienced and knowledgeable bankruptcy practitioner is absolutely essential.

Burton J. Haynes, P.C.

Attorney at Law

Page 2 of 12

Types of bankruptcies.

Two forms of bankruptcy are typically used by individual debtors:³ Chapter 7 and Chapter 13.⁴

A Chapter 7 is a traditional "liquidating" bankruptcy. A trustee is appointed for the principal purpose of protecting the unsecured creditors. Secured creditors don't require the same degree of judicial concern -- they have already protected themselves by becoming secured creditors in the first place. Under the supervision of the trustee, and subject to certain statutory exemptions, the debtor's assets are marshalled and sold.⁵ Assets which are fully encumbered by the claims of secured creditors are usually abandoned by the trustee to the secured creditors or to the debtor, subject to those liens, since such fully encumbered assets are of no benefit to the unsecured creditors.

A Chapter 13 is for a small debtor with regular income who can make monthly payments against his or her debts. In order to "qualify" to use Chapter 13, a debtor must have unsecured debts of less than \$269,250 and secured debts of less than \$807,750.⁶ Under a Chapter 13 "plan," the debtor makes monthly payments to a trustee, who distributes the money, less a commission, to the creditors.⁷ To be "confirmable," a Chapter 13 plan must provide for the full payment of all priority debts.⁸ At the conclusion of the required series of monthly payments, all dischargeable debts which remain unpaid are discharged.⁹

³ In this article we will focus on individual taxpayers, although bankruptcy can also be extremely useful to business entities.

⁴ Although an individual may file for reorganization under Chapter 11, this is a more complicated and expensive procedure usually appropriate only for business entities.

⁵ Often these statutory exemptions are sufficient to protect most or even all of a debtor's assets. Thus, many Chapter 7 filings are for what are called "no asset" cases. And the "sale" of the assets is often back to the debtor himself for a price negotiated between the debtor and the trustee.

⁶ See BC §109(e). The above amounts are effective for cases filed after March 31, 1998, and are indexed for inflation as required by BC §104(b).

⁷ See BC §1326.

⁸ See BC §1322(a)(2).

⁹ See BC §1328(a). See also §1328(b) for a "hardship discharge" where the debtor is unable to complete the monthly payments required under the Chapter 13 plan.

Burton J. Haynes, P.C.

Attorney at Law

Page 3 of 12

Tax treatment of the debtor and the bankruptcy estate.

Separate taxable estate.

Under Internal Revenue Code §1398, added by the Bankruptcy Tax Act of 1980, the filing of a bankruptcy petition by an individual under Chapter 7 creates an "estate" which is treated as a separate taxable entity.¹⁰ The estate files its own tax returns and pays taxes on its own income.¹¹ The transfer of an asset between the debtor and the estate is not treated as a disposition, and thus typically has no separate tax consequences. In contrast, while the filing of a Chapter 13 action creates an estate for purposes of the Bankruptcy Code, the estate is not treated as a separate taxable entity for tax purposes.

Treatment of tax attributes.

It is important to know that in addition to receiving the debtor's assets, a Chapter 7 estate succeeds to the debtor's "tax attributes."¹² This includes the basis, character and holding period of assets, net operating losses, capital losses, suspended passive losses, and various tax credits. These transfers are deemed to occur as of the first day of the debtor's taxable year in which the petition is filed. Because these tax attributes are transferred to the bankruptcy estate, they are thereafter no longer available to the debtor. The estate also succeeds to the debtor's right to file refund claims to recover taxes paid in pre-petition years.¹³ At the conclusion of the bankruptcy case, the estate's unused tax attributes are transferred back to the debtor.¹⁴ Planning how to best structure and time the proposed bankruptcy in light of these attribute transfer and reduction rules requires both a thorough knowledge of the rules and more than a little creativity.

¹⁰ See IRC §1398(e)(2) and BC §541(a). See also IRS Pub. 908 "Bankruptcy Tax Outline."

¹¹ IRC §1398(e).

¹² See IRC §1398(g) and BC §346(i)(1).

¹³ See IRC §1398(j)(2).

¹⁴ See IRC §1398(i) and Regs. §1.1398-1(e) et seq. Note also that these tax attributes are reduced to the extent of the debts discharged. See IRC §108(b). This reduction in tax attributes occurs on the first day of the taxable year following the year of the discharge, thus giving rise to interesting planning opportunities. The attribute reductions are reflected on IRS Form 982, filed with the taxpayer's return for the year of the discharge.

Burton J. Haynes, P.C.

Attorney at Law

Page 4 of 12

Election to close tax year.

The filing of a bankruptcy petition does not cut off the debtor's tax year.¹⁵ This means that if a petition is filed late in the year, the debtor can be left with responsibility for taxes on his pre-petition income, even though his assets are transferred to his bankruptcy estate upon filing of the petition. However, an election to bifurcate the debtor's tax year is available.¹⁶ If the election is made, the debtor's taxable year ends on the day before the petition is filed, and a new taxable year starts on the petition date. Deciding whether to make this election is an important issue which can have a significant impact on the outcome of the case. In essence, the election permits the debtor to shift responsibility to the estate for taxes on income earned before the petition date.

Where the estate has assets which might otherwise be applied to debts owed to general unsecured creditors (including dischargeable tax debts for earlier years), bifurcating the tax year can cause those assets to be applied instead to the taxes owed for the short pre-petition year -- taxes which if unpaid would survive the bankruptcy to be paid out of the debtor's post-petition income. The election also permits the debtor to use his tax attributes, such as the basis in depreciable assets and net operating loss carryforwards, to reduce the tax on the pre-petition income. Absent the election, these tax attributes would be lost as of January 1st of the year in which the petition is filed, as explained above.

As with so many other aspects of the complex interface between bankruptcy law and tax law, the IRC §1398(d)(2) election presents both planning opportunities and traps for the unwary. The election must be made on or before the due date of the tax return for the short pre-petition year, and this date cannot be extended. Furthermore, the election is irrevocable once made.¹⁷ The return for a tax reportable on an annual basis is typically due by the 15th day of the fourth month following the close of the year. Because in this situation the taxable year can end on a day other than the end of a month, the filing deadline for the short year is the 15th day of the fourth full month following the petition date.¹⁸

¹⁵ See IRC §1398(d)(1).

¹⁶ See IRC §1398(d)(2).

¹⁷ See Regs. §301.9100-14T(e).

¹⁸ See Regs. §301.9100-14T(d) and (g).

Burton J. Haynes, P.C.

Attorney at Law

Page 5 of 12

Effect of bankruptcy on IRS collection action.

Filing a bankruptcy petition is like holding a crucifix in front of a vampire. Immediately upon filing, an "automatic stay" arises under BC §362(a), and all IRS enforcement action must cease.¹⁹ As soon as it learns of the filing of a bankruptcy petition, the IRS posts its computer system with a "bankruptcy hold" code to avoid inadvertent violation of the automatic stay. Nevertheless, because of changes made by the Bankruptcy Reform Act of 1994, the IRS is now allowed to take some limited steps to determine and assess tax debts despite the filing of a petition. The permitted actions include the following:

- (1) Demanding that any delinquent returns be filed;
- (2) Auditing the taxpayer's returns;
- (3) Issuing a statutory notice of deficiency;
- (4) Assessing uncontested liabilities and pre-petition taxes shown on the taxpayer's returns;
- (5) Refiling a notice of federal tax lien;
- (6) Issuing summonses to determine the tax liability.

It is unfortunately true, however, that the IRS routinely violates the automatic stay. Usually this is the result of inadequacies in the IRS's computer system.²⁰ Like the malevolent computer HAL in the movie "2001 - A Space Odyssey," the IRS computer system often proceeds with automated collection action despite the posting of a bankruptcy hold code:

IRS's failure to correct known, glaring weaknesses in its internal controls which cause it to repeatedly violate the automatic stay constitutes bad faith and an arrogant defiance of the majesty of the Federal Law which has embodied in U.S.C. section 362 as its "fundamental protection" to debtors in bankruptcy. In re Flynn, 169 B.R. at 1024.

¹⁹ If assets are seized by the IRS before the filing of the petition, but haven't yet been sold, the trustee can demand that they be surrendered to the estate for the benefit of the creditors if "adequate security" can be provided. See U.S. v. Whiting Pools, 462 U.S. 198 (1983). This "turnover" power can be extremely useful if the IRS has seized assets necessary for the operation of the taxpayer's business.

²⁰ One commentator notes that IRS "is a frequent violator of the automatic stay provisions of the bankruptcy code" and "[d]ue to an uncooperative computer, the IRS has not adequately controlled enforcement actions against tax debtors, a shortcoming that has resulted in numerous 'opportunities' for the IRS to appear before the bankruptcy courts to try and explain its repeated violations. . ." Matthew J. Fischer, *The Equal Access to Justice Act -- Are the Bankruptcy Courts Less Equal than Others?*, 92 Mich.L.Rev. 2248, 2250-51 (1994).

Burton J. Haynes, P.C.

Attorney at Law

Page 6 of 12

A typical computerized action violating the automatic stay is the Service's practice of offsetting a current period refund against a prior period delinquency. Even though the Internal Revenue Manual acknowledges that the automatic stay bars refund offsets unless and until a lift stay order is obtained from the Bankruptcy Court, it is not uncommon to find that the IRS has offset a post-petition refund against a pre-petition tax debt. In an effort to convince the IRS to be more punctilious about such matters, the new IRS Restructuring and Reform Act allows damages of up to \$1,000,000 for violations of the automatic stay.²¹

When a Revenue Officer learns of the filing of a bankruptcy petition, he or she packs up the case file and ships it to the Special Procedures Office.²² Special Procedures then files a proof of claim in the bankruptcy case when appropriate and, in consultation with District Counsel when necessary, determines what other actions are needed to protect the government's interests. The automatic stay remains in place until the discharge is entered at the conclusion of the case. At that point the automatic stay is converted into a permanent injunction barring any effort on the part of a creditor, including the IRS, to collect a discharged debt.

Classifying tax debts.

Secured vs. unsecured.

In bankruptcy, the Internal Revenue Service, despite its Draconian collection powers, is just another creditor. It can be secured creditor if a Notice of Federal Tax Lien has been filed. Or it can be an unsecured creditor if no lien has been filed. Finally, the IRS can be partially secured and partially unsecured if a lien has been filed but the amount of tax owed exceeds the taxpayer's equity in the property covered by the lien.²³

Priority vs. nonpriority.

Apart from the question of whether the IRS is secured or unsecured, tax debts (like other debts) have to be categorized as to their priority. Certain taxes are given a higher priority in bankruptcy than that of most other commonly encountered debts. Section 507(a)(8) of the Bankruptcy Code gives this priority status to income taxes under the

²¹ See IRS Restructuring and Reform Act §3102(c). See also IRS Announcement 98-89 (1998-40 I.R.B. 11) describing a pilot program to (1) streamline the handling of bankruptcy cases, (2) avoid inadvertent violations of the automatic stay, and (3) resolve taxpayer claims for damages resulting from IRS violations.

²² See IRM 34(10)00, IRM 64(40)0 and IRM 57(13)1.

²³ See BC §506.

Burton J. Haynes, P.C.

Attorney at Law

Page 7 of 12

following circumstances, thus effectively making them nondischargeable in the typical Chapter 7 bankruptcy:

507(a)(8)(A)(i) -- Taxes are nondischargeable if the return was last due (with extension) less than three years prior to the filing of the bankruptcy petition.

507(a)(8)(A)(ii) -- Taxes are nondischargeable if assessed less than 240 days prior to the filing of the bankruptcy petition (with this 240 days being extended for the period of time an offer in compromise is pending, plus 30 days).

A third important timing rule, applicable in Chapter 7 cases but not in Chapter 13, is found in BC §523(a)(1)(B):

523(a)(1)(B) -- Taxes are nondischargeable if the tax return was not filed, or was filed less than two years prior to the filing of the bankruptcy petition.²⁴

Thus, as with so many things in life, timing is everything. Income tax debts which are nondischargeable today may be dischargeable tomorrow. These timing rules can be the basis for the effective planning in preparing for the use of bankruptcy to obtain relief for a financially pressed taxpayer. But they also pose the threat of indefensible malpractice claims against those who fail to consider their impact. For example, the accountant or attorney who participates in the filing of a bankruptcy case for a client a week before his or her tax debts would have been dischargeable under the above-described rules may later find himself with both an unhappy client and a claim against his malpractice insurance policy. This is an area in which it pays to be very, very careful.

Nondischargeable taxes.

In addition to those income taxes made nondischargeable by the above-described timing rules, the Bankruptcy Code provides that certain specified kinds of taxes are nondischargeable regardless of when the petition is filed.

First, under BC §507(a)(8)(C), withholding tax liabilities are given a priority sufficient to make them nondischargeable. This covers a direct obligation for withholding taxes as well as indirect responsibility through the so-called "trust fund recovery penalty." Unfortunately, this rule denies relief to many taxpayers faced with truly unmanageable debts stemming from their involvement in failed businesses. Nevertheless, BC §507(a)(8)(C) is cruelly unambigu-

²⁴ A "substitute for return" prepared by the IRS as the basis for an assessment in the absence of a filed return does not constitute the filing of a return for purposes of BC §523. See e.g. In re Gushue, 126 Bankr. 202 (Bankr. E.D. Pa. 1991).

Burton J. Haynes, P.C.

Attorney at Law

Page 8 of 12

ous on this subject, giving priority to "a tax required to be collected or withheld and for which the debtor is liable in any capacity." This same language also prevents the discharge of a liability for sales taxes which were collected, or which should have been collected, by the debtor.

Second, BC §523(a)(C) bars discharge of debts, including taxes, arising due to fraud:

(a) a discharge . . . does not discharge an individual debtor from any debt--

(1) for a tax or customs duty--

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

Note, however, that this rule does not apply to Chapter 13 cases, thus making it possible to discharge even taxes resulting from fraud if the taxpayer can meet the jurisdictional requirements of Chapter 13. The reason for the difference is that Chapter 13 discharges are granted under BC §1328(a), which protects only debts described in §523(a)(5)(8) and (9), and not those described in §523(a)(1)(C). This is the same reason that the "two year from date of filing" rule of §523(a)(1)(B) doesn't apply to Chapter 13 cases.²⁵ These subtle but important statutory differences can be crucial in determining the appropriate kind of bankruptcy to be used in any given case.

Equitable considerations.

Overriding all of these statutory timing issues is the question of "bad faith." The Bankruptcy Court is a court of equity, and can deny a debtor a discharge either in response to a motion from the IRS or *sui sponte* (i.e. on the Court's own initiative). This can occur when the Court is convinced that the debtor could pay at least a portion of the debts in question, but is instead inappropriately hiding behind the Bankruptcy Code and acting unjustly toward his or her creditors. For example, in In re Zuercher, 93 TNT 57-23 (Bankr. D. Hawaii 1993), the Court had little sympathy for a dentist with an "extravagant lifestyle" who had filed a previous bankruptcy case and took numerous actions designed to thwart his creditors. The Court denied the discharge, stating that "a person seeking relief under the Code must come in with clean hands, with an honorable purpose, and must be willing to use all of his resources to, at least, try to pay his creditors."

²⁵ Note that these §523(a)(1) issues do prevent the discharge of such taxes in Chapter 13 "hardship discharges" granted under BC §1328(b) when the debtor is unable to complete the payments provided for in the Chapter 13 plan.

Burton J. Haynes, P.C.

Attorney at Law

Page 9 of 12

Fortunately, bad faith is not often raised by the IRS except in cases involving tax protesters. In one such case, the Court observed that "[a]ll courts . . . have concluded that the use of Chapter 13 by so-called tax protesters in an attempt to discharge their federal tax liabilities amounts to an unfair manipulation of the Bankruptcy Code."²⁶ Similarly, several bankruptcy courts have held that the debtor's refusal to file tax returns constitutes bad faith.²⁷ Also, the fact that a bankruptcy is directed at a single creditor (such as the IRS) is often a factor in finding bad faith.²⁸ Accordingly, before advising a client to seek relief from tax debts in bankruptcy, all the facts and circumstances must be carefully reviewed.

After the discharge.

In the perfect case, upon entry of the discharge order the taxpayer would have no further obligations to the IRS, and would have thus achieved a complete fresh start. In the typical case, however, two problems often remain after the discharge. First, some taxes may survive the bankruptcy, and will therefore have to be addressed in the normal way. These might be taxes which were too new to be dischargeable, or which were of a kind not subject to discharge. And second, some dischargeable taxes may have been secured by liens. In this situation, while the client's personal liability for the taxes is discharged, the lien nevertheless continues as a valid encumbrance on the taxpayer's property. In other words, a distinction is drawn between the *in personam* liability, which is discharged, and the *in rem* claim against the assets covered by the lien, which survives.

Resolving tax problems through bankruptcy.

Having recited all of these complex rules, how does bankruptcy compare to other available approaches in securing relief from unmanageable tax debts? This is a fact-driven determination, and each case must be analyzed very carefully. There is no set answer which will be right in every case or for every client. All you can do is carefully assemble the facts and apply the relevant statutory rules to see where the client would come out under each approach. Nevertheless, some general observations can be made.

²⁶ In re Paulson, 170 B.R. 496 (Bankr. D. Conn. 1994). See also In re Love, 957 F.2d 1350, 1359 (7th Cir. 1992), noting that "filing a Chapter 13 petition in order to thwart the payment of an otherwise nondischargeable income tax debt arising from the unlawful failure to pay income taxes was not one of the intended purposes of the bankruptcy provisions."

²⁷ In re Crayton, 169 B.R. 243, 245 (Bankr. S.D. Ga. 1994), holding that failure to file returns is the "epitome of a lack of good faith on the part of Debtor and demands dismissal."

²⁸ See In re Hammonds, 139 Bankr. 535 (Bankr. D. Col. 1992); In re Brown, 88 Bankr. 280 (Bankr. D. Haw. 1988).

Burton J. Haynes, P.C.

Attorney at Law

Page 10 of 12

First, note that a Chapter 7 bankruptcy is a one-time, snapshot event. It looks at the debtor's assets and liabilities, and provides a fresh start by wiping out all dischargeable debts which exceed the value of the nonexempt assets. Hence, anticipated future income has no bearing on the matter, and no future monthly payments are required. By contrast, in an offer in compromise future income is an important factor. A taxpayer's ability to make payments to the Service from future income figures directly into the amount which must be offered before the IRS will accept the compromise offer. And note that the portion of the offer amount representing the present value of the future ability to pay must typically be funded from some outside source -- often a loan or gift from a family member. In Chapter 7, there is no obligation to fund any payment to creditors in excess of the value of the nonexempt, unencumbered assets.

Second, sometimes there are significant differences in the way assets are treated in bankruptcy versus in an offer in compromise. For example, a taxpayer may be married and yet have a tax debt for which his spouse is not liable. This can occur when the taxpayer owes income taxes for years prior to the marriage, or for years for which separate returns were filed.²⁹ For purposes of an offer in compromise, the amount offered typically must include at least 50% of the equity in tenants by the entireties property, even if only one spouse owes tax and the property is clearly beyond the Collection Division's reach! In bankruptcy, by contrast, if only one spouse files a petition, such jointly owned property can be exempted from the debtor's bankruptcy estate. Jointly held property can be administered by the trustee for the benefit of joint creditors, even where only one spouse files bankruptcy. However, where the debts in question are owed by only one spouse there are no joint debts, and hence the tenants by the entireties property is off the table. In such cases a bankruptcy can yield a much better result than might be available through an offer in compromise.

Third, while an offer in compromise may do the job with respect to a client's federal tax liabilities, people who are in trouble with the IRS often have many other debts as well -- large credit card balances, bank loans, state tax liabilities, and more. Obviously, the offer in compromise involves only the IRS, and does nothing to solve these other significant financial difficulties. In contrast, a Chapter 7 bankruptcy addresses all of the debtor's liabilities, and therefore may be a much better choice for providing the "fresh start" the client needs.

On the other hand, some cases involve tax liabilities which are partially or entirely nondischargeable -- either because they are too "new" to meet one or more of the three time-related tests described above, or because the taxes are of a type not subject to discharge regardless of timing, e.g. withholding taxes or trust fund liabilities. In these cases, an offer in compromise might provide more relief than would be available from a bankruptcy.

²⁹ Whether married persons should file "married filing jointly" or "married filing separately" is an important decision requiring far more thought and analysis than it usually receives.

Burton J. Haynes, P.C.

Attorney at Law

Page 11 of 12

Finally, in most cases it is not a question of which single approach produces the best result on its own, but rather which combination of devices can be brought to bear on the taxpayer's problems and in what order. For example, often clients have to wait out the passage of the §507(a)(8)(A) and 523(a)(1)(B) time periods, and therefore will have to enter into installment agreements to make orderly and regular payments against their tax debts for some period of months or years to avoid the pain and suffering of IRS levy and distraint action. In other cases, the various dischargeability dates work out such that the client can at least try an offer in compromise while waiting for the taxes to lose their priority status. If the compromise is accepted, it can be used to solve the tax problem. But if it is rejected, the client can then use bankruptcy to discharge the liabilities.

In addition to combining bankruptcy with administrative remedies like installment agreements and/or offers in compromise, it is also possible to combine bankruptcies. Most notably, under present law it is possible to use a Chapter 13 in combination with a Chapter 7 -- described by some wags as a "Chapter 20." The approach is as follows: The Chapter 7 is first used to strip off those debts (including tax debts) which are subject to discharge in that case. Then a Chapter 13 is used to either discharge the remaining tax debts or to provide a vehicle through which they can be satisfied by monthly payments, free of late payment penalties and the threat of enforced IRS collection action. As noted above, Chapter 13 has jurisdictional limits which may make it unavailable to some debtors -- a maximum of \$269,250 of unsecured debts and \$807,750 of secured debts. There are no such limitations in Chapter 7. But under the right circumstances, sometimes the Chapter 7 can strip down the debts so that those which survive are small enough for the debtor to fit within the Chapter 13 limits. Obviously, this is a very complex technique requiring both extremely careful planning based on a full understanding of the facts, and a long process of implementation before the desired results are achieved. In certain circumstances, however, the "Chapter 20" approach can provide relief for taxpayers who could have solved their problems in no other way.

In combining these bankruptcy and nonbankruptcy techniques, it is important to note that they have interesting and complex effects on one another. In particular, the above-described §507(a)(8) and §523(a)(1) time periods are in some cases extended. One such effect was mentioned above -- specifically, while §507(a)(8) requires that the taxes have been assessed for 240 days before the filing of the bankruptcy petition, the running of this 240 day period is suspended for the time an offer in compromise is pending, plus 30 days. Furthermore, all three of the statutory time periods are extended for the time any prior bankruptcy case was open, plus six months.³⁰ These extension rules can make the determination of the relevant bankruptcy priority dates very tricky indeed.

³⁰ In re Brickley, 70 B.R. 113 (Bankr. 9th Cir. 1986), In re Molina, 99 B.R. 792 (Bankr. S.D. Ohio 1988); In re Deitz, 116 B.R. 792 (Bankr. D. Colo. 1990); In re Quinlan, 107 B.R. 300 (Bankr. D. Colo. 1989).

Burton J. Haynes, P.C.

Attorney at Law

Page 12 of 12

Conclusion.

Of all the techniques addressed by this series of articles on dealing with the IRS Collection Division, using bankruptcy to resolve tax liabilities is by far the most complex. It should not be approached without consulting specialists thoroughly familiar with the relevant issues. However, in the appropriate circumstances and after proper planning, bankruptcy can provide relief which is simply not available in any other way, and can enable financially strapped clients to put their problems behind them and start over. It is not for everyone, but for some it can produce miraculous results.

Redacted -- Bankruptcy Dischargeability Dates

Tax year	Balance due	BC 507(a)(8)(A)(i)		BC 523(a)(1)(B)(ii)		BC 507(a)(8)(A)(ii)		Last Chap. 7 priority date	Last Chap. 13 priority date	Liens filed	
		As of	Due date	plus 3 years	Date filed	plus 2 years	Assmt date				plus 240 days
<u>Internal Revenue Service</u>											
1983	\$5,839	22-Dec-03	15-Apr-84	15-Apr-87	21-May-87	21-May-89	24-Aug-87	20-Apr-88	21-May-89	20-Apr-88	26-Aug-94
1983 audit #1											
1983 audit #2											
1995	\$10,536	29-Dec-03	15-Oct-96	15-Oct-99	10-Nov-99	10-Nov-01	27-Dec-99	23-Aug-00	10-Nov-01	23-Aug-00	10-Jan-03
1996	\$65,029	29-Dec-03	15-Oct-97	15-Oct-00	9-Nov-99	9-Nov-01	20-Dec-99	16-Aug-00	9-Nov-01	15-Oct-00	10-Jan-03
1997	\$89,674	29-Dec-03	15-Oct-98	15-Oct-01	8-Dec-99	8-Dec-01	28-Feb-00	25-Oct-00	8-Dec-01	15-Oct-01	10-Jan-03
1998	\$65,668	29-Dec-03	15-Oct-99	15-Oct-02	6-Apr-00	7-Apr-02	22-May-00	17-Jan-01	15-Oct-02	15-Oct-02	10-Jan-03
1999	\$34,606	29-Dec-03	15-Oct-00	15-Oct-03	26-Oct-00	27-Oct-02	8-Jan-01	5-Sep-01	15-Oct-03	15-Oct-03	10-Jan-03
2000	\$0	22-Dec-03	15-Apr-01	15-Apr-04	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2001	\$0	22-Dec-03	15-Apr-02	15-Apr-05	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2002	\$0	22-Dec-03	15-Apr-03	15-Apr-06	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Total IRS	\$271,352										
<u>Maryland Comptroller's Office</u>											
1983 audit	?	24-Dec-03	15-Apr-84	15-Apr-87	?	?	?	?	?	?	none
1993	\$2,799	19-Dec-03	15-Oct-94	15-Oct-97	15-Oct-97	15-Oct-99	9-Feb-95	7-Oct-95	15-Oct-99	15-Oct-97	25-Apr-95
1994	\$16,158	19-Dec-03	15-Oct-95	15-Oct-98	15-Oct-98	15-Oct-00	3-Jan-96	30-Aug-96	15-Oct-00	15-Oct-98	9-Feb-96
1995	\$12,995	19-Dec-03	15-Oct-96	15-Oct-99	2-Feb-99	2-Feb-01	18-May-99	13-Jan-00	2-Feb-01	13-Jan-00	24-Jan-03
1996	\$10,707	19-Dec-03	15-Oct-97	15-Oct-00	25-Jan-99	25-Jan-01	16-Mar-99	11-Nov-99	25-Jan-01	15-Oct-00	24-Jan-03
1997	\$11,939	19-Dec-03	15-Oct-98	15-Oct-01	22-Dec-99	22-Dec-01	18-Feb-00	15-Oct-00	22-Dec-01	15-Oct-01	none
1998	\$8,770	19-Dec-03	15-Oct-99	15-Oct-02	11-Apr-00	11-Apr-02	16-Oct-00	13-Jun-01	15-Oct-02	15-Oct-02	none
1999	\$13,523	19-Dec-03	15-Oct-00	15-Oct-03	15-Oct-00	15-Oct-02	28-Feb-01	26-Oct-01	15-Oct-03	15-Oct-03	none
2000	\$0	19-Dec-03	15-Apr-01	15-Apr-04	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2001	\$0	19-Dec-03	15-Apr-02	15-Apr-05	\$0	\$0	\$0	\$0	\$0	\$0	\$0
2002	\$0	19-Dec-03	15-Apr-03	15-Apr-06	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Total Maryland	\$76,891										
TOTAL TAX	\$348,243										

Name redacted (SSAN) --- Analysis of Bankruptcy Dischargeability Dates

Tax year	Balance due		Filing status	BC 507(a)(8)(A)(i)		BC 523(a)(1)(B)(ii)		BC 507(a)(8)(A)(ii)		Last Chap. 7 priority date	CSED per IRS	CSED per RRA-98 *
	Amount	As of		Due date	plus 3 years	Date filed	plus 2 years	Date assessed	plus 240 days			
Internal Revenue Service												
Taxes currently dischargeable												
1990	time-barred	9-Feb-04	MFJ	15-Oct-91	15-Oct-94	18-Oct-91	18-Oct-93	15-Jul-92	19-Jan-94	15-Oct-94	19-Oct-05	31-Dec-02
1991	time-barred	9-Feb-04	MFJ	15-Oct-92	16-Oct-95	19-Oct-92	20-Oct-94	14-Jul-93	18-Jan-95	16-Oct-95	17-Oct-06	31-Dec-02
1992	\$203,594	9-Feb-04	MFJ	15-Oct-93	15-Oct-96	12-Oct-93	13-Oct-95	20-Jul-94	24-Jan-96	15-Oct-96	23-Oct-07	22-Nov-03
1993	\$230,072	9-Feb-04	MFJ	15-Oct-94	15-Oct-97	31-May-94	31-May-96	15-Mar-95	18-Sep-96	15-Oct-97	18-Jun-08	18-Jul-04
1994	\$0	9-Feb-04	MFJ	15-Oct-95	15-Oct-98	5-Oct-95	5-Oct-97	10-Jul-96	14-Jan-98	\$0	13-Nov-05	13-Nov-05
1995	\$223,277	9-Feb-04	MFJ	15-Oct-96	15-Oct-99	23-Apr-98	22-Apr-00	29-Jul-98	N/A	22-Apr-00	8-Jun-08	8-Jun-08
1996	\$2,132	9-Feb-04	MFJ	15-Oct-97	15-Oct-00	21-Oct-97	21-Oct-99	29-Jul-98	N/A	15-Oct-00	1-Dec-07	1-Dec-07
1997	\$10,515	9-Feb-04	MFJ	15-Oct-98	15-Oct-01	7-Jan-99	6-Jan-01	13-Oct-99	N/A	15-Oct-01	15-Feb-09	15-Feb-09
1998	\$20	9-Feb-04	MFJ	15-Aug-99	15-Aug-02	10-Aug-00	10-Aug-02	16-May-01	N/A	\$0	18-Sep-10	18-Sep-10
1999	\$88,549	9-Feb-04	MFJ	15-Aug-00	15-Aug-03	18-Feb-02	18-Feb-04	4-Dec-02	N/A	18-Feb-04	8-Apr-12	8-Apr-12
Subtotal	\$669,610											
Taxes not yet dischargeable												
2000	\$360,805	9-Feb-04	MFS	15-Oct-01	15-Oct-04	3-Jan-03	3-Jan-05	29-Oct-03	N/A	3-Jan-05	3-Mar-13	3-Mar-13
2001	\$254,622	9-Feb-04	MFS	15-Oct-02	15-Oct-05	12-Mar-03	12-Mar-05	24-Dec-03	pending	15-Oct-05	on hold	on hold
2002	\$0	9-Feb-04	MFS	15-Oct-03	15-Oct-06	3-Oct-03	3-Oct-05	30-Jun-04	pending	\$0	on hold	on hold
2003	\$0	9-Feb-04	MFS	15-Oct-04	15-Oct-07	pending	pending	pending	pending	?	?	?
Subtotal	\$615,427											
Total - IRS	\$1,285,037											
Filing OIC will stay the running of the SOL on collection, extending the CSED on the large 1992 and 1993 taxes that would otherwise become time-barred in 2003 and 2004. OIC filed 4-14-03 (marked received by IRS 5-9-03), thus extending the 240-day period on tax years 2001 and 2002 (although 2002 has \$0 balance anyway).												
State of New York												
1992	\$63,391	est. 10-1-02	SFR	15-Oct-93	15-Oct-96	unfiled	unfiled	26-May-99		unfiled		
1993	\$47,523	est. 10-1-02	SFR	15-Oct-94	15-Oct-97	unfiled	unfiled	28-Sep-98		unfiled		
1994	\$47,078	est. 10-1-02	SFR	15-Oct-95	15-Oct-98	unfiled	unfiled	28-Sep-98		unfiled		
1995	\$13,275	est. 10-1-02	SFR	15-Oct-96	15-Oct-99	unfiled	unfiled	28-Sep-98		unfiled		
1996	\$2,957	est. 10-1-02	SFR	15-Oct-97	15-Oct-00	unfiled	unfiled	28-Sep-98		unfiled		
Total - NY	\$174,224	total										

TP was a partner in national law firm, redacted. Returns should have been filed with NY reporting NY portion of income. No returns were filed, and NY made SFR assessments.

Tax year	Balance due		Filing status	BC 507(a)(8)(A)(i)		BC 523(a)(1)(B)(ii)		BC 507(a)(9)(A)(ii)		Last Chap. 7 priority date
	Amount	As of		Due date	plus 3 years	Date filed	plus 2 years	Date assessed	plus 240 days	
1992	\$0	5-Feb-04			unfiled					N/A
1993	\$0	5-Feb-04			unfiled					N/A
1994	unfiled	5-Feb-04		15-Oct-95	15-Oct-98	unfiled	unfiled	unfiled		unfiled
1995	\$0	5-Feb-04			unfiled					\$0
1996	\$0	5-Feb-04			15-Sep-01					\$0
1997	\$0	5-Feb-04			15-Sep-01					\$0
1998	\$0	5-Feb-04			15-Sep-01					\$0
1999	\$0	5-Feb-04			15-Oct-03	15-Sep-03				\$0
2000	\$60,000	est. from 502	MFS	15-Oct-01	15-Oct-04	unfiled	unfiled	unfiled		unfiled
2001	\$30,558	5-Feb-04	MFS	15-Oct-02	15-Oct-05	21-Mar-03	23-Apr-03	19-Dec-03		unfiled
Total - MD	\$90,558									15-Oct-05

Total - MD Were taxes paid to MD on income taxable by NY? Can funds be recovered from MD? MD was paid under amnesty program. Does this bar refunds?

District of Columbia

2001	\$26,670			15-Oct-02	15-Oct-05	?	?	?		N/A	15-Oct-05
TOTAL DUE	\$1,576,489										

Comparison of offer in compromise to bankruptcy

Assume Chapter 7 filed > 18-Feb-2004	OIC	Chapter 7	Assume Chapter 7 filed > 15-Oct-2005	OIC	Chapter 7
Amount paid to IRS under offer in compromise	\$230,000	\$0	Amount paid to IRS under offer in compromise	\$230,000	\$0
IRS liabilities remaining after discharge	\$0	\$615,427	IRS liabilities remaining after discharge	\$0	\$0
NY income taxes (no returns filed)	\$174,224	\$174,224	NY income taxes (no returns filed)	\$174,224	\$174,224
MD income taxes (too new to be dischargeable)	\$90,558	\$90,558	MD income taxes (too new to be dischargeable)	\$90,558	\$60,000
DC income taxes (too new to be dischargeable)	\$26,670	\$26,670	DC income taxes	\$26,670	\$0
Total paid and/or surviving discharge:	\$521,452	\$906,879	Total paid and/or surviving discharge:	\$521,452	\$234,224
Assume Chapter 7 filed > 3-Jan-2005	OIC	Chapter 7	NOTES:		
Amount paid to IRS under offer in compromise	\$230,000	\$0	OIC does not resolve any non-tax debts (or non-IRS tax debts).		
IRS liabilities remaining after discharge	\$0	\$254,622	NY taxes not subject to discharge in Chapter 7 because no NY returns were filed.		
NY income taxes (no returns filed)	\$174,224	\$174,224	It may be possible to compromise MD / DC / NY taxes for some reduced amount.		
MD income taxes (too new to be dischargeable)	\$90,558	\$90,558	MD 2000 tax not dischargeable because return not filed.		
DC income taxes (too new to be dischargeable)	\$26,670	\$26,670			
Total paid and/or surviving discharge:	\$521,452	\$546,074			

Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

Notice

CC-2002-023

May 9, 2002

Tolling of Priority and Dischargeability
Periods in Bankruptcy after
Subject: Young v. United States Cancellation Date: Upon Incorporation
into CCDM

Purpose

This notice clarifies that, in light of the rationale of Young v. United States, the three-year lookback period of B.C. § 507(a)(8)(A)(i) should not be computed by including an additional six months based on I.R.C. § 6503(h).

Discussion

The Supreme Court, in Young v. United States, 122 S. Ct. 1036 (2002), held that the three-year lookback period of B. C. § 507(a)(8)(A)(i) is a limitations period subject to equitable tolling. Equitable tolling automatically applies and is appropriate whenever the Internal Revenue Service has been prevented by reason of a prior bankruptcy from collecting its claim, regardless of whether the bankruptcy petition was filed in good faith. Therefore, in accordance with the Young holding, the lookback period of B.C. § 507 is tolled during the pendency of a prior bankruptcy petition. Further, the automatic tolling rule adopted in Young will determine the priority or dischargeability of any tax debt unless a court has issued a final order on the priority or dischargeability of the debt and all applicable appeal periods have expired.

Before Young, certain circuits held that the three-year lookback period was tolled during the period the Service was prohibited from collecting the tax by reason of the prior bankruptcy case, and, in reliance on B.C. § 108(c), for the additional six months provided in I.R.C. § 6503(h). See, e.g., In re West, 5 F.3d 423 (9th Cir. 1993), cert. denied, 511 U.S. 1081(1994); In re Montoya, 965 F.2d 554 (7th Cir. 1992). In light of the rationale of Young, the three-year lookback period of B.C. § 507(a)(8)(A)(i) should not be computed by including an additional six months, based on I.R.C. § 6503(h).

Filing Instructions: Binder Part () _____ Master Sets: NO RO
NO: Circulate Distribute to: All Personnel _____ Attorneys _____ In: all NO functions
Field: Circulate Distribute to: All Personnel _____ Attorneys _____ In: all field offices
Other: FOIA Reading Room
Electronic Filename: YoungUS.pdf Original signed copy in: CC:F&M:PM:P



Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

Notice

CC-2004-25

July 12, 2004

Subject: Offers in Compromise in Bankruptcy **Cancel Date:** Upon incorporation into CCDM

Purpose

This Notice explains the Service's policy of returning administrative offers in compromise as nonprocessable to taxpayers currently in a bankruptcy proceeding. Additionally, this Notice provides clarification regarding the Service's authority to acquiesce in treatment of its claims in bankruptcy cases that is less favorable than that provided for under the Bankruptcy Code.

Discussion

The Service's authority to compromise tax liabilities is provided by I.R.C. § 7122(a), which states as follows:

(a) AUTHORIZATION.—The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

The decision to compromise, including whether to consider a compromise and how much to accept, is within the Service's discretion. See Treas. Reg. § 301.7122-1(a). It has been the Service's long-standing policy to compromise cases only when settlement furthers the best interests of both the taxpayer and the Government. See Policy Statement P-5-100 (approved Jan. 30, 1992), reprinted in IRM 1.2.1.5.18. See also Policy Statement P-5-89 (approved July 26, 1960), reprinted in IRM 1.2.1.5.16.

The Commissioner is charged with the power to administer and supervise the execution and application of the Internal Revenue Code. See I.R.C. § 7803(a)(2). Pursuant to

Filing Instructions: Binder

NO: Circulate ___ Distribute X to: All Personnel ___ Attorneys ___ In: All offices

Other

Electronic Filename: CC-2004-025.pdf Original signed copy in: CC:FM:PM:P

that authority, the Commissioner has developed criteria for determining the types of cases that may be compromised under the Service's administrative offer in compromise procedures. The Commissioner has determined that certain cases are not appropriate candidates for compromise under the Service's administrative procedures and that offers submitted in these cases will not be accepted for processing, but rather will be returned to the taxpayer. Treasury Regulation § 301.7122-1(d)(2) provides that if an offer does not contain sufficient information, was submitted solely to delay collection, or is "otherwise nonprocessable," the Service will return the offer to the taxpayer. An offer will be returned as "nonprocessable" unless the following requirements are met: (1) the offer is submitted on the proper version of Form 656 and Form 433-A or B, as appropriate; (2) the taxpayer is not in bankruptcy; (3) the taxpayer has complied with all filing and payment requirements listed in the instructions to Form 656; (4) the taxpayer has enclosed the application fee, if required; and (5) the offer meets any other minimum requirement established by the Service. See Rev. Proc. 2003-71, 2003-36 I.R.B. 517.

In the case of taxpayers in bankruptcy, the Commissioner has determined that processing such compromises under the Service's administrative offer in compromise procedures is not in the Government's best interests. When a taxpayer is in bankruptcy, the resolution of a taxpayer's Federal tax liabilities is best accomplished in the context of the bankruptcy proceeding and in accordance with applicable bankruptcy law and procedures. Timeframes for the consideration of claims and payment proposals in a bankruptcy case do not mesh with the bulk processing operations established for the high volume of administrative offers in compromise received by the Service. Rather than trying to integrate processes that are inherently incompatible, the Service considers payment proposals submitted by taxpayers in bankruptcy through the plan confirmation process.

Employees of the Service's Insolvency function are responsible for protecting the Service's interests in bankruptcy cases and are the first to consider payment proposals, usually in the form of a proposed plan, regarding the payment of the Service's claims in a bankruptcy case. See IRM 25.17.1.3 and 25.17.3.2. Insolvency employees are charged with processing bankruptcy cases fairly and efficiently, in a manner that balances the interests of the debtor and the Government, while also attempting to collect the proper amount of tax. See IRM 25.17.1.3(5).

Under provisions of the Bankruptcy Code, a plan cannot be confirmed unless it provides for the full payment of the Service's priority tax claims, or the Service agrees to different treatment. See 11 U.S.C. §§ 1129(a)(9)(C), 1222(a)(2), and 1322(a)(2). The Service's discretion to acquiesce in less favorable treatment of its priority claims is not a valid basis for ordering the Service to alter its administrative offer in compromise program to accommodate taxpayers in bankruptcy. Court orders directing the Service to alter the processes by which it administers its authority to compromise as well as the processes by which it administers its interests as a creditor in bankruptcy are in the nature of writs of mandamus and go beyond the authority granted to bankruptcy courts under section 105 of the Bankruptcy Code.

Courts will not compel Service employees to perform acts where there is no showing of a clear right to the relief sought, and no clearly defined duty to do the act in question. See, e.g., Georges v. Quinn, 853 F.2d 994 (1st Cir. 1988) (taxpayer not entitled to order compelling the Service to use delinquent-filed tax returns in place of substitute returns created and used by the Service in assessing his tax deficiency); Stang v. Internal Revenue Service, 788 F.2d 564 (9th Cir. 1986) (mandamus jurisdiction did not exist where the Service did not owe the plaintiff a nondiscretionary duty to assess his taxes on demand); Wingreen Co. v. United States, 412 F.2d 1048 (5th Cir. 1969) (viewing an order directing the Service to audit a debtor's books and records as one in the nature of mandamus, the district court was without jurisdiction to enter the order because the Service owed no duty to the trustee to make the determination he sought); Short v. Murphy, 512 F.2d 374 (6th Cir. 1975) (mandamus relief properly denied where the court determined that furnishing additional information sought by the taxpayer was discretionary, not mandatory or ministerial).

Consistent with its responsibility to protect the Government's interests, the Service will not accept less than what is statutorily required to be paid under the Bankruptcy Code unless the taxpayer demonstrates that agreeing to receive less under a bankruptcy plan is in the Government's best interests. This is a discretionary determination to be made in the context of the particular bankruptcy case, through consideration of a proposed bankruptcy plan, and not through the Service's administrative offer in compromise procedures. In order to be considered, the plan may not provide for the payment of claims with lower priority than those of the Service, and all income that is not necessary for the health and welfare of the debtor's family or the production of income must be committed to the plan. In addition, other factors that may be considered in determining whether it is in the Government's best interest to accept less favorable treatment than is statutorily required under the Bankruptcy Code include, but are not limited to:

whether the taxpayer has the ability to pay the Service's claims as required under the Bankruptcy Code,

whether the taxpayer is in compliance with tax return filing requirements,

the extent of the taxpayer's previous noncompliance with filing and payment requirements,

whether creditors with the same priority, such as state taxing authorities, are accepting less than full payment of their claims,

whether the Service would receive more if the bankruptcy case is dismissed or converted to a Chapter 7 liquidation,

the amount of time remaining on the statute of limitations for collection,

whether there is anything precluding the debtor from dismissing the bankruptcy case and submitting an administrative offer in compromise (e.g., is the Service the only creditor in the case), and

whether the tax liabilities are nondischargeable.

The taxpayer has the burden of demonstrating that it is in the Government's best interest to accept less favorable treatment than is statutorily required in a bankruptcy case.

Offers in compromise submitted on Forms 656 by taxpayers who are currently in bankruptcy will continue to be returned as nonprocessable under the procedures set forth in Rev. Proc. 2003-71 and IRM 5.8 et seq. Payment proposals submitted by taxpayers in bankruptcy will be considered by Insolvency employees in the context of their review of proposed plans, subject to the time constraints and other factors that are unique to bankruptcy litigation, and will be accepted when it is in the interest of the United States to do so.

Questions about this Notice should be directed to Collection, Bankruptcy & Summonses, Branch 2 at 622-3620.

/s/
DEBORAH A. BUTLER
Associate Chief Counsel
(Procedure & Administration)

United States Court of Appeals for the Fourth Circuit

MICHAEL J. MORONEY

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA; INTERNAL REVENUE SERVICE,

Defendants-Appellees.

(In Re: MICHAEL J. MORONEY, Debtor.)

Docket No. 02-2417

Date of Decision: December 19, 2003

Judge: Wilkinson, J. Harvie, III

Tax Analysts Citation: 2003 TNT 245-23

Principal Code Reference: Section 6871

Summary

Provided by Tax Analysts. Copyright 2004 Tax Analysts. All rights reserved.

LATE-FILED RETURNS DON'T QUALIFY AS RETURNS.

The Fourth Circuit, affirming a district court, has held that an individual's late-filed returns did not qualify as returns and that his prebankruptcy taxes weren't discharged in bankruptcy.

Michael Moroney filed for bankruptcy in 2000 and was granted a general discharge. In 2001 Moroney moved to reopen the bankruptcy case to determine the dischargeability of his 1990 and 1992 income taxes. Moroney hadn't filed timely returns for those years, and the IRS posted substitute returns for them in 1993. In July 1995 the IRS assessed the liabilities for both years. In 1998 Moroney filed his 1990 and 1992 tax returns. The bankruptcy court held that the taxes weren't discharged.

A U.S. district court noted that under 11 U.S.C. section 523(a)(1)(B)(i), taxes won't be discharged if no return was filed, and the issue was whether Moroney's documents were returns. The court noted that they were filed five years late, after the IRS had assessed taxes. The court looked to the Sixth Circuit's decision in *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), in which a test was adopted to determine what is a tax return under the bankruptcy code. The final prong provides that a document must be an honest and reasonable attempt to satisfy the requirements. The court, noting that there was no reason for the untimely filing, found that Moroney failed to show he had an honest intent to obey his filing duty. *Michael J. Moroney v. United States (In re Michael J. Moroney)*, Civil Action No. 02-1062-A (E.D. Va. Oct. 30, 2002.) (For the full text, see *Doc 2002-26338 (13 original pages)* or *2002 TNT 233-4.*)

Circuit Judge J. Harvie Wilkinson III noted that neither the bankruptcy code nor the tax code define "return." The court noted that the parties agree that Moroney's documents satisfy the first three *Hindenlang* requirements. Judge Wilkinson found that a debtor's delinquency is relevant to determining if the debtor filed a

return and there is no question that Moroney failed to timely file returns. Judge Wilkinson held that income tax forms unjustifiably filed years late, when the IRS had already prepared substitute returns and assessed taxes, aren't returns under 11 U.S.C. section 523(a)(1)(B)(i).

Full Text

Provided by Tax Analysts. Copyright 2004 Tax Analysts. All rights reserved.

**UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT**

Appeal from the United States District Court
for the Eastern District of Virginia, at Alexandria.

James C. Cacheris, Senior District Judge.

(CA-02-1062-A, BK-00-11276-SSM, AP-01-1194)

Argued: October 30, 2003

Decided: December 19, 2003

Before WILKINSON and TRAXLER, Circuit Judges, and
Robert E. PAYNE, United States District Judge for the
Eastern District of Virginia, sitting by designation.

Affirmed by published opinion. Judge Wilkinson wrote the opinion, in which Judge Traxler and Judge Payne joined.

COUNSEL

ARGUED: Marla Lynn Howell, DECARO & HOWELL, P.C., Upper Marlboro, Maryland, for Appellant. Kenneth L. Greene, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellees. **ON BRIEF:** Thomas M. DeCaro, Jr., DECARO & HOWELL, P.C., Upper Marlboro, Maryland, for Appellant. Eileen J. O'Connor, Assistant Attorney General, Paul J. McNulty, United States Attorney, Ellen Page DelSole, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellees.

OPINION

WILKINSON, Circuit Judge:

[1] The question in this case is whether delinquent personal income tax filings, submitted years after the Internal Revenue Service has already prepared its own assessments, constitute "returns" for purposes of the Bankruptcy Code. A debtor in bankruptcy is permitted to discharge personal income tax liabilities, but only if he has filed a return with the IRS reporting those tax liabilities. In the present case, because the debtor's eventual submissions were neither honest nor reasonable attempts to comply with the tax laws, both the bankruptcy and district courts found that no returns had ever been filed. We affirm that judgment.

I.

[2] The basic facts in this case are not in dispute. Debtor Michael J. Moroney did not submit timely personal income tax filings for either the 1990 or 1992 tax years. Moroney never offered any evidence to the bankruptcy or district courts to explain his late filing. When asked before the district court, Moroney's attorney said that Moroney "just didn't get around to filing his tax returns," because he had been "extremely busy" with his job. Filing tax statements "was just something that got pushed to the back burner."

[3] As a result of Moroney's failure to file, in 1994 the IRS began to examine Moroney's income tax liabilities. The IRS then independently prepared "Substitutes for Returns" ("SFRs") to determine the amounts that Moroney owed for the 1990 and 1992 tax years. On the basis of the SFRs, the IRS assessed taxes against Moroney of \$23,197.00 for the 1990 tax year and \$45,567.00 for the 1992 tax year.

[4] At some point thereafter, Moroney submitted income tax statements for 1990 and 1992. The IRS contends that Moroney did not file his forms until November 1998. Moroney, however, points to communications between his accountants and the IRS that indicate the forms were filed two years earlier in November 1996. Regardless, Moroney concedes that his forms postdated by at least two years the SFRs prepared by the IRS, and that his forms postdated the original filing deadlines by at least four and six years, respectively. Because Moroney's forms reported tax liabilities that were less than the IRS's assessments, the IRS lowered Moroney's unpaid assessments. Specifically, the IRS abated \$8,330 of the 1990 tax year assessment and \$14,980 of the 1992 tax year assessment.

[5] On March 23, 2000, Moroney filed a voluntary petition for Chapter 7 bankruptcy in the United States Bankruptcy Court for the Eastern District of Virginia. Moroney listed his 1990 and 1992 tax liabilities as nonpriority claims, subject to discharge in a Chapter 7 proceeding. However, the IRS notified Moroney that, given his delinquency in filing for those years, it did not consider his tax liabilities subject to discharge. The IRS and Moroney filed cross-motions for summary judgment before the bankruptcy court, seeking a determination of whether Moroney's tax liabilities were excepted from discharge under Section 523 of the Bankruptcy Code. The bankruptcy court held that Moroney had not filed a "return" within the meaning of Section 523 and therefore that Moroney's tax liabilities were not dischargeable in bankruptcy. On appeal, the United States District Court for the Eastern District of Virginia affirmed the bankruptcy court's grant of summary judgment. Moroney now challenges the decisions of the bankruptcy and district courts.

II.

[6] In general, a debtor filing for relief under Chapter 7 of the Bankruptcy Code is discharged from all pre-petition debt, subject to the exceptions enumerated in Section 523. In relevant part, Section 523 provides:

(a) A discharge under section 727 . . . does not discharge an individual debtor from any debt --

(1) for a tax or a customs duty --

* * *

(B) with respect to which a return, if required --

(i) was not filed; or

(ii) was filed after the date on which such return was last due . . . and after two years before the date of the filing of the petition; or

--

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

11 U.S.C. § 523 (2000). The exception at issue here, set forth in Section 523(a)(1)(B)(i), excludes from discharge taxes "with respect to which a return, if required[,]" "was not filed."¹ The question is whether Moroney's late-filed forms constitute returns, thus rendering his tax liabilities dischargeable.

A.

[7] Neither the Bankruptcy Code nor the Internal Revenue Code defines the term "return." The Internal Revenue Code generally requires that those owing taxes "make a return or statement" on the necessary forms, without specifying how timely the forms must be in order to qualify as returns. 26 U.S.C. § 6011(a) (2000). However, our sister circuits have uniformly held that in order for a document to be considered a "return," under either the bankruptcy or the tax laws, it must (1) purport to be a return; (2) be executed under penalty of perjury; (3) contain sufficient data to allow calculation of tax; and (4) represent an honest and reasonable attempt to satisfy the requirements of the tax laws. *See, e.g., In re Hindenlang*, 164 F.3d 1029, 1033 (6th Cir. 1999) (citing *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)); *In re Hatton*, 220 F.3d 1057, 1060-61 (9th Cir. 2000) (citing *Hindenlang* and *Beard*).

[8] Moroney and the IRS agree that Moroney's late-filed statements purported to be returns; that they were executed under penalty of perjury; and that they contained sufficient data to permit calculation of Moroney's taxes, although of course the IRS had already determined Moroney's taxes using SFRs. Moroney and the IRS's disagreement concerns whether Moroney's statements were honest and reasonable attempts to satisfy the filing requirement imposed by the bankruptcy and tax laws.

[9] More fundamentally, they disagree about the relevant time frame in which to assess the honesty and reasonableness of Moroney's belated statements. Moroney contends that his purported returns satisfy the filing requirement, because -- at the time they were filed -- they were accurate on their face and intended to comply with the tax laws. Moroney notes that some courts in determining good faith have focused on the debtor's intent at the time the returns are filed, rather than on the debtor's intent during the delay prior to filing. *See, e.g., In re Nunez*, 232 B.R. 778, 783 (B.A.P. 9th Cir. 1999);² *In re Crawley*, 244 B.R. 121, 128 (Bankr. N.D. Ill. 2000).

[10] The IRS, however, rejoins that most courts have not ignored a debtor's delinquency in filing, especially where the IRS's interim preparation of a SFR renders the debtor's filing unnecessary. According to these courts, forms filed after an involuntary assessment do not serve the purposes of the tax system, and thus rarely, if ever, qualify as honest and reasonable attempts to comply with the tax laws. *See, e.g., Hindenlang*, 164 F.3d at 1034; *In re Sgarlat*, 271 B.R. 688, 696 (Bankr. M.D. Fla. 2001); *In re Hetzler*, 262 B.R. 47, 54 (Bankr. D.N.J. 2001); *In re Walsh*, 260 B.R. 142, 151 (Bankr. D. Minn. 2001); *In re Pierchoski*, 243 B.R. 267, 271 (W.D. Pa. 1999); *In re Prince*, 240 B.R. 261, 263-64 (Bankr.

N.D. Ohio 1999).

[11] We agree with the weight of authority that a debtor's delinquency is relevant to determining whether the debtor has filed a return. The very essence of our system of taxation lies in the self-reporting and self-assessment of one's tax liabilities. See *Commissioner v. Lane Wells Co.*, 321 U.S. 219, 223 (1944). Timely filed federal income tax returns are the mainstay of that system. A reporting form filed after the IRS has completed the burdensome process of assessment without any assistance from the taxpayer does not serve the basic purpose of tax returns: to self-report to the IRS sufficient information that the returns may be readily processed and verified. See *id.*; *United States v. Boyle*, 469 U.S. 241, 249 (1985). Simply put, to belatedly accept responsibility for one's tax liabilities, only when the IRS has left one with no other choice, is hardly how honest and reasonable taxpayers attempt to comply with the tax code. See *Hatton*, 220 F.3d at 1061.

[12] Here, there is no question that Moroney failed to file timely returns, and that as a result of his failure, the IRS had to assume the onerous task of estimating Moroney's taxes without his assistance. Moroney did not explain to the bankruptcy or district courts why his eventual filings were anything other than self-serving attempts to reduce his tax liabilities. And he never attempted to explain why his statements, which were submitted at least four to six years after the original deadlines, should be considered honest and reasonable attempts at compliance with the tax laws. To consider Moroney's statements "returns" would thus be to render that word a ghost of its true self. In fact, by Moroney's own admission, he simply did not "get around to filing his tax returns." As the district court correctly observed, such nonchalance falls well short of satisfying the statutory standard.

B.

[13] However, Moroney argues that his late-filed statements, despite their extreme delinquency, functioned no differently from timely filed tax returns. His statements, like timely filed returns, self-reported his tax liabilities. And although the IRS had prepared SFRs before Moroney filed, Moroney contends that his statements still were not purposelessly duplicative. Rather, because his statements showed lesser liabilities than the IRS had estimated, the IRS abated portions of its prior assessments. In Moroney's view, his statements must be considered honest and reasonable attempts to comply with the tax laws -- after all, the IRS credited them enough to reduce his assessments.

[14] Moroney's argument, however, misses the point. The relevant inquiry is whether Moroney made an honest and reasonable effort to comply with the tax laws, and not whether Moroney's eventual effort had some effect on his tax liability. Under Moroney's approach, the availability of discharge would turn on the IRS's accuracy in assessing taxes, rather than on Moroney's sincerity and diligence in complying with the tax code. In effect, Moroney failed to provide the IRS with the very information it needed to accurately assess his taxes, and now he seeks to benefit from the IRS's resulting imprecision (which was hardly surprising, given Moroney's lack of assistance). Moroney's approach would only discourage the IRS from abating debtors' tax liabilities -- especially when any adjustment, no matter how small, would lead to a discharge of the entire tax liability, no matter how large.

C.

[15] Moroney also argues that any inquiry into his honesty and reasonableness in filing late should occur not under Section 523(a)(1)(B)(i), which excepts from discharge taxes for which returns were never filed; but instead under Section 523(a)(1)(C), which excepts from discharge taxes "with respect to which the debtor has made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." In Moroney's view, Section 523(a)(1)(B)(i) requires only that a statement be filed. To the extent that the statement is inaccurate, incomplete or untimely, that is the purview solely of Section

