

# Federal Tax Issues in Bankruptcy

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## I. Obtaining Tax Return Information

### A. How Do I Get a Copy of a Tax Return?

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. Type in “Get Transcript” at [irs.gov](http://irs.gov).

b. Use Form 4506-T to request a copy of the return transcript by mail (this should take 5 – 10 days)

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

2. There is no charge to obtain a transcript

3. Return transcripts are available for the current and 3 prior calendar years.

B. You can use the same method to obtain an *account* transcript. An account transcript is a brief history of the taxpayer’s account, showing the date the return was filed, any payments, credits or refunds, some of the notices that were sent to the taxpayer, and any tolling events (such as litigation, Collection Due Process requests, installment agreements and/or offers in compromise).

1. Account transcripts are available for the current and 9 prior tax years.

2. You can also request a Wage and Income transcript for the same periods. A W&I transcript contains data from information returns such as W-2, 1098, 1099 and 5498 (IRA).

### C. Copies of the debtors' tax returns can also be requested

1. Use Form 4506 to get a copy of the actual return

2. There is a user fee of \$50 for each return requested

3. Takes up to 75 days to process

4. Copies of individual returns are usually available for 7 years from the date of filing. Business returns may be available for a longer period.

5. Forms 4506, 4506-T and other forms can be found on [irs.gov](http://irs.gov).

### D. IRS Walk-in no longer stamps copies of returns

1. Neither does Insolvency

2. Stamped copy does not mean the IRS accepted the return for processing. See “How do I get a Proof of Claim Amended?” below.

## II. Disclosure of Tax Information

A. The IRS cannot disclose taxpayer information to third parties except as provided by statute. This usually means we can't disclose without a Power of Attorney (POA) form. I.R.C. § 6103 [except for trustees – see sec. 6103(e)(4) & (5)]

1. No POA is needed by the attorney of record if the IRS filed a proof of claim in the bankruptcy

2. POA will be needed to discuss:

- a. post-petition debts
- b. debts not included on the proof of claim
- c. non-debtor spousal debts if only one spouse files the petition
- d. any tax debt if the bankruptcy case is closed

3. POA Forms are available online at irs.gov (type in "Form 2848" in the search box).

a. Years, taxes at issue are strictly construed (for example, if the POA lists only the 2013 year, you will not be able to discuss the 2012 year, even if that year directly impacts 2013 or both years are under audit).

b. POA is only effective for tax periods up to three years after the date POA was signed.

4. Taxpayer's signature and date:

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

5. 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.

### B. 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, but you may be present when the debtor calls).

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

D. E-Services access (see irs.gov for more information)

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

## III. How do I contact the IRS?

### 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 tax liabilities. B.C. § 523(a)(3)

b. You can provide a notice to local Insolvency and/or Counsel, but these do not provide official notice and are not forwarded. Instead, send notice to Centralized Insolvency (the IRS bankruptcy computer center) at this address:

Internal Revenue Service  
P.O. Box 7346  
Philadelphia, PA 19101-7346

B. Address to mail payments:

Internal Revenue Service  
P.O. Box 7317  
Philadelphia, PA 19101-7317

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

C. Who to contact? Look on proof of claim.

1. If POC outdated, that Insolvency Specialist will refer you to current Specialist
2. UNAX (an IRS rule to protect taxpayer information) limits employee access to cases, so only the assigned Specialist can access the account
3. If no Specialist assigned, or Specialist is not responding, call **Mark Miller (414) 231-2422**
4. Counsel does not have access to account information – we get it from the Specialist.

D. How to request a Prompt Determination

1. See Rev. Proc. 2006-24 & Announcement 2011-77
2. Address:  
IRS  
Centralized Insolvency Operation  
P.O. Box 7346  
Philadelphia, PA 19101-7346  
Attn: Request for Prompt Determination
3. Letter must be dated *after* end date of taxable year for which request for determination is made (i.e., you can't request a determination for a year that has not yet ended).

IV. Providing for the IRS' Claim

A. Debtors need to file tax returns (also see the section on post-petition taxes in the Intermediate section).

1. Current year return. B.C. § 521(e)
2. Certain unfiled past-year returns. B.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" B.C. § 1308(a)

b. Note: under the Long (docket no. 19-20186) decision (7/22/19), the debtor does not have to file the current year return prior to the due date (or extended due date) under B.C. § 1308. If no return is filed, however, the IRS will file an estimated claim, and will only amend this estimate if a return is filed.

c. Insolvency may send a Letter 1714 to remind debtor of missing returns – usually not sent between Jan – May (filing season).

3. Post-petition returns. B.C. § 521(j)

a. Send to IRS Service Center, not just to Trustee +/- Insolvency

4. Failure to file is grounds for denial of discharge or denial of confirmation of plan. BAPCPA § 1228; B.C. §§ 1112; 1307(e)

a. The IRS will not file a motion to dismiss if a post-petition return is not filed or paid. Because post-petition years are not automatically coded as being in bankruptcy, the debtor may get collection notices if post-petition taxes are not paid.

b. If the debtor consistently fails to pay post-petition taxes, the IRS may take collection action against exempt assets or other property not subject to the stay.

5. Returns on Extension. Your client does not need to file a tax return until April 15, and can get an extension until October 15. But, if a return is not filed, we must estimate our proof of claim. If you object that our claim is wrong, we will argue to the Court that we cannot amend unless a return is filed.

## B. Proof of Claim

1. IRS has 180 days from the date of filing to file a proof of claim. B.C. § 502(b)(9)

a. Can also file within 90 days of initial 341 hearing. Rule 3002(c).

b. In ch. 13, 60 days from date of filing of return. B.C. § 1308.

c. Extended time for ch. 7 priority claims. B.C. § 726(a).

2. 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).

3. Once the return posts, the claim will be amended with the notation "per return." If you need the return amended sooner, see Section V below.

4. If the IRS does not file a POC, you can file a claim for the IRS under B.C. § 501(c) [but note (b) & (c) below]

a. Must be done within 30 days *after* bar date for Government claims. Bankruptcy Rule 3004.

b. If the IRS did not file a claim, there is no one assigned to the case. Payments made by debtors on the claim you filed may be misapplied. Also, the amount you list may not agree with the amount on the IRS' system.

c. If the IRS has not filed a claim, and you think the debtor owes us, **contact Counsel**. We will ask Insolvency if there is a balance due and, if needed, file a claim.

## C. Priority claims

1. Under B.C. § 507(a)(1)(8), taxes for which a return was last due, *with extensions*, up to three years prior to filing is a priority tax.

a. Tax is incurred by the bankruptcy estate on the last day of the taxable period. Hy-Test v. Missouri Dept. of Revenue, 143 B.R. 707 (Bnk. E.D.Mo

1992) affd. 64 F.3d 1146 (8<sup>th</sup> Cir. 1995); Towers for Pacific-Atlantic Trading Co. v. United States, 64 F.3d 1292 (9<sup>th</sup> Cir. 1995).

2. Also taxes for any year which were assessed within 240 days of filing  
3. Also taxes for pre-petition years which are assessed post-petition  
4. Note the tolling provisions in section 507(a)(1)(8)(A)(ii) and the unnumbered paragraph following section 507(a)(1)(8)(G).

a. Generally speaking, the priority period will be extended for any period of time the debtor was in a prior bankruptcy or other court proceeding, or was involved in collection negotiations with the IRS (such as collection due process or an offer-in-compromise).

b. In addition to the tolled period(s), the IRS gets an additional 90 days for every tolling event.

c. You can find the tolling events on an account transcript.

5. Priority taxes include interest but not penalties. However, penalties may be nondischargeable under section 523.

6. Note that the IRS may collect accrued but unpaid interest after discharge. See Hanna v. United States, 872 F.3d 829 (8<sup>th</sup> Cir. 1989).

#### D. Secured claims

1. IRS attaches Notices of Federal Tax Liens to our proof of claim.

a. For lien priority determinations with the State of Wisconsin, the IRS and the State look to the assessment date (not the lien filing date).

b. For other priority determinations, I.R.C. § 6323 controls.

2. The secured portion of the claim is based on the property values as set out in the debtor's schedules.

a. The IRS may use exempt property to support our secured claim. I.R.C. § 6334, Matter of Voelker, 42 F.3d 1050 (7<sup>th</sup> Cir. 1994)

b. The IRS will not secure to ERISA pension plans. However, any tax lien against such pension will survive the bankruptcy. United States v. Snyder, 343 F.3d 1171, 1179 (9<sup>th</sup> Cir. 2003).

3. No lien stripping in chapter 13 cases. Ryan v. United States, 725 F.3d 623 (7<sup>th</sup> Cir. 2013). Follows Dewsnup v. Timm, 502 U.S. 410 (1992) (no lien stripping in chapter 7 cases).

4. The interest rate on secured claims is the Federal underpayment rate. This is set every 3 months by Revenue Ruling. Currently the rate is 5% (Rev. Rul. 2019-15).

#### V. How Do I Get a Proof of Claim Amended?

##### A. Proof of claim process

1. Centralized Insolvency (CIO, in Philadelphia) gets the notice of bankruptcy

2. Case is assigned to Insolvency Specialist's queue

a. No longer enough Specialists actually in Wisconsin, so overflow goes to Specialists in other states

b. Inventory rebalanced about every three months

c. Specialist in ch. 13 will keep case until plan confirmation, then returned to CIO

d. Ch. 7A, 11 & 12 go to Advisor (higher-grade Specialist)  
e. Ch. 7N not assigned, no POC filed – if assets are found, notice will go to Centralized Insolvency and a Specialist will be assigned

3. Specialist investigates case

- a. If return filed, Specialist will prepare and file POC
- b. If no return filed, Specialist will estimate claim
  - i. Some Specialists used to contact the debtor's attorney or Trustee to get copy of unfiled return; this is being phased out.
- c. If audit, Specialist will file estimated POC
  - i. If the IRS issues a statutory notice of deficiency, your client will need to lift the stay if they wish to challenge the assessment. B.C. § 362(a)(8)
  - ii. If the IRS does not issue a stat notice, the POC will not be amended (it will remain an "estimated" claim, even if the audit results in less tax due) – unless the debtor agrees to the audit results
  - iii. Best way to get audit completed and finalized is to expeditiously provide requested documents to Examiner/Revenue Agent.

B. Will the IRS amend the Proof of Claim?

1. No – if partial payment received (even if payment received outside of the bankruptcy)
2. Yes – if paid in full
3. Yes – if substantive change in tax (amended return, completed audit)
4. Yes – if offset
5. Yes – if return processed
  - i. Insolvency will amend POC to reflect return
    - (a) if return is e-filed, Insolvency will amend POC when status is "pending"
    - (b) if return is mailed to Service Center, Insolvency will amend POC when return posts (can be months if in filing season)
  - ii. If you need the return amended before this, you need to fax a signed copy of the return to the Insolvency Specialist on the claim (if the return was e-filed, also provide a copy of the Form 8879 signature authorization).
    - (a) follow-up with the Insolvency Specialist if the claim is not amended within 10 days
    - (b) please don't file objection to claim at the same time your client files the return – it's an unnecessary burden for the United States Attorney, who has to enter an appearance and file a response. If Insolvency is unresponsive, I understand your need to file to protect your client.
  - iii. claim won't be amended if the return requests a refund; if other years are under audit, or if the return is an amended return – in these cases, you'll have to wait for the return to actually post.

C. Adjustments (moving money)

1. This function is now with Centralized Insolvency (so Specialists can't make individual account adjustments without authorization)
2. Follow-up with Insolvency Specialist until client receives notification of adjustment (Form 4549 or other record of change).

D. Rate of interest = 5% since June 1, 2019.

1. See B.C. § 511 (rate of interest on tax claims); IRC § 6621(a)(2) (underpayment rate); Rev. Rul. 2019-15
2. May change quarterly

## VI. Impact of the Automatic Stay

A. The IRS may audit and assess taxes without violating the automatic stay.  
B.C. § 362(b)(9)(A) & (D)

B. The IRS may issue a Notice of Deficiency. B.C. § 362(b)(9)(B)  
1. While in bankruptcy, the stay prevents the debtor from filing a petition in Tax Court. B.C. § 362(a)(8).

2. If the debtor files a Tax Court petition after filing bankruptcy, the Tax Court proceeding will be dismissed (unless the debtor lifts the stay).

3. 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.

a. If the debtor wants to continue the Tax Court proceeding, the debtor needs to lift the stay.

C. The IRS may issue a demand for payment. B.C. § 362(b)(9)(D)

D. Filing for bankruptcy extends the statute of limitations for assessment and collection. I.R.C. § 6503(h)

## VII. 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. Can't make an IA while the debtor is in bankruptcy.  
a. If the debtor has a non-defaulted IA prior to bankruptcy, the IA will reactivate once Insolvency closes the bankruptcy case.  
b. The debtor should resume IA payments after the bankruptcy  
c. The debtor should not call Insolvency about the IA (Insolvency does not have access to IA information), but should contact whomever processed the IA initially (there's a contact person on the acceptance letter).

d. If the debtor has a direct-debit IA prior to bankruptcy, funds will continue to be withdrawn post-petition. The debtor may think the IRS is levying – but the IRS cannot cancel a direct-debit IA. Only the debtor can stop the payments by contacting his bank.

2. 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.

c. Use Form 9465 (available on irs.gov).

i. User fee of \$225 (\$107 for direct debit).

3. Online Payment Agreement may available

a. Individual tax debt must be less than \$50,000

- b. Business tax debt must be less than \$25,000.
  - c. Must have filed all past-due returns
  - b. User fee of \$149 (\$31 for direct debit).
4. 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-B (irs.gov).
    - a. User Fee of \$186 plus initial installment payment or 20% of total offer. Note that this amount is **not** refunded if the offer is rejected.
    - 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 (basically the equivalent of a chapter 7 liquidation).
    - c. Note that unless the Offer is fully consummated prior to filing (which is unlikely, as we usually have clauses that require filing compliance or installment payments), Insolvency will include the full amount of the pre-Offer tax liability on the proof of claim. I.R.M. 5.9.4.10.1. You may treat the Offer in the plan as an executory contract and pay according to the Offer's terms.
4. Offers during bankruptcy - the Service will not consider an offer in compromise where a bankruptcy matter is currently proceeding.

D. After Bankruptcy Concludes:

- 1. If the debtor had a valid installment agreement or offer in compromise prior to bankruptcy, that will be reactivated after the automatic stay lifts
- 2. The debtor needs to follow-up immediately after the bankruptcy concludes – once the IRS records that the automatic stay is lifted, we will cancel the installment agreement or offer if our records show a default

E. Office of 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 (collection due process).

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

F. 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.

3. Milwaukee office – (414) 231-2390

VIII. Tax Offsets and Refunds

A. IRS has a right of offset. B.C. § 553; I.R.C. § 6402.

1. Offset creates a secured claim. B.C. § 506(a)

B. Offsets of tax refunds do not require a motion to lift the stay. In re Pugh, Case No. 13-23483 (Bnk. E.D. WI) (memorandum decision May 27, 2014)

1. The word “refund” is shorthand for the process. It is more accurate to say that the debtor has a claim to a tax refund. For that claim to ripen into an actual refund, there must be monies owing to the debtor’s estate after offset. If no amount is left after the offset, there is no refund to become property of the estate. See Internal Revenue Service v. Luongo, 259 F.3d 323, 335 (5<sup>th</sup> Cir. 2001); In re Gould, 401 B.R. 415, 423-26 (9<sup>th</sup> Cir. BAP 2009); In re Lyle, 324 B.R. 128 (Bnk. N.D. Cal. 2005) (non-tax case with discussion on when debtor has a property interest in a tax overpayment).

2. I.R.C. § 6402(a) provides that in the case of any overpayment, the Service may credit such overpayment against any tax liability, and then refund any balance to the taxpayer.

3. Unless there is a net amount owing after offset, there is no actual refund to be issued to the debtor.

a. If the amount of the debtor’s overpayment for a tax year is less than the amount of the debtor’s acknowledged tax liability for all outstanding tax years, the Service will, under I.R.C. § 6402(a), credit the overpayment against the liability.

4. This process is not a setoff in the traditional sense

a. The IRS is not taking debtor’s property (like a bank setoff); instead, the IRS is keeping the property of the Government.

b. When the debtor has taxes withheld, those are taxes that are owed to the Government. The withheld taxes are the

Government’s money. If the taxpayer pays in more taxes than are owed, the taxpayer gets that money back in the form of a refund.

c. However, if the debtor claims a refund for the current tax year, but owes for prior years, the Government can keep that money –

because it's the Government's money which the debtor previously underpaid. The debtor's claim is denied.

C. How does this work in practice?

1. Offset occurs, the IRS sends a letter to debtor, notifying the debtor that the refund has been affected by an offset.

2. Insolvency notified by Centralized Insolvency, Specialist will amend POC (new language):

3. Below is the form language that we currently use in the first paragraph of the attachment to Form 410 Proof of Claim (where we breakout the actual amounts owed):

The United States has not identified a right of setoff or counterclaim. However, this determination is based on available data and is not intended to waive any right to setoff against this claim debts owed to this debtor by this or any other federal agency. All rights of setoff are preserved and will be asserted to the extent lawful.

Once we have offset a debtor's refund, the following language will replace the language above in the first paragraph (I've italicized the key change):

*The United States has the right of setoff or counterclaim(s) in the amount of \$ \_\_\_\_\_.*  
The identification of the right of setoff in the amount is based on available data and is not intended to waive or limit the right to setoff against this claim debts owed to this debtor by this or any other federal agency that have not been identified. All rights of setoff are preserved and will be asserted to the extent lawful.

4. The dollar amount shown (\$ \_\_\_\_\_) will be the amount that we have taken from the debtor's overpayment and applied to other tax debts. The amount shown also will be the difference in amount between the amended claim and the preceding claim, so everyone can see where the offset was applied. We will send a letter to the debtor with a more detailed explanation of how the offset was applied, as we have done in the past. The amended proof of claim will contain only the offset and not any other adjustments – if we have to show any outside payments, abatements or exam adjustments, we will file an additional amended claim, without the offset paragraph.

- a. POC provided to all parties
- b. no setoff letter

D. Exceptions – The IRS will move to lift stay in these situations:

- 1. non-tax debts (such as Affordable Care Act)
  - 2. Business taxes owed in individual chapter 11 cases
- Why must the IRS lift the stay in these cases? No mutuality in the debt.*

E. Other Government agencies may offset if IRS doesn't.

- 1. We do not have any details about these offsets. The debtor will get a letter from the offsetting agency.
- 2. You can contact the Federal Agency Offset at 1-800-304-3107.

3. Other agency offsets are handled by the United States Attorney's Office. They will file the motion to lift stay.

F. *Please* don't have debtors call Insolvency to ask where refunds are – direct them to “Where's My Refund?” on [irs.gov](http://irs.gov).

1. Insolvency has no control over refunds – it's an automated process. The Specialist cannot override that system to issue a refund to the debtor.

2. “Where's My Refund” is updated daily, and is more current than the information available to Insolvency.

3. Refunds can take a long time to go out (6 months or more) – but you can order a transcript (see Section I) to see the status if the debtor has not received an expected refund.

## IX. Post-petition Claims

A. Debtors need to pay postpetition taxes. Postpetition tax debts are often not coded as being in bankruptcy, so the debtors will get collection notices unless Insolvency is contacted and payment arrangements made.

1. In Chapter 7 asset cases, the IRS can file a claim for priority taxes up to the point the trustee makes a final distribution. B.C. § 726(a)(1).

2. 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 B.C. §§ 1112 or 1116

3. In a Chapter 13 case, if liabilities are incurred but not paid post-petition, IRS will collect.

i. The Service changed its procedures on section 1305 claims, and no longer files these claims.

ii. **Do not** amend the IRS claim to include a post-petition year. The Trustee will object.

iii. Debtors should pay post-petition taxes directly to the IRS. Be sure to designate the year for which the payment is to be applied (both on the payment and on an accompanying letter), or the IRS may apply the payment to a pre-petition year.

iv. Post-petition payments may be made in installments; although the IRS cannot enter into a formal installment agreement until the bankruptcy closes.

B. If an assessment occurs post-petition, IRS has authority file a late claim. B.C. § 502(i); In re Hight, 670 F.3d 699 (6<sup>th</sup> Cir. 2012). This is very rarely exercised.

C. Returns by the bankruptcy estate (chapter 11)

1. Trustee has a duty to file returns. I.R.C. § 6012(b)(3) & (4)

i. Duty exists whether estate is operating or liquidating. Holywell Corp. v. Smith, 503 U.S. 47, 53-54 (1992); 800Ideas.com v. IRS, 496 B.R. 165 (9<sup>th</sup> Cir. BAP 2013)

ii. Duty also exists if individual is debtor. I.R.C. § 6012(a)(8)

iii. Same requirements as debtor. 28 U.S.C. §§ 959(b), 960.

2. If no income, see Rev. Proc. 84-123

#### D. Penalty relief

1. "Reasonable cause" required (see, e.g., I.R.C. § 6699; Treas. Reg. § 301.6651-1(c)(1))

i. Standard is whether "ordinary business care and prudence" was exercised. However, this standard is met only when factors beyond your control intervene, and is almost never available if a filing deadline is missed. United States v. Boyle, 469 U.S. 241 (1985).

ii. Reasonable cause may also be found from reliance on professional advice, such as from a CPA. This generally goes to mistakes of law (for example, your accountant tells you that a loss is deductible, and it isn't).

2. First Time Penalty Relief is available in certain circumstances. See IRM 20.1.1.3.6.1.

#### X. Discharge

##### A. Taxes that are not discharged:

1. Priority taxes. B.C. § 523(a)(1)(A); § 507(a)(8)
  - a. return due within past 3 years (plus extensions)
  - b. assessed within 240 days
  - c. trust fund taxes. B.C. § 507(a)(8)(C)
2. Administrative expense taxes. B.C. § 523(a)(1)(A); § 507(a)(2); § 503(b)
3. No return filed, or filed within 2 years of petition. B.C. § 523(a)(1)(B)
4. Substitute for return under I.R.C. § 6020(b). B.C. § 523(a)(19) (unnumbered paragraph)
5. Fraud. B.C. § 523(a)(1)(C)
6. Nonpecuniary loss penalties (restitution). B.C. § 523(a)(7)

##### B. Extensions of priority period (tolling). B.C. § 507(a)(8)(G) (unnumbered paragraph)

1. Prior bankruptcy (or other tax litigation)
2. Appeal hearing on collection action (Collection Due Process)
3. + 90 days for each event

C. Under B.C. § 1328(a)(2) & (3), IRS may collect penalties and interest on non-dischargeable taxes even if those amounts are not included on the proof of claim if the underlying tax is:

1. Trust fund tax
2. Based on an unfiled return or return filed within 2 years of the petition
3. Fraud
4. Restitution

D. If the debtor gets a collection notice for a discharged period, get a transcript and see if the IRS made an adjustment/abatement after the bankruptcy closed.

1. If such an adjustment was made, the remaining balance is due to one of the excepted circumstances.
2. If no adjustment was made, see if there is any indication of the bankruptcy (there will be a "520" code in the left-hand column, and the words

“Bankruptcy or Other Legal Action” following). If there is no such indication, the tax may be dischargeable. **Contact Counsel** so that Centralized Insolvency can review the account.

## XI. Tax Liens

A. A federal tax lien, under I.R.C. § 6321, attaches to any property interest of the debtor. Any such property interest which survives the bankruptcy – in other words, a secured claim which is not paid or was not provided for – remains subject to the lien.

1. Even if the underlying tax is discharged, the IRS does not have to release the tax lien. See, e.g., In re Isom, 901 F.2d 744 (9<sup>th</sup> Cir. 1990); United States v. Uria, 180 B.R. 688 (S.D. Fla. 1995); United States v. Sanabria, 424 F.2d 1121 (7<sup>th</sup> Cir. 1970).

B. If there is no secured property to which the tax lien could attach, the IRS will remove a Notice of Federal Tax Lien once the underlying debt is discharged in bankruptcy.

1. This is a manual, not automated, process
2. Often takes 90 – 180 days for the bankruptcy information to post on the IRS’ computer and for the case to be assigned to Advisory to address the liens.
3. If the refiling period expired during the bankruptcy, no certificate of release will be issued. The NFTL contains language that acts as a release when the underlying liability is satisfied or removed. See Treas. Reg. § 401.6325-1(b).

### C. Discharge v. Release v. Subordination

1. It is important to note that there is a "fundamental legal distinction between the 'release' of a federal tax lien provided for by . . . § 6325(a) and the 'discharge' of property from the tax lien provided for by . . . § 6325(b)." Adamowicz v. United States, 101 Fed. Cl. 485, 487-88 (2011) (quoting Internal Revenue Manual 5.17.2.8.3(1)).

2. When the IRS, following a demand, issues a lien against an individual for unpaid taxes, the lien applies to all of the individual's property. See I.R.C. §§ 6321 and 6322. A release or withdrawal "extinguishes the federal tax lien itself," requiring that the amount owed underlying the tax liability is paid or that the lien is deemed unenforceable. Following a release, the IRS no longer has a lien against any of the individual's property.

3. A discharge, however, is applicable only to a portion of an individual's property subject to the lien. A discharge "permit[s] the transfer of [a] property free from the lien," but does not release an individual's other property from the lien. *Id.* (quoting Treas. Reg. § 301.6325-1(c))

4. With a subordination, the lien still exists against the property, but the IRS agrees that another lien takes priority.

5. A “withdrawal” is similar to a release – the IRS is removing the Notice of Federal Tax Lien from the records. Unlike a release, a withdrawal does not mean the underlying tax liability is gone.

### D. Process – go to irs.gov and type in “Get Rid of Lien”:

1. For discharge – see Publication 783 and Form 14135

2. For subordination – see Publication 784 and Form 14134
3. For release/withdrawal – see Form 12277

E. Who to contact – see Pub 4235

1. Send the required documents to Advisory at the following address:

Internal Revenue Service  
Advisory Unit, Stop 5012  
230 S Dearborn St. Rm 2630  
Chicago, IL 60604-1505  
Fax: 877-477-8752  
Tel: 312-292-2892

2. You should be contacted within 30 days of sending in your request. If not, send in a follow-up fax asking for Advisory to call you about the status of your request. If you still don't hear anything, call Counsel.

## XII. Referral of Bankruptcy Litigation

A. IRS Counsel cannot represent the IRS in bankruptcy court (only in Tax Court). So, any case requiring an appearance will be handled by the Department of Justice, usually by a local United States Attorney. Insolvency sends a request, called a referral, directly to the United States' Attorney's Office, asking that the U.S. Attorney represent the Service's interests in a particular case. The following cases may be referred:

1. If the debtor files an objection to our proof of claim
2. If the debtor files an adversary proceeding against the United States
  - a. Adversary cases include determination of dischargeability, determination of tax liability, and determination of the validity or extent of a federal tax lien.
  - b. Adversary cases are normally handled by Department of Justice attorneys from Washington, D.C.
3. A motion for sanctions or contempt against the United States
4. If the debtor files a motion involving the IRS, or which may affect the interests of the United States (for example, a unique plan provision which may jeopardize the Government's claim).
5. IRS objection to plan confirmation (or, in chapter 11, to the disclosure statement)
6. IRS motion to lift the automatic stay
7. IRS motion for adequate protection

B. Other than a proof of claim, any time the debtor files a motion/action in bankruptcy court that affects the IRS, the Department of Justice and the United States Attorney need to get notice.

1. The address for the Department of Justice is:

United States Department of Justice  
P.O. Box 7238

Ben Franklin Station  
Washington, DC 20044

2. The Assistant United States Attorney in charge of Insolvency matters for the Eastern District is:

Susan M. Knepel  
Office of the United States Attorney  
517 E. Wisconsin Ave.  
Suite 530  
Milwaukee, WI 53202  
414/297-1723  
FAX: 414/297-4394

3. The Assistant United States Attorney in charge of Insolvency matters for the Eastern District is:

Theresa M. Anzivino  
Office of the United States Attorney  
222 West Washington Avenue  
Suite 700  
Madison, WI 53703  
608/250-5454  
FAX: 608/264-5724

### XIII. Reorganization Plans

A. The IRS will not agree to the payment of priority taxes outside of the plan, or in an amount different from what is on the proof of claim.

B. In Chapter 13 cases, secured claims may be handled one of three ways:

1. The plan provides for payment of the IRS claim in full. As noted elsewhere, the IRS may object to the plan if the amount, including the rate of interest, differs from our proof of claim.

2. The plan is completely silent as to the IRS's secured claim. The IRS' position is that in this case, the secured claim is not "provided for" under B.C. § 1325(a)(5) and is not bound by the plan's provisions. Therefore the claim, and the tax lien, survive the bankruptcy. The IRS may move to lift the stay, or take collection action against property outside of the bankruptcy estate, if we are not provided for in the plan.

3. The plan states that the claim of the IRS will be paid outside of the plan. It does not appear that there is a legal impediment to paying the IRS in this manner. As with # 2 above, however, the IRS may take collection action on property outside of the estate.

a. Please be aware that the IRS has no mechanism for processing payments received outside of the bankruptcy. Such payments will most likely be treated by the computer as voluntary payments.

b. Voluntary payments ordinarily are applied to the earliest open tax year, with interest and penalties paid before the underlying tax.

c. Also, because Insolvency does not handle installment agreements, such payments are not monitored. If payments are sent to the Insolvency

address above, they likely will be returned. Payments must be sent to the same address as ordinary tax payments submitted with a return.

C. In Chapter 11 cases, the IRS will object if the plan does not properly provide for our secured claim. To be properly provided for, the plan must provide:

1. IRS gets equal payments throughout the plan. B.C. §§ 1129 & 1322
2. Interest at IRS rate as of date of plan confirmation. B.C. § 511; I.R.C. § 6621 (currently 5%)
3. Plan should provide that if default occurs, IRS may take administrative collection action. Alternative is motion to lift stay or motion to convert/dismiss.
4. Payments in a Chapter 11 case should be paid as directed by the Insolvency Specialist who filed the proof of claim.

#### D. Innocent Spouse

1. If one spouse is granted tax relief (e.g., under I.R.C. § 66 or 6015); IRS creates a special Non-Master File account. A NMF account generally does not operate systemically, but must be checked/updated/alterd manually.

2. Because NMF accounts are accessed manually, you will not get an NMF transcript through normal process (e.g., "Get Transcript" on irs.gov).

3. A decision on whether or not to grant innocent spouse relief under sections 66 or 6015 is made by a Notice of Determination.

a. Issuing a Notice of Determination does not violate the automatic stay.

b. However, the automatic stay would prevent an individual seeking to determine liability before the Tax Court. B.C. § 362(a)(8) ; Allison v. Commissioner, 97 T.C. 544, 545 (1991).

c. Note that the 90-day period under section 6015(e) for filing a Tax Court petition after issuance of a Notice of Determination in an innocent spouse case is **not** suspended by filing of a bankruptcy petition. Drake v. Commissioner, 123 T.C. 320 (2004).

i. In these circumstances, the debtor must file a motion with the bankruptcy court asking the bankruptcy court to lift the automatic stay.

ii. If the bankruptcy court lifts the stay, then the taxpayer can petition the Tax Court so long as the 90 days for petitioning has not expired.

4. Bankruptcy courts can grant innocent spouse relief. See, e.g., In re Shafman, 267 B.R. 709 (Bankr. N.D. W.Va. 2001); In re Hinckley, 256 B.R. 814 (Bankr. M.D. Fla. 2000); In re Capasso, 225 B.R. 573 (Bankr. S.D.N.Y. 1998).

a. The Tax Court views a bankruptcy court's determination regarding innocent spouse relief as res judicata. Freytag v. Commissioner, 110 T.C. 35 (1998).

b. Bankruptcy courts also may abstain from deciding an innocent spouse issue. In re Hunt, 95 B.R. 442 (Bankr. N.D. Tex. 1989).

#### E. Co-Debtor Stay

1. The co-debtor stay in B.C. § 1301 applies only to commercial debt, not taxes.

2. However, any marital (community) property is subject to the stay. This includes marital property titled in solely the name of the non-debtor spouse and marital



obligations in the name of the non-debtor spouse. In re Passmore, 156 B.R. 595 (Bankr. E.D. Wis. 1993).

3. The IRS may file a Notice of Federal Tax Lien against a non-debtor spouse. The non-debtor spouse has a residual claim to the community/marital property brought into the bankruptcy estate. In creating or perfecting a tax lien against a non-debtor spouse, the lien attaches to the non-debtor spouse's residual interest in the community/marital property, and not to the property in the bankruptcy estate.

#### F. Discharge

1. The non-debtor spouse is said to receive a "hypothetical discharge," which is only good while the non-debtor spouse remains married to the debtor or the debtor is alive. B.C. §§ 524(a)(3) and (b).

2. If the spouses are divorced or if the debtor spouse dies, the marital claims assessed against the non-debtor spouse can again be collected from the non-debtor spouse.

3. The IRS can collect marital claims assessed against the non-debtor spouse from the individual (nonmarital) property of the non-debtor spouse. The IRS may also pursue after-acquired property against the non-debtor spouse.

#### XIV. Entities in Bankruptcy

A. If you include a former LLC or corporation in chapter 13, the IRS may not include the business on the proof of claim. The IRS tracks entities by Employer Identification Number (EIN), and tracks chapter 13 cases by the debtor's Social Security Number. Chapter 13 is limited to individuals, so Insolvency will not always cross-reference a business even if it shows up in the schedules.

1. The LLC will continue to get collection notices, because the EIN will not be coded for bankruptcy.

2. If the business is not on the proof of claim, and you believe there are taxes owed, contact Insolvency (or Counsel, if no proof of claim has been filed).

3. If the taxes for the business are not included on the IRS proof of claim, your client likely will get collection notices after bankruptcy.

4. If the debtor continues to use the pre-filing EIN, the IRS will not consider the entity to be included in the bankruptcy, and will collect the taxes accrued under that EIN after the bankruptcy closes. The debtor should report business taxes as a sole proprietor from the date of filing, if not before.

B. If you are a chapter 7 trustee, or are handling a business in a chapter 11 case; please see Publication 908, *Bankruptcy Tax Guide*.

1. A bankruptcy estate is a separate taxable entity, so you will need to get a new Employer Identification Number and file a Form 1041 (tax return for trusts & estates) while the bankruptcy estate is open.

2. Once the estate closes, be sure to notify the IRS (you can attach a letter to the last-filed return). Otherwise the IRS will assume the estate is failing to file required returns.

a. That means the IRS will be contacting you about the missing returns.

C. The automatic stay does not prevent the IRS from assessing trust fund recovery penalty taxes against responsible persons of a business.

1. If your client is or had been operating a business where the trust-fund portion of employment taxes were not fully paid, expect that a trust-fund assessment will be made.

2. Unless you have a Power of Attorney on file with the IRS, you will not be notified of ongoing audits or assessments just because you are representing the debtor in bankruptcy. The IRS has no mechanism to cross-reference your involvement.

D. A debtor doing business while in bankruptcy, whether as a sole proprietor, disregarded entity, or debtor-in-possession, must file required tax returns and pay post-petition taxes as due. B.C. §§ 704(a)(8), 1108(a), 1304(c); 28 U.S.C. §§ 959(b), 960.

#### XV. Administrative Expenses

A. A tax is incurred by the estate on the last day of the taxable period. Hy-Test v. Missouri Dept. of Revenue, 143 B.R. 707 (Bnk. E.D.Mo 1992) aff'd. 64 F.3d 1146 (8<sup>th</sup> Cir. 1995); Towers for Pacific-Atlantic Trading Co. v. United States, 64 F.3d 1292 (9<sup>th</sup> Cir. 1995)

B. A tax incurred by the estate is a first priority administrative expense. 11 U.S.C. § 503(b)(1)(B)(i) and § 507(a)(1). See, e.g., In re Columbia Gas Systems, 142 B.R. 114 (Bnk. D. Del. 1992), aff'd 50 F.3d 233 (3<sup>d</sup> Cir. 1995); Midland Cent. Appraisal Dist. V. Midland Indus. Serv. Corp., 35 F.3d 164 (5<sup>th</sup> Cir. 1994).

C. Preconversion administrative taxes retain their character after conversion, although subordinate to the trustee's post-conversion administrative expenses. 11 U.S.C. § 726(b).

XVI. The e-mail address for Centralized Insolvency is: **`cio.bncmail@irs.gov`**