

# Federal Tax Issues in Bankruptcy

## A View From Your Friends at the IRS and DOJ

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### I. Obtaining Information

A. The IRS cannot disclose taxpayer information to third parties without a power of attorney form. I.R.C. § 6103 [except for trustees – see sec. 6103(e)(4) & (5)]

1. Power of Attorney Forms are available online at [irs.gov](http://irs.gov) (type in “Form 2848” in the search box).

a. Years, taxes at issue strictly construed

b. POA is only effective for tax periods up to three years from date

of POA

2. Taxpayer’s signature and date

a. Faxed signatures are acceptable

b. Facsimile signatures (*i.e., digital or electronic*) are not acceptable. Notice 2004-54

3. Power of attorney forms are sent to the Ogden campus, so when contacting the IRS attach a copy of form until the original is processed.

4. Oral Consent to Disclosure

a. authorized by Treas. Reg. § 301.6103(c)-1T(b) and IRM

21.1.3.3.2

b. IRS must verify the identity of the taxpayer (so, you can’t call on the debtor’s behalf).

5. Form 8821 (Tax Information Authorization) – information only; cannot represent or advocate

6. E-Services access (see [irs.gov](http://irs.gov) for more information)

### B. How to Request Return Transcripts:

1. Debtors who do not have copies of their returns can obtain a tax return transcript which shows most of the line items of a return as filed. The return transcript is not a copy of the return but a computerized transcript.

a. Use Form 4506-T to request a copy of the return transcript (don’t ask for an account transcript – an account transcript contains only a summary of the return).

b. Transcripts can also be ordered by calling 1-800-908-9946.

c. There is no charge to obtain a transcript.

d. Return transcripts are available for the current and nine prior calendar years.

2. Copies of the debtors' tax returns can also be requested.
  - a. Use Form 4506 to get a copy of the actual return.
  - b. There is a user fee of \$57 for each return requested.
  - c. Takes up to 60 days to process.
  - d. Copies of individual returns are usually available for 7 years from the date of filing. Business returns may be available for a longer period.
3. Forms 4506, 4506-T and other forms can be found on irs.gov.

C. Also see Publication 908, *Bankruptcy Tax Guide*.

## II. Providing for the IRS Claim

### A. Notice of Filing:

1. Make sure the IRS is given proper notice of the bankruptcy.
  - a. If the IRS is not given proper notice, your client may not be discharged of their IRS liabilities. 11 U.S.C. § 523(a)(3)
  - b. IRS address to be used for giving notice of a bankruptcy:  
Internal Revenue Service  
P.O. Box 7346  
Philadelphia, PA 19101-7346
  - c. Don't send notice if no taxes due
    - i. generates estimated tax POC (automated)
    - ii. limitations on Insolvency staff

### B. Debtors need to file tax returns.

1. Current year return. 11 U.S.C. § 521(e)
2. Certain unfiled past-year returns. 11 U.S.C. § 521(f)
  - a. In Ch. 13 cases, by the date of the 341 hearing debtors are to file "all tax returns for all taxable periods ending during the 4-year period on the date of the filing of the petition" 11 U.S.C. § 1308(a)
3. Post-petition returns. 11 U.S.C. § 521(j)
  - a. Send to Insolvency & Service Center, not just to Trustee
4. Failure to file is grounds for denial of discharge or denial of confirmation of plan. BAPCPA § 1228; 11 U.S.C. §§ 1112; 1307(e)

### C. Debtors need to pay postpetition taxes.

1. In a Chapter 11 case, failure to file or pay post petition taxes for debtors in chapter 11 can result in the case being dismissed or converted to another chapter under 11 U.S.C. §§ 1112 or 1116
2. In a Chapter 13 case, if tax returns are filed but liabilities not paid postpetition, IRS can file an 11 U.S.C. § 1305 claim and add in the amount of postpetition tax liabilities to the bankruptcy.
  - a. IRS can levy on post-petition earnings of debtor. Heath, 115 F.3d 321 (7<sup>th</sup> Cir. 1997)
  - b. Failure to pursue post-petition collection could result in blown statute of limitations – if property remains with debtor and not estate. Kolve, No. 10-18348-7 (Bankr. W.D. Wis. Sept. 22, 2011). This is usually not the case with the standard plans used in Wisconsin.

3. Debtor statistically unlikely to complete plan and receive discharge if not current on postpetition tax payments.

D. Impact of the Automatic Stay:

1. The IRS can audit and assess taxes without violating the automatic stay. 11 U.S.C. § 362(b)(9)(A) & (D)
2. The IRS may issue a Notice of Deficiency. 11 U.S.C. § 362(b)(9)(B)
  - a. While in bankruptcy, the stay prevents the debtor from filing a petition in Tax Court. 11 U.S.C. § 362(a)(8). If the debtor files a Tax Court petition after filing bankruptcy, the Tax Court proceeding will be dismissed (unless the debtor lifts the stay).
  - b. If the debtor files a Tax Court petition prior to filing bankruptcy, the Tax Court proceeding will be stayed pending the resolution of the bankruptcy.
3. The IRS can issue a demand for payment. 11 U.S.C. § 362(b)(9)(D)
3. Filing for bankruptcy extends the statute of limitations for assessment and collection. I.R.C. § 6503(h)

E. Offset:

1. IRS has a right of offset. 11 U.S.C. § 553; I.R.C. § 6402.
2. Automatic stay does not apply to setoff of prepetition refunds against prepetition tax debts. 11 U.S.C. § 362(b)(26)
3. IRS will lift stay for other refunds. 11 U.S.C. § 362(a)(7)
  - a. Why does this benefit the debtor?
    - (1) Only 1/3 of ch 13 result in discharge (ABI paper)
    - (2) For 2010, only 25% in E.D. (Grossman & King)
    - (3) No fresh start for debtors if they get windfall from refund
    - (4) At 3% interest, better to pay IRS claim via refund
  - b. Even if trustee does not request ½ of refund, IRS can offset the full amount. So debtor will not get full refund back if has post-petition tax debts.
  - c. 2012 refunds are pre-petition; please don't have debtors call Insolvency to ask where refunds are.

F. Reorganization Plans:

1. No outside of plan agreements, the IRS must be accounted for in full in the plan.
2. IRS gets equal payments throughout the plan. 11 U.S.C. §§ 1129 & 1322
3. Interest at IRS rate as of date of plan confirmation. 11 U.S.C. § 511; I.R.C. § 6621 (currently 3%)
4. Plan should provide that if default occurs, IRS may take administrative collection action. Alternative is motion to lift stay or motion to convert/dismiss.

III. Proof of Claim

A. IRS has 180 days from the date of filing to file a proof of claim. 11 U.S.C. § 502(b)(9)

1. Can also file within 90 days of 341 hearing. Rule 3002(c).
2. In ch. 13, 60 days from date of filing of return. 11 U.S.C. § 1308.

3. Extended time for ch. 7 priority claims. 11 U.S.C. § 726(a).

B. IRS will estimate the tax claim if no return has been filed or if the amount is in dispute. This may mean secured or priority amounts on the POC beyond the debtor's expectations (or the plan limits).

1. Also, in order to properly reflect any taxes owed on the proof of claim, copies of returns can be sent directly to Insolvency to expedite the assessment of any liability.

2. Returns still need to be filed with the proper Service Center.

C. Husband and wife cases

1. If husband and wife file joint returns, they are jointly and severally liable for the taxes.

a. The amounts are assessed against both social security numbers

b. Proof of claim will show amounts for both social security numbers but will only be collected once.

2. If one spouse is granted tax relief (e.g., under I.R.C. § 6015); IRS creates a special Non-Master File account. A NMF account generally does not operate systemically, but must be checked/updated/alterd personally.

D. Unless you are otherwise instructed by Insolvency, payments should be mailed to:

Internal Revenue Service

P.O. Box 7317

Philadelphia, PA 19101-7317

*NOTE: For ch. 11 cases, talk to Insolvency for payment locations.*

E. Rate of interest = 3% as of October 1, 2011.

1. See B.C. § 511 (rate of interest on tax claims); IRC § 6621(a)(2) (underpayment rate); Rev. Rul. 2011-5

2. May change quarterly

F. Notice

1. If IRS automatically included in creditor matrix (i.e., automatically noticed), will file automatic estimated POC (Ames issue)

2. IRS will amend POC to reflect filed returns, payments outside of bankruptcy, abatements.

a. IRS will not amend POC to reflect in-plan payments or amounts received from setoff (the trustee is told of setoff amounts).

b. Trustees will only pay POC amounts, even if Plan provides for greater amount.

IV. Referral of Bankruptcy Litigation

A. IRS Insolvency will refer an objection or adversary complaint to SBSE Counsel (Milwaukee), along with any information pertaining to the controversy (such as the proof of claim filed by the Service, the amount of the liability at issue, copies of any notices of federal tax liens and any other pertinent information).

1. SBSE Counsel reviews the referral from the Insolvency Group to determine whether any other information is needed, including transcripts of accounts.
2. SBSE Counsel reviews the pleadings and determines the position of the Internal Revenue Service with consultation from the Insolvency Group.
3. SBSE Counsel may prepare a litigation memorandum for the United States Department of Justice regarding the factual and legal positions pertaining to the litigation.
4. The Department of Justice has primary litigation responsibility but consults regularly with SBSE Counsel and Insolvency.
5. Prior to the initiation of litigation through an objection to claim or complaint or dischargeability, the Service prefers an administrative contact be made with Insolvency.

B. If secured amount in dispute, call before filing adversary action

1. If IRS undersecured, will file amended POC
2. Adversary needed only if serious valuation dispute

C. Special Assistant United States Attorney

1. Acts as United States Attorney for all purposes in bankruptcy court.
2. Department of Justice (D.C.) may still handle complex litigation (adversary proceedings or substantive tax determinations).

V. Resolving Federal Tax Liabilities Without Filing for Bankruptcy

A. See Publication 594 - *The IRS Collection Process*

B. Installment Agreement (IA) - I.R.C. § 6159

1. Debtor pays tax over a period of time (like a loan).
  - a. Interest continues to run on the tax debt.
  - b. Debtor must pay other taxes on time or IA will be cancelled.
2. Use Form 9465 (available on irs.gov).
  - a. Online Payment Agreement available if tax debt >\$25K.
  - b. User fee of \$105 (\$52 for direct withdrawal).
3. The IRS is more expensive to borrow from than a bank.

C. Offer in Compromise - I.R.C. § 7122

1. Debtor makes an offer to pay less than the amount owed.
  - a. If accepted, remaining liability is abated.
  - b. Payment need not be 100% lump sum (can be combined with installment agreement).
2. Use Form 656.
  - a. User Fee of \$150 plus 20% of total offer
  - b. Exceptions for low-income taxpayers
3. Categories under which the IRS may accept an Offer in Compromise:
  - a. Promote Effective Tax Administration
  - b. Doubt as to Liability
  - c. Doubt as to Collectibility

4. General Rule. Offers in compromise will not receive favorable consideration unless it can be established that the Service will collect more from a compromise than from a liquidating bankruptcy proceeding.

a. Offers before bankruptcy – taxpayer considerations:

- i. What portion of the tax would be dischargeable?
- ii. What assets are exempt from bankruptcy or abandoned and subject to postbankruptcy collection?
- iii. Was there a fraudulent return or willful attempt to evade or defeat collection of the proper tax liability?
- iv. What is the IRS equity in assets (including accounts receivable)?

b. The Service will not compromise for anything less than net realizable equity in assets to which the federal tax lien has priority.

4. Offers during bankruptcy - the Service will not consider an offer in compromise where a bankruptcy matter is currently proceeding.

#### D. Appeals

1. Taxpayers can have any liability determination reviewed by the Office of Appeals (a tax liability is proposed in a 30-day letter and confirmed in statutory notice of deficiency, after which the tax is assessed).

2. Appeals will also review administrative collection actions.

3. Although part of the IRS, Appeals is independent of Exam and Collections.

#### E. Taxpayer Advocate – I.R.C. § 7803(c)

1. Independent organization within IRS.

2. Assists taxpayers faced with economic harm and/or delay in IRS response.

*Feel free to call me or Insolvency (414/231-2201) before filing an objection to claim, adversary proceeding, motion to dismiss proof of claim, etc., as we may be able to resolve issues before incurring your clients additional costs.*