

SELECTED TAX ISSUES IN INDIVIDUAL BANKRUPTCY CASES

Peter L. Banis, Esquire
Keith D. Lowey, CPA

We have selected several topics important to representing individuals in bankruptcy cases. The topics remain relevant after the Reform Act and in some cases become critical to effective practice dealing with taxes in a bankruptcy case.

The materials commence with the basics of determining the dischargeability of individual income taxes in bankruptcy cases. As will be seen, because of the state of the case law under §523(a)(1)(C), there can be no certainty in opining upon dischargeability. The solution is the Doubt as to Collectibility Offer in Compromise as to internal revenue taxes if an adverse result in an adversary proceeding is a possibility, since it is unlikely the Internal Revenue Service (IRS) would later seriously entertain such an Offer if an adverse §523(a)(1)(C) judgement is suffered.

The second part of the materials deal with the calculations necessary to get a rough idea of how much an Offer needs to be in order to be acceptable to the IRS. Actual calculation of amounts necessary to effect such an Offer is almost an art form because many current IRS valuation and expense calculations are matters of practice and are not easily gleaned from the Internal Revenue Manual (IRM). Considering that Congress has now limited the so-called “super discharge” in Chapter 13 cases to require **full payment in the plan of so-called trust fund taxes and those described in §523(a)(1)(B) and (C)**, and that priority taxes be paid within 5 years of **entry of the order for relief** in Chapter 11 cases with interest, the likely necessity is seeking one in the course of Chapter 11 and 13 cases where the requirements of fully paying priority and other nondischargeable taxes in full makes the financial realities of the case one of unlikely confirmation.

As will be seen, the current IRS practice of refusing to process such Offers is likely a Due Process violation, and under the standard of review of administrative decisions, that of “abuse of discretion”, courts can in fact compel the IRS to accept such an Offer. Expect a spirited defense by the United States to opening the floodgates of Collectibility Offers concurrent with Chapter cases because it costs them money, and lots of it, not to mention the institutional mind set to resist changes foisted upon their bureaucracy.

The third part, the last, reviews and makes comment upon several of the tax law changes inside Title 11 cases which effect and affect individuals.

I. DETERMINING DISCHARGEABILITY OF INDIVIDUAL INCOME TAXES.

A. THE RULES OF §523.

This is where the action is. §523 is entitled “Exceptions to Discharge”, rightly so, because your analysis of whether a tax is dischargeable should commence with the assumption it is dischargeable unless the “exceptions” state otherwise. §523(a) states as follows (matters in italics indicate the provisions of the New Law):

“523(a). A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

- (1) for a tax or customs duty -
 - (A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
 - (B) with respect to a return, *or equivalent report or notice*, if required-
 - (i) was not filed or *given*; or
 - (ii) was filed *or given* after the date on which such return, *report or notice* was last due, under applicable law or under any extension, 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;”

The reference to §507(a)(8), the priority tax definition section, declares under §523 they will not be dischargeable. Those priority income taxes that will not be dischargeable are defined as follows under §507(a)(8)(A):

“(8) Eighth, allowed **unsecured** claims of governmental units, only to the extent that such claims are for-

- (A) a tax on or measured by income or gross receipts *for a taxable year ending on or before the date of filing of the petition--*
 - (i) for *which* a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
 - (ii) assessed within 240 day *before the date of the filing of the petition, exclusive of--*
 - (I) any time during which an Offer in Compromise with respect to *that tax* was pending or *in effect during that 240 day period, plus 30 days.*
 - (II) *any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240 day period, plus 90 days.*

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;”

The most significant change to the definition of a priority tax is not in any addition of any tax but in the new tolling provisions for administrative actions taken between a taxpayer and the government agency regarding resolution of a tax matter. It appears at the end of the section as a throw in and it reads:

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

The importance of this “throw in” section is discussed below.

B. THE RULES OF §523 IN OPERATION.

(1) §523(a)(1)(A). The statutory rule of this part of the test is that for the tax due on the return to be dischargeable, the return must have been **due more than three years before the bankruptcy petition filing date, including the time granted for any extensions of time to file the income tax return.**

Example #1. Debtor owes Federal income taxes for the calendar years ending December 31, 2003 (the “2003 return”), December 31, 2002 (the “2002 return”), December 31, 2001 (the “2001 return”) and December 31, 2000 (the “2000” return). You examine the Federal income tax transcripts (the Individual Master File or “IMF” transcripts) you have obtained from the IRS and determine the debtor sought an extension of time to file the 2000 return until August 15, 2001, but did not seek extension of time to file any of the other returns.

(a) As to the 2000 return, the debtor filed a 4 month extension of time to file the 2000 return on US Form 4868, the so-called “automatic extension”, thus extending the due date of that return, normally first due on April 15, 2001, until August 15, 2001. The debtor did NOT request an additional extension of time to file on US Form 2688, which would have sought an additional two months to file the 2000 return, to October 15, 2001. Thus, this return, under analysis today, July 15, 2005, was first due including extensions of time to file on August 15, 2001 and it was due more than three years before a hypothetical petition date of July 15, 2005 and the tax due is

dischargeable under this first test for dischargeability.

(b) As to the 2001 return, the debtor did not file any extensions of time to file the 2001 return, so, it was first due on April 15, 2002. Thus, this return, under analysis today, July 15, 2005, was first due on April 15, 2002, and it was due more than three years before a hypothetical petition date of July 15, 2005 and the tax due is dischargeable under this first test for dischargeability.

(c) As to the 2002 return, the debtor did not file any extensions of time to file the 2002 return, so, it was first due on April 15, 2003. Thus, this return, under analysis today, July 15, 2005, was first due on April 15, 2003, and it was due WITHIN three years before a hypothetical petition date of July 15, 2005 and the tax due is NOT dischargeable under this first test for dischargeability. Your analysis of dischargeability for this return, the 2002, may stop here; the tax due for that return is not dischargeable.

(d) As to the 2003 return, the debtor did not file any extensions of time to file the 2003 return, so, it was first due on April 15, 2004. Thus, this return, under analysis today, July 15, 2005, was first due on April 15, 2004, and it was due WITHIN three years before a hypothetical petition date of July 15, 2005 and the tax due is NOT dischargeable under this first test for dischargeability. Your analysis of dischargeability for this return, the 2003, may stop here; the tax due for that return is not dischargeable.

Thus, the 2000 and 2001 liability years pass the first test of dischargeability but the 2002 and 2003 liability years do not.

Your first test for dischargeability is **ALWAYS** §523(a)(1)(A), the so-called three year test. If a return liability fails this 3 year rule it is NOT dischargeable and you need go no further in your dischargeability analysis.

(2) §523(a)(1)(B). The statutory rule for this second test for dischargeability has to do with late filed returns, meaning an income tax return that was **NOT filed on time** including giving consideration to extensions of time to file. For an income tax to be dischargeable under this test of §523(a)(1)(B), having satisfied the first test of §523(a)(1)(A) because you have determined it was first due more than three years before your hypothetical petition date, the tax will be dischargeable if it was filed more than two years before the petition date.

EXAMPLE #2. To demonstrate what a late filed return is, consider an income tax return for the year 2000, normally due on April 15, 2001, for which the debtor filed an extension of time to file until August 15, 2001 and another extension of time to file until October 15, 2001, thus using both of the two extensions available to file Federal income tax returns. If the 2000 Federal income tax return is filed AFTER October 15, 2001 it is for purposes of §523 analysis a LATE FILED return. Your debtor filed the 2000 Federal income tax return on October 25, 2002. Because the 2000 return was filed outside the extension period, it is a late filed return. Thus, if we

are considering a petition date of July 15, 2005, we have met the first test under §523(a)(1)(A) because in this example it was first due on October 15, 2001 and three years takes us to October 16, 2004. In addition, the return liability for the year 2000 is dischargeable under the second test, that of §523(a)(1)(B), in that the 2000 return was filed more than two years before the hypothetical petition date of July 15, 2005, which two year period for this return liability expired on October 26, 2004. Thus, the year 2000 return liability meets the first two tests of §523(a)(1)(A) and (B) and is so far, dischargeable.

C. EXCEPTIONS TO DISCHARGEABILITY.

(1) Income Tax Assessed Within 240 Days of the Petition. §507(a)(8)(A)(ii).

This exception provides that if there is a subsequent assessment made by the tax authorities, whether by actual examination of a return or otherwise, a petition filed within 240 days of the date that assessment is made will not be dischargeable. It may be that the actual return filed by the debtor would satisfy the criteria of either the three or two year rule, above, and the tax shown on the return filed would be dischargeable but the amount of tax and interest to the petition date if filed within 240 days of the subsequent assessment would not.

Caution must be taken with regard to examination changes made by the IRS where there exists an affirmative obligation on the taxpayer to file an amended State income tax return. For example, M.G.L. Ch. 62 §30 commands a taxpayer who has had Massachusetts income tax increased as a result of Federal change to file an amended return, and, until an amended return is filed any increase in tax remains assessable and nondischargeable.

(2) Offer in Compromise Filed Within 240 Days of Assessment. §507(a)(8)(A)(ii).

This exception provides that if a debtor has filed a Federal Offer in Compromise under I.R.C. §7122, as a Doubt as to Liability Offer or a Doubt as to Collectibility Offer, this bankruptcy statute making no distinction between them, the 240 days of assessment discharge period is tolled for the period that the Offer was pending plus 30 days.

A few observations. First, try not to file an Offer in Compromise within 240 days after an assessment of tax by IRS, be it an assessment relating to a filed income tax return or a subsequent assessment. The regular IRS notice cycle for unpaid tax is some 120 days and after that the case will be assigned out to a field office, which takes another cycle period. In short, try to wait out the 240 days before resorting to this IRS administrative procedure to forestall enforced collection. If you do not, the Act extends the discharge tolling period by the Offer cycle plus 30 days. Second, an Offer in Compromise filed after 240 days of the assessment does not toll the discharge period as to that subsequent assessment. Third, this exception applies only to IRS Offers in Compromise. Although the New Act provides a host of new discharge tolling provisions, discussed below, this exception applies to IRS Offers in Compromise. For example, M.G.L. Ch. 62C §37A, the Massachusetts Department of Revenue (“MDOR”) Offer in Settlement procedure, would not toll

the statute under the Old or New Law, but, be certain of it, the MDOR, other states and lesser agencies will argue their programs constitute a stay and appeal of collection action under the “throw in” covering IRS CDP hearings, discussed at I.C(4), *infra*.

(3) New Law. §507(a)(8)(A)(ii)(II).

Any tax assessed within 240 days of a petition will be nondischargeable and that 240 day period will be tolled as a result of (1) an assessment made during the pendency of a prior bankruptcy case, (2) for the period in which a stay of collections was in effect in a prior case during that 240 day period, (3) plus 90 days.

This covers the situation where a debtor is in a Chapter 13 and suffers a post-petition assessment for a post-petition tax return. The debtor must dismiss and refile 330 days later. Tax authorities now have the remaining period of the 240 days which was stayed in the prior case plus 90 days to file a Federal Tax Lien (FTL) or state equivalent to secure their position.

(4) New Law. The Tolling For Federal Collection Due Process Proceedings under IRC §6320 (Liens) and §6330 (Levies) (Except IRS Equivalent Hearings) and Corresponding Provisions of any State laws.

As a result of the Taxpayer Bill of Rights enacted by Congress in 1998, taxpayers under immediate enforced tax collection threat from the IRS were granted important new rights contained in the cited sections of the IRC. The most important is §6330, dealing with a taxpayer’s ability to **TIMELY** seek and be granted a Collection Due Process (CDP) hearing with the IRS Office of Appeals and during the pendency of those proceedings including any appeals to the United States Tax Court or the United States District Courts or further, have the IRS prohibited from taking enforced collection action against them. If the CDP hearing is timely requested, IRS is stayed from enforced collection except as to jeopardy assessments and the levy upon state income tax refunds if the levy was already served.

If a taxpayer does not **TIMELY** request a CDP Hearing with IRS Appeals, then there is no stay of collection and there is no tolling. A late requested hearing is called an Equivalent Hearing and under the IRS’s rules they are not prohibited from maintaining enforced collection action during the pendency of those proceedings (but usually do so refrain). As a result of this change, it is likely IRS will pay close attention to any Equivalent Hearings requested when a possible discharge period may be within reach of a taxpayer.

Since this applies to “a government unit”, states and lesser political subdivisions whose procedures conform to the CDP provisions for collection stays will be benefitted by having their discharge periods tolled, also. As noted, states and lesser political subdivisions will argue their procedures meet the definition.

D. §523(a)(1)(C), OR, WHY NOTHING ELSE MATTERS.

As will be seen in the following discussion of the state of the law under §523(a)(1)(C), satisfying of all of the discussed discharge provisions for individual income taxes is almost irrelevant. That section states a discharge will not be granted an individual regarding income tax:

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

No one can have a problem with a fraudulent return and there is no rational argument to allow tax criminals filing fraudulent returns to be discharged of their tax obligations in bankruptcy. However, there has been a vociferous dialog between the Circuit Courts on the exact meaning of the phrase “willfully attempted in any manner to evade or defeat such tax”. Because that dialog is now substantially resolved, the practitioner must understand that the determination to object to discharge now rests in the hands of the various IRS and State tax officials charged with bankruptcy jurisdiction; and should they so choose, based on the state of the law, they may hold almost anyone’s income tax nondischargeable on a dissipation of assets theory with liability based upon the I.R.C. §6672(a) standard.

Because of the state of the law under §523(c)(1)(C), it is **not possible** to render an affirmative discharge opinion involving individual income taxes. Even though a potential debtor satisfies all other criteria for dischargeability, because there is no predictability resulting from the state of the law under this section, no discharge certainty exists.

To get the true flavor of the debate, and to see how it has now been substantially resolved, a review of the case law is necessary. The debate started with *Toti v. United States*, 24 F.3d 806 (6th Cir., 1994), and, if ever there was substance to the axiom “bad cases make bad law”, that was it.

1. *Toti v. United States*, 24 F.3d 806 (6th Cir., 1994)

Findings:

From 1974 to 1981, no returns, no payments, despite the fact he knew he was liable for the taxes and he had the wherewithal to pay his taxes during some of those years at least. Debtor claimed he didn’t file 1974 or 1975 because of no funds on hand to pay the tax, and, for the next 6 years, he didn’t file or pay because of the penalties and interest accruing on 1974 and 1975. In 1981, Toti was indicted on 3 counts of failure to file under I.R.C. §7203, a misdemeanor. Convicted and sentenced for willfully failing to file his 1976 return, government dismissing 1974 and 1975 counts. In 1982, Toti paid in full 1976 liability and filed all delinquent returns, timely filed 1982 and 1983 but did not pay. In April 1985, Toti entered Installment Agreement for payment of 1977 through 1983 liabilities and eventually defaulted. In 1990, Toti filed Chapter 7 and discharge litigation ensued.

Bankruptcy Court holds taxes dischargeable because government required to present evidence that debtor engaged in willful commission act to evade or defeat

liability, the I.R.C. §7201 evasion standard, not an omission standard, and could not.

District Court reversed, holding that only a civil standard, that of failing to file and pay need only be “voluntary, conscious and intentional”, holding Toti’s failure to file and pay were willful acts.

The Circuit Opinion - Short and Sweet

Recited the Bankruptcy Court holding that an affirmative act of evasion is required to deny a discharge under 523(a)(1)(C). Recited Toti argued 523(a)(1)(C) closely parallels I.R.C. §7201 making it a felony for a person wilfully to attempt to evade or defeat a tax. Left out that §7201 adds “or payment thereof”. Recited Toti argued I.R.C. §7203 makes it a misdemeanor for any person wilfully to fail to pay an estimated tax or the tax itself, or, fail to file, timely, a return. Left out the fact that all elements of I.R.C. §7203 are specifically contemplated as dischargeable under §§523(a)(1)(A) and (B).

Recited Toti argued that the I.R.C.’s delineation between commission (felony) and omission (misdemeanor) should apply to Bankruptcy Code, and since I.R.C. §7201 (felony evasion) mirrors §523(a)(1)(C), Toti argued only when the debtor committed some identifiable affirmative act to evade payment can §523(a)(1)(C) apply. In short, mere failure to file and pay would not rise to the requisite criminality for non-dischargeability.

In three paragraphs, the *Toti* Court stated its holding:

“The Supreme Court has held that courts should interpret the Bankruptcy Code according to the plain meaning of an individual provision as long as the provision’s language is unambiguous. *United States v. Ron Pair Enters.*, 489 U.S. 235, 240 (1989). Where statutory language is not expressly defined, that language should be given its common meaning. *Burlington N.R.R. Co. v. Oklahoma Tax Comm’n*, 481 U.S. 454, 461 (1987). The district court here held that the definition of “willfully attempted to evade” was consistent with the definition found in other civil cases, which equates “willful” with voluntary, conscious, and intentional evasions of tax liabilities. *Collins v. United States*, 848 F.2d 740, 742 (6 Cir. 1988); *Domanus V. United States*, 961 F2d 1323, 1326 (7 Cir. 1992). We believe that a plain reading of section 523(a)(1)(C) includes both acts of commission and acts of omission.

As the district court states, “the purpose of the Bankruptcy Code is to allow the honest debtor a fresh start”. *United States v. Toti*, 149 B.R. 829, 834 (E.D. Mich 1993). **Toti does not fall within the category of honest debtors. He had the wherewithal to file his return and pay his taxes, but he did not fulfill his obligation. It is undisputed that he do so voluntarily, consciously and**

intentionally.

We agree with the district court's holding that Toti willfully attempted to evade or defeat his tax liability within the meaning of section 523(a)(1)(C) and that his debt was not discharged by his bankruptcy". (Emphasis supplied).

The District Court applied the standard of §6672(a) of the IRC, the so-called "responsible person" statute, holding that "wilfully" means voluntary, conscious and intentional. U.S. v. Toti, 71 AFTR2d 93-870 (1993).

The logical extension of the holding in *Toti* is that no tax is dischargeable if the Government brings or defends an adversary complaint on dischargeability and is able to show that taxes were not paid and that the failure was voluntary (not hard), conscious (easier still) and intentional (easier still).

2. The More Debtor Friendly Rule of the 11th Circuit, Then and Now.

A. *In re Haas*, 48 F.3d 1153 (1995)

Findings:

Debtor Haas timely and accurately filed his returns with IRS. Used income to pay personal and business debts rather than taxes, like all debtors. 1987 pled guilty to willful failure to pay for 1980, 1981 and 1982. 1987 pled guilty to willful failure to pay employment taxes for Q1, Q2 & Q3 of 1984. One year suspended, 5 years probation, restitution to pled years and remain current as to estimated taxes. Did so. 1991, file joint Chapter 11 with wife. Proof of claim by IRS for \$705,044.25.

Bankruptcy Court held dischargeable, and, 523(a)(1)(C) only applied to the assessment of the tax, not the payment of the tax. Because no materially false or misleading tax returns, no attempt to evade or defeat.

Government appealed, DC remanded for determination of whether failure to pay was willful.

On remand, Bankruptcy court found Haas readily acknowledged the tax liability and, other than this failure to pay the obligation, made no attempt to evade or defeat his obligation. Held dischargeable again.

DC reversed. DC applied a civil standard for willfulness under 26 U.S.C. §6672 reasoning that:

"The most persuasive interpretation of the statutory language at issue is to construe the phrase "willfully attempted in any manner to evade or defeat the tax to mean: (1) the debtor had a duty under the law, (2) the debtor knew he or she had that duty, and (3) the debtor voluntarily and intentionally violated that duty..."[W]here the

debtor is financially able to pay the taxes due, but chooses *not to do so*, the government has met its burden of proof”.

(B) The Circuit Opinion.

Issues phrased: “The sole question at issue in this case is whether a debtor’s failure to pay his taxes, without more, constitutes a “willful attempt in any manner to evade or defeat such tax under section 523 (a)(1)(C)”.

The Argument of the United States:

Government argued the plain meaning of the phrase “willfully attempted in any manner to evade or defeat such tax” was broad enough to include a debtor’s “voluntary, conscious, and intentional” failure to pay taxes”, citing *In re Toti*, 24 F.3d 806 (6th Cir. 1994), cert. denied, 115 S. Ct. 482 (1994). The government argued that if a debtor had both an awareness of his duty to pay his taxes and the present ability to pay them but did not, then the tax is non-dischargeable under 523 (a)(1)(C).

(C) *Haas* Court Analysis.

First, *Haas* Court stated the problem with the Government’s “plain meaning argument” was that it would make all tax debts non-dischargeable, and, by a footnote to the decision, that is apparently what the Government argued; there is no such thing as an honest tax debtor.

Second, the *Haas* Court noted that §523(a)(1)(B) would be read out of the Code.

Third, the *Haas* Court stated the Government’s position would make no distinction between honest and dishonest debtors since both have the same characteristic of not being able to pay all of their debts as they come due, an “honest debtor” being one who pays taxes as due, one who cannot being not.

(i) The *Haas* Court’s Question: Does 523(a)(1)(C) include the willful attempt to evade or defeat the tax including the phrase, “or payment thereof”?

(ii) *Haas* Answers No.

Had Congress intended failure to pay, without more, would except tax liabilities from discharge, it could have written such a provision into 523(a)(1)(C).

Of course, Congress could have never allowed taxes to be dischargeable in the first place, as was the case under 98 Act, Bankruptcy Act of 1898, Ch. 541, Section 17 (a); 30 Stat. 544,550 (1898).

On four separate occasions, Congress showed itself capable of differentiating

between evasion of tax and evasion of payment and they are:

I.R.C. §6531(2), the Statute of Limitations on criminal prosecutions for I.R.C. offenses including “the offense of willfully attempting in any manner to evade or defeat the tax **or the payment thereof**”;

I.R.C. §6653, imposing a penalty upon any person who “willfully attempts in any manner to evade or defeat any such [stamp] tax **or the payment thereof**”;

I.R.C. §6672(a), the Responsible Person statute, imposing a penalty upon any person “who willfully attempts in any manner to evade or defeat any such tax **or the payment thereof**”;

I.R.C. §7201, providing “any person who willfully attempts in any manner to evade or defeat any tax imposed by this title **or the payment thereof** shall... be guilty of a felony...”.

Haas Court concluded, under accepted rules of statutory construction, that Congress did not intend that a failure to pay taxes, without more, should result in the non-dischargeability of a debtor’s tax liabilities in bankruptcy.

(D) The Legislative History of 523(a)(1)(C)

The House Bill, H.R. 8200, would have excepted from discharge taxes “with respect to which the debtor...willfully attempted in any manner to evade or defeat”. 123 Cong. Rec. 35, 655 (1977).

The Senate version proposed to narrow the 523(a)(1)(C) exception by striking the words “in any manner” and inserting in place thereof “with respect to which the debtor ... fraudulently attempted to evade or defeat”. Senate Comm. On the Judiciary, 85th Cong. 1st Sess. Comparison of H.R. 8200, as Reported, and S. 2266, as Introduced 106 (Comm. Print 1978), reprinted in Bankruptcy Reform Act of 1978; Hearing before the Subcomm. On Improvements in Judicial Machinery of the Senate Comm. On the Judiciary, 95th Cong. 1st Sess. 3, 108 91978) (red-lined text of H.R. 8200 omitted).

It should be clear that the House and Senate were talking about tax evasion cases and not payment evasion cases, as the Haas Court implicitly stated in its rebuttal to the Government’s three (3) principal arguments.

(E) The Government’s Argument and Rebuttal

The phrase “in any manner” is broad enough to include a debtor’s failure to pay a properly acknowledged tax. The Government cited, inter alia, In re Toti, supra.

The *Haas* Court then stated that adopting the Government’s view of “in any manner” as including the words “or the payment thereof” would render the words “or the payment thereof” superfluous in I.R.C. §§6531(2), 6653, 6672 and 7201. The *Haas* Court said the better view in those I.R.C. sections is that “in any manner” modifies either attempts to evade or defeat the tax or attempts to evade or defeat payment, but that its use does not eradicate the distinction between an assessment of a tax any payment of a tax.

Government argued, next, that the *Haas* Court’s reading of 523(a)(1)(C) made the entire section superfluous because if then the only way to evade or defeat a tax is by a fraudulent return, the fraudulent return is already there and the remainder of the section becomes a nullity.

The *Haas* Court rebutted by noting that I.R.C. §7201 made it a felony to “willfully attempt [] in any manner to evade or defeat any tax imposed by this title or the payment thereof (Emphasis supplied), and noted that at the same time it enacted I.R.C. §7201, it enacted I.R.C. §7207, which made it a misdemeanor for any person to “willfully deliver [] or disclose [] to the Secretary any . . . return . . . known by him to be fraudulent or to be false as to any material matter”.

The *Haas* Court then stated:

‘Since Congress purposely devoted separate sections of the I.R.C. to penalize evasion of a tax or payment thereof and to penalize filing a fraudulent return, it clearly did not consider the scope of their two provisions to be identical. Mindful of the different judicial interpretation of sections 7201 and 7202, Congress evidently chose to proscribe only selected elements of the conduct described in each provision when drafting section 523 (a)(1)(C).

Government argues *Haas* Court reading of 523(a)(1)(C) subverts Congressional intent to prevent the Bankruptcy Code from being used as a tax evasion device.

The *Haas* Court rebuts by pointing to the many taxes not dischargeable under 507(a)(8) and as to those taxes Congress allowed to be discharged, 523(a)(1)(A) and 523 (a)(1)(B), the Court stated Congress (repealed and) did not grant an absolute priority in bankruptcy for delinquent taxes. The Government’s reading of 523(a)(1)(C) would repeal 523(a)(1)(A) and 523 (a)(1)(B), and the Court held taxes other than those excepted from discharge by 523(c)(1)(A), discharged.

3. CASE LAW FOLLOWING THE TOTI/HAAAS COLLOQUY.

Bruner v. United States, 55 F. 3d 195 (5th Cir., 1995) (rejected both holdings that mere

nonpayment is not enough and attempts to evade or defeat tax not encompassed by attempts to evade or defeat payment; preferred the *Toti* reasoning).

Dalton v. IRS, 77 F. 3d 1297 (10th Cir., 1996) (agreed with *Haas* that mere non-payment alone is outside scope of 523(a)(1)(C) but any statutory interpretation of “evade or defeat” which relived dishonest debtor who conceals assets to avoid payment or collection of taxes, but which penalizes the same dishonesty to avoid assessment, is absurd).

In re Birkenstock, 87 F. 3d 947 (7th Cir., 1996) (agreed with *Haas* that mere non-payment alone is outside scope of 523(a)(1)(C) but if accompanied by pattern of unfiled returns or other measure to conceal assets, discharge denied).

U.S. v. Fegeley, 116 F. 3d 979 (3rd Cir., 1997) (intentional failure to file together with failure to pay taxes when he had the resources to do so was enough).

Tudisco v. U.S., 183 F. 3d 133 (2nd Cir., 1999) (conduct element satisfied by failure to timely file, failure to timely pay, and changing employment status from employee subject to withholding to independent contractor, while wilfulness element satisfied by knowledge of duty to file and pay; refused to pass on whether “mere non-payment” is enough).

4. THE 11th Circuit Revisits *Haas*. *Griffith v. US*, 206 F. 3d 1389 (11th Cir., en banc, 2000), *cert. denied*, 121 S. Ct. 73 (2000).

In *Griffith*, the debtor litigated his tax liabilities in the Tax Court and lost, but, the Tax Court did not impose the asserted civil fraud penalties because the Government had failed to prove fraud by clear and convincing evidence. See, *Griffith v. Commissioner*, ¶88,445 PH Memo TC, *modified by* ¶89,070 PH Memo TC. Before the Tax Court judgment had become final in 1988, a corporation, NuWave, was created in 1988 with debtor’s live-in girlfriend as sole stockholder, she and debtor married in 1989 and executed an antenuptial agreement, debtor transferring assets to himself and wife as T by E’s and assets from a corporation owned by him to NuWave by a reorganization. Debtor filed a Chapter 7 in 1993, and the Bankruptcy Court held the asset transfers were enough to find attempt to evade or defeat the tax, which was decided before *Haas*. The District Court affirmed. See, *In re Griffith*, 210 B.R. (S.D. Fla., 1997), *rev’d*, 174 F. 3d 1222 (11th Cir., 1999) *vacated and reh’g en banc granted*, 182 F. 3d 1297 (11th Cir., 1999). 174 F. 3d 1222 (11th Cir., 1999). The District Court found that unlike *Haas*, *Griffith* had done more than simply pay other debts before paying his taxes in engaging in a fraudulent transfer of assets in order to prevent collection of his tax debt. 210 B.R. 216, 220.

The *Griffith* court stated that while most courts have agreed with its original holding in *Haas* that a debtor’s mere failure to pay his taxes, without more, will not bar discharge under 523

(a)(1)(C), other court had taken exception to its second holding, that attempts to evade or defeat the tax does not encompass attempts to evade or defeat payment. It reaffirmed its prior holding that mere non-payment is not enough, but, then reversed its holding in *Haas* and concluded that the more reasonable interpretation of 523(a)(1)(C) is that affirmative acts to evade payment will now render a tax non-dischargeable. The point it reversed was its rebuttal to the Government's argument in *Haas* that a reading of 523(a)(1)(C) which does not punish evasion of payment means then that other than a fraudulent return, such a reading made the entire balance of the section superfluous because if then the only way to evade or defeat a tax is by a fraudulent return, the fraudulent return element is already present in the statute. It adopted the holdings of other courts that failure to timely file, failure to timely pay, and, evidence of income or assets capable of at least in part liquidating the tax debt is enough if coupled with any act capable of being characterized as evasion of payment was enough.

5. *Haas* Further Limited.

A year later, the 11th Circuit again apologized for its prior sins with *U.S. v. Fretz*, 244 F. 3d 1323 (11th Cir., 2001). In that case, a doctor was found to have been a functioning alcoholic, failed to file tax returns or pay taxes for the years 1982 through 1992. Although he managed to maintain his employment as an emergency room physician, ceasing consumption 8 hours before a shift but getting plastered immediately after, so the Court found, the Court also found that although all of the hospitals which employed him dutifully filed U.S. Form 1099's with the IRS reporting his self-employment income, Fretz made no estimated tax payments, ever, never filed a return nor made any payment of tax, hired an accountant to prepare his 1986 tax return but did not file it, and on the other hand **never attempted to move any of his assets around or otherwise conceal them with the parenthetical that "except to the extent that failing to file returns conceals assets"**. The Court then recited that Fretz stopped drinking on April 15, 1993, joined Alcoholics Anonymous, regained control of his life and had remained sober.

IRS had him indicted and he pled guilty to one count of wilful failure to file under 26 U.S.C. §7203, the misdemeanor statute, in January, 1994, and in November of 1994, signed returns prepared by IRS for 1982 through 1992 which included a mix of civil fraud and fraudulent failure to file penalties. In June of 1997 Fretz filed a Chapter 7 petition.

The Bankruptcy Court found his alcoholism to have been a mitigating factor to fraudulent intent and found the taxes dischargeable. The District Court affirmed, holding that because intent was the determinative factor in §523(a)(1)(C) and Fretz had not engaged in any affirmative acts to avoid his taxes, there was no willful attempt to evade or defeat the taxes.

The *Fretz* court then stated the question to be whether the Government had met its burden of showing Fretz failed the conduct requirement (that the debtor "attempted in any manner to evade or defeat [a] tax") and the mental state requirement (that the attempt was done "willfully").

First, it reaffirmed that mere failure to pay is still not enough in the 11th Circuit, stating the conduct requirement of §523(a)(1)(C) is not met where a debtor has filed accurate (non-fraudulent?) returns and merely failed to pay. Then, it held Fretz to have met the test of being an essentially “dishonest” debtor. The Court stated that while it had not previously faced a case where the only act of the debtor was one of omission, meaning, a mere failure to file, the third and Sixth Circuits have, citing *Fegeley* (stating the holding to have been Fegeley’s intentional failure to file returns, together with his failure to pay taxes when he had the resources to do so, was sufficient to bar the discharge under §523(a)(1)(C)) and *Toti* (stating the holding to have been failure to file a tax return and failure to pay a tax fall within the definition of §523(a)(1)(C) of a willful attempt to evade or defeat a tax liability) (emphasis supplied).

The First Circuit, as of the preparation of these materials, has not ruled on these issues. Thus, satisfying §523(a)(1)(A) and §523(a)(1)(B) are no longer relevant to the discharge determination, and, the prophecy of the *Haas* court has come to pass; that, at the least onerous level of what is a dishonest debtor, no tax is dischargeable if the return was not timely filed, any time the Government, and any government, wants to so challenge or object to a discharge. Again, it is not possible, in our view, to give an income tax discharge opinion under the current state of the case law under §523(a)(1)(C).

PART TWO

II. REMEDIES INSIDE AND OUTSIDE BANKRUPTCY WHEN FEDERAL TAXES ARE A DOMINANT LIABILITY.

The purpose of this part is to describe the available remedies and resolution tools for Federal taxes owed by a taxpayer who or which cannot readily pay them. In order of quality of result they are:

the Offer in Compromise - Doubt as to Collectibility; I.R.C. §7122 (hereinafter, “OIC”)

the part pay Installment Agreement (hereinafter, “PPI”) under I.R.C. §6519; and, the Installment Agreement (hereinafter, “IA”) under §6519.

Remedies are available to business taxpayers as well. It is possible to effect an OIC for a continuing business concurrent with a Chapter 11 proceeding to side step the onerous payment requirements of Chapter 11 and at the same time deal with Federal tax liens.

Because the PPI and IA are not as effective in relieving a taxpayer of Federal tax obligations as the OIC, our focus will be on the OIC, since the OIC when its terms of payment are met discharge the entire obligation and effect the removal of all liens as the tax is deemed paid in full. As will be seen, an OIC is a combination of a Chapter 7 liquidation for purposes of assets and a pre-Act Chapter 13 as to income. We say pre-Act because the Act now severely reduces the taxes capable of discharge in Chapter 13 cases. And, because of the limitations under the Act's change to Chapter 13, a Plan may not be viable. Because of the state of the law under §523(a)(1)(C), a tax debtor may never get a fresh start under the Bankruptcy laws.

A. *THE OIC.*

(1) Quality of Result.

From the time the OIC is received by IRS and the waiver of the running of the statute of limitations provision is signed by an authorized IRS official, IRS is prohibited from engaging in or continuing enforced collection activities, e.g., levies and seizures.

The filing of an OIC does not prevent the filing of a Federal Tax Lien (hereinafter "FTL"), but, under I.R.C. §6320, a Collection Due Process hearing is allowed to try to convince an IRS Appeals or Settlement Officer that the filing of the liens impairs collectibility of the IRS debt.

- (c) All unfiled tax returns must be filed before or relatively contemporaneous with the OIC or it will be returned "not processable".
- (d) All post OIC filing and estimated tax payment requirements must be met or the OIC will be summarily returned without administrative appeal rights.

(2) The Result.

When an OIC is accepted and terms of payment are met and satisfied, the following occurs:

The taxpayer is discharged from all tax debt included in the OIC.
All FTL's are immediately released.

The practitioner must be aware the IRS position is not to assert Cancellation of Debt Income (COD) under I.R.C. §108, relying upon Eagle Asbestos & Packing Co. v. United States, 348 F. 2d 528 (Ct. Cl., 1965). See, Service Center Advise, SCA 1998-039. That case, however, does not exactly comport with that section, and, the case cited in the footnote, Denman Tire & Rubber Co. v. Commissioner of Internal Revenue, 192 F. 2d 261 (6th Cir., 1951), seems to say the opposite. Although we have not seen it happen nor suggested by IRS, nor threatened by DOJ Tax, it remains problematic that inside a Title 11 case exceptions contained in IRC §108 would NOT apply to taxes discharged through an OIC because they were not discharged under the provisions of Title 11, but under I.R.C. §7122, and thus another exception other than IRC §108(a)(1)(A) may

be required. Careful planning by the tax professionals is required to adequately address and deal with this COD issue, especially taxable year timing of any discharge income effected through an OIC and not Title 11 should IRS change it's position in your case.

(3) Availability of the OIC in Title 11 Cases.

Generally, there is no reason an OIC cannot be effected inside of Title 11 cases to deal with taxes that could not otherwise be paid. If your analysis is the priority tax and other payment requirements of the Title 11 make confirmation unlikely or not feasible, an OIC analysis for all taxes should be made, especially if a release of FTL's before conclusion of the case allows assets to become unencumbered by the FTL and then available for use in satisfying other claims or other debtor uses, or eventual discharge of the FTL is sought.

The IRM provides for OIC's being available to individuals and operating businesses.

(4) Justification for Allowing OIC's in Title 11 Cases and The Due Process and Equal Protection Clauses of the Constitution of the United States.

You needn't be Laurence Tribe to understand there are constitutional issues.

For the United States to allow a tax debtor to settle debts owed to the United States for internal revenue taxes under I.R.C. §7122's favorable rules but deny that same Congressionally granted right to a debtor in bankruptcy calls forth the Due Process Clause with an equal protection type analysis.

(5) Case Law Allowing OIC's in Bankruptcy.

While there were a few cases preceding it, the leading case in this area is *In re Holmes*, 298 B.R. 477 (M. Dist., Ga., 2003, Hershner, Chief Judge), *aff'd*, 309 B.R. 824 (M. Dist. Ga., 2004).

In *Holmes*, the debtor at one time owned \$200 MILLION dollars worth of Worldcom stock. However, that went to zero in an apparently agonizing series of broker margin calls. On May 15, 2003, debtor sought an Order compelling the IRS to process and consider a filed OIC which IRS had returned under its policy of not processing OIC's while a Title 11 case is open. The debtor had about \$9 million of unsecured priority taxes and due to the size of the priority it appears no plan was confirmable because the sum of the assets and available income to the debtor resulted in him filing an OIC for some \$600,000.

Judge Hershner held an OIC is not a "license, permit, charter, franchise, or other similar grant under §525(a) of the Bankruptcy Code, but, held that §105(a) gave him the authority to order the IRS to process and consider the OIC as a method of resolving the tax liabilities, which he did. There was no

discussion of the Due Process Clause or any equal protection type analysis. IRS through DOJ Tax appealed.

The IRS appealed and lost. District Judge Royal affirmed and took the opportunity to state the Due Process/Equal Protection argument:

“First, Appellant outlines how a debtor’s tax liabilities are non-dischargeable under 11 U.S.C. §523 or §1141 because they are claims for priority tax, resulting interest and related penalties. Appellant argues that these are rights afforded to creditors by the Bankruptcy Code that the Bankruptcy Court is trying to abridge by its Order. This Court fails to see how the Bankruptcy Court is trying to abridge any right afforded to Appellant. There is no argument made by any party to discharge any tax liability under any Bankruptcy Code provision. Debtor is asking for Appellant to consider discharging a portion of his tax liability under the IRS’ own offer in compromise provision set forth in the Internal Revenue Code at I.R.C. § 7122. The Order of the Bankruptcy Court merely insists that Appellant IRS apply the same guidelines applicable to other taxpayers to debtors involved in bankruptcy when assessing these offers in compromise. The Court finds no merit to the argument that the Bankruptcy Court is attempting to abridge rights afforded to the Appellant as a creditor of Appellee.”

(Emphasis supplied).

The affirming court then went on to affirm the Bankruptcy Court’s authority to so order IRS under §105, and, that there was no violation of the Anti-Injunction Act, 26 U.S.C. §7421, in that the order was to process and consider, not accept.

IRS’s decision whether to accept or reject an OIC is reviewable under the abuse of discretion standard applicable to agency. The agency decision to accept or reject an OIC is reviewable under the abuse of discretion standard applicable to other administrative decisions, as are appeals of rejected Offers in Compromise made in the context of Collection Due Process cases under IRC §§6320 and 6330. If you meet the IRS criteria for an acceptable OIC, the United States should be able to be compelled to accept it. Since the IRS is an “agency” within the meaning the Administrative Procedures Act, 5 USC §501 et seq, the agency decision is reviewable under the standards stated in 5 USC §§ 706(2)(A) - (2)(D), and, 706(2)(F), which includes abuse of discretion. There is no valid argument that the “discretionary” decision of the IRS is not reviewable since there are in fact judicially manageable standards under which to assess whether the IRS decision was

justified (the US Tax Court does it regularly). *See, e.g.*, Heckler v. Chaney, 470 U.S. 825 (1991)(judicially manageable standards requirement for APA review). The claim is essentially one of Due Process. At the State level, the claim would include one of Equal Protection. For an excellent discussion of the abuse of discretion standard in application to IRS rulemaking under IRC 7805(b), *see*, International Business Machines Corporation v. United States, 343 F.2d 914 (Ct. Cl., 1965).

Query whether a Bankruptcy Court has jurisdiction to review a rejected OIC and compel acceptance under a finding of abuse of discretion.

After *Holmes*, the following cases ordered the IRS to process the OIC like any other OIC filed by a taxpayer outside a Title 11 case. They are, in no particular order and not exclusively, as follows:

In re Macher, 303 B.R. 798 (USDC, Dist. W. Va. 2003), *aff'g*, 92 AFTR2d 2003-7437 (Bkcty VA, 2003);
In re Kline, 94 AFTR2d 2004-6626 (Bkcty NY, 2004);
In re Peterson, 94 AFTR2d 2004-7117 (Bkcty NE, 2004);
Mills v. U.S., 240 B.R. 689 (Bkcty WV, 1999);
Chapman v. U.S., 84 AFTR2d 99-5271 (Bkcty WV, 1999).

There is one case which held the IRS need not process OIC while a Title 11 case is pending. *See In re 1900 M. Restaurant*, 95 AFTR2d 2005-684.

This case is understood to be under appeal. *See also*, AOD 2004-003 (08/04/2004) (IRS will not follow *Macher*).

Jurisdiction over OIC's during Title 11 cases lies with the U.S. Department of Justice. Acting as an administrative agency operating under the IRS rules for OIC's should make its determination regarding acceptability of the OIC subject to abuse of discretion standard of review, as they are representing the Commissioner of Internal Revenue.

(xii) As a practical matter, IRS performs the financial analysis of an OIC and makes a report to DOJ Tax.

(B) Calculating An Acceptable OIC Amount for Individuals, in and not in Title 11 Cases.

There are two components to calculation; Assets and Monthly Disposable Income.

(1) The Income Component - Collection Financial Standards Now Made Part of the so-called Means Test Under 11 U.S.C. §707.

Example #1: Taxpayer is a single parent living in Middlesex County, Massachusetts with two

minor children who are in employer provided daycare while taxpayer works. Stemming from divorce, taxpayer was left with substantial debt including joint income tax liabilities to IRS and Massachusetts. Massachusetts assessed their income tax first. You have determined the income tax is not dischargeable as to either. The taxpayer's income is solely for employment and is a gross of \$7,500 per month, paid monthly once, \$90,000 per year. The taxpayer has the following monthly expenses:

<u>Expense Items</u>	<u>Maximum Allowable Under Collection Financial Standards</u>	<u>Amount</u>
SS Tax @ 6.2%	In Full	465.00
Medicare Tax @ 1.45%	In Full	108.75
Withheld Federal Income Tax	In Full	1,608
Withheld Massachusetts Tax	In Full	365.00
Provided Health Care Contribution to Employer	In Full	300.00
Provided Dental Contribution to Employer	In Full	42.25
Group Term Life Insurance	In Full	11.00
Rent, including utilities, heat, etc. @2,400 maximum allowable	IRS Limitation	1,948.00
Maximum Allowable National Standard Expense	IRS Limitation	1,430.00
Maximum Allowable \$475 Auto Lease, \$270 per month	In Full	270.00
Actual \$380 Auto, Operating Costs	IRS Limitation	284.00
Payment Agreement, Mass. DOR	Not Allowed	0.00

\$200.00 per month

Total Allowable Expenses
\$6,832.00

Net Monthly Disposable Income
\$668.00

(NMDI)

Total Actual Expenses
\$7,580.00

The available methods to determine the amount of the income portion of an OIC are three. They are, payment within ninety (90) days of the date of acceptance, within two (2) years of acceptance, and payment of the NMDI over the life of the remaining months of the statute of limitations on collection.

For payment within 90 days of acceptance, the NMDI is multiplied by 48 and is \$32,064.

For payment within 2 years of acceptance, the NMDI is multiplied by 60 and is \$40,080.

Or, the taxpayer may pay \$668.00 per month over the life of the statute of limitations on collection, which may or may not exceed any maximum payment terms under Chapters 11 or 13.

It is critical to be extremely diligent in finding allowable items to reduce the NMDI since every \$100 of additional allowable monthly expenses reduces the income component of an acceptable OIC proposal as follows:

<u>Payment Option</u>	<u>OIC Income Component Increase</u>
PAYABLE IN 90 DAYS	\$4800
PAYABLE IN 2 YEARS	\$6000
LIFE COLLECTION STATUTE MONTH.	\$100 PER

Example #2: (A more complicated analysis would be the following set of facts)

Husband operated a business which has failed. He fully paid the State income tax withholding and unemployment insurance contributions until the business ceased operations. However, the IRS asserted a Trust Fund Recovery Penalty (TFRP) against the Husband for failure to pay over withheld employee Social Security, Medicare and Federal income tax in the amount of \$398,000. Husband and Wife stopped filing joint income tax returns several years ago, but, alone, Husband owes IRS \$92,000 in priority income taxes, which at the date of visiting you now totals \$132,000 with interest exclusive of penalties. Husband and Wife own a single family residence with a fair market value of \$400,000 encumbered by a first mortgage of \$240,000 and a second

mortgage of \$60,000. The IRS filed a Federal Tax Lien (FTL) against Husband and holds a 3rd position against Husband's equity in that property. In addition, Husband and Wife own rental property worth \$500,000 with 1st mortgage of \$400,000 acquired before the FTL went on. That property carries itself but there is no excess income. Husband has \$60,000 of general unsecured debt.

Husband has obtained employment which pays him \$7,500 per month. Wife has gone back to work and has obtained part-time employment which pays her \$2,500 per month. Husband's employer provides contributory health care for himself, the Wife, and their two minor children, deducting \$260 per month from his wages. Husband leases a vehicle for \$450 per month and Wife uses her car always owned in her own name. Their monthly first mortgage payment, including principal, interest, taxes and insurance is \$2,000 per month. The second mortgage payment is \$200 per month. It costs another \$400 per month to run the house, making actual housing costs \$2,600.00. Husband and Wife incur \$100 per month of dental expenses for the family. You sent them to CVS to get a one-year print out of their out-of-pocket prescription and Medicare costs and it worked out to \$80 per month. Their medical co-pays were an average of \$30 per month, but that was under the plan maintained by the Husband's business which had \$5 co-pays, Husband's current plan has \$20 co-pays. They have no other allowable expenses under the Collection Financial Standards.

The OIC analysis and computation for debtor H would be as follows:

<u>ASSETS</u>	<u>OIC VALUE</u>	
1. Principal Residence		
FMV	\$400,000	
1 st Mortgage	(240,000)	
2 nd Mortgage	(60,000)	
Net Value before		
FTL	\$100,000	
½ to H	50,000	
x .80 for IRS		
Quick Sale Value*	\$40,000	\$40,000

*IRS allows an immediate 20% reduction in value for OIC purposes on all assets other than marketable securities, pension assets and other liquid assets not involving other than minor costs to liquidate.

2. Investment/Rental Property

FMV	\$500,000
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1 st Mortgage	(400,000)	
Net Value before		
FTL	\$100,000	
½ to H	\$ 50,000	
x .80 for IRS		
Quick Sale Value	\$ 40,000	\$40,000

Since H has no other assets with equity, we now conclude the Offer value of his assets are \$40,000 on the residence and \$40,000 on the investment property, for a total of \$80,000.

Turning now to income, the Collection Financial Standards of IRS require that an allocation be made between the Husband and Wife to determine the amount. That application to shared expenses is made by setting up a fraction where the numerator is Husband's gross monthly income and the denominator is the sum of Husband and Wife's monthly income. In this example, the fraction would be:

<u>H's Monthly</u>	<u>\$ 7,500</u>	
<u>H & W's Monthly</u>		<u>\$10,000</u>

Thus, the % for H is 75%. That % is now applied to allocable expenses under the Collection Financial Standards as follows:

<u>EXPENSE ACTUAL</u>	<u>MAX ALLOWED</u>	<u>H% FOR OIC</u>	
Housing - \$2,600		\$2,240	\$1,680
National Standard Expense		\$1,564	1,173
(NSE), Family; Food, Clothing, Housekeeping, Supplies, Personal Care, Miscellaneous			
Transportation, Ownership			
Monthly - \$450		\$ 450	\$ 450
Transportation, Operating			
Monthly - \$350		\$ 284	\$ 284
FICA & Medicare Tax		FULL	\$ 573.75
Mass. Income Tax @5%		FULL	\$ 300
FIT	FULL	\$1,100	

@ 260	Health Insurance	FULL	\$ 260
	Dental @ 100	75%	\$ 75
	Medical Co-pays		
	30 x 12 = 360 / 5 = 72 x 20 =		
	1,440	75%	\$ 1,080
	TOTAL ALLOWABLE EXPENSES		\$ 6,975.75

H's NMDI is \$7,500 less allowable expenses of \$6,975.75 for \$524.25. Thus, Husband's OIC with IRS would include his \$80,000 in asset value and his \$524.25 in monthly income.

Comparing this to a possible Chapter 13 with payments over 5 years on the trust fund and priority tax in full now required by the Act, taxes totaling \$530,000, a Chapter 13 example using same facts as this OIC:

A Chapter 13 plan requires a liquidation analysis to be sure that creditors will not receive less in the plan than they would in a Chapter 7 case. For the Chapter 13 plan, the Quick Sale Value of 80%, which is available in an offer in compromise, is not used. Instead exemptions available under the applicable state or federal laws are applied to the value of the Husband's assets.

In this case, the Husband and Wife are assumed to have filed a valid declaration of homestead on their residence prior to filing for protection in Chapter 13.

Residence Value	\$50,000	
Less exemption	<u>50,000</u>	
Available Chapter 7		0
Investment Property	\$50,000	
Less exemption	<u>0</u>	
Available Chapter 7		\$50,000
Total available Chapter 7		\$50,000

Therefore, the Husband's plan payments must exceed \$50,000. Assuming that, besides his unpaid taxes, he has \$60,000 in general unsecured debts and the couple has \$850 per month to devote to the Chapter 13 plan, over 60 months this plan will yield \$51,000. If he has the \$80,000 offer in compromise per the above example, converting the IRS from a secured or priority or both creditor to a contract creditor on a secured, partly secured or unsecured basis (admittedly, that is wholly new ground), the numbers will work as follows:

IRS Secured and Priority Claims:

Satisfied by		
General Unsecured Claims	IRS OIC	\$80,000
Total \$60,000 at		
	dividend of 10%	<u>6,000</u>
	Total claims to be paid	\$86,000
Divide total by .90 to include		
	trustee's fee	\$95,555.55
	Less \$850/mo over 60 months	<u>\$51,000</u>
Amount to be financed to pay		
balloon payment at		
	end of plan*	<u>\$44,555.55</u>

*At the end of the plan, the Husband and Wife will refinance the mortgage on their residence to fund this balloon payment. Note, however, that this is but an example. Satisfaction of the IRS OIC will be driven by the payment terms of that OIC and may not include a balloon payment. Further, it may come to pass that the payments to be made on the OIC are not a part of the 13 payment plan and are effected outside of Title 11. However, following is the calculation if there is no OIC:

Priority Claims:

	IRS	\$132,000
	TFRP	<u>398,000</u>
	Total priority claims	\$530,000
General Unsecured Claims		
Total \$60,000 at		
	dividend of 10%	<u>6,000</u>
	Total claims to be paid	\$536,000
Divide total by .90 to include		
	trustee's fee	\$595,555.55
	Less \$850/mo over 60 months	<u>51,000.00</u>
Amount to be financed to pay		
balloon payment at		
	end of plan**	<u>\$544,555.55</u>

**The plan is not confirmable because the financing of the proposed balloon payment is most likely not feasible due to the equity of the property being \$100,000 at the beginning of the Chapter 13 case. In a Chapter 7, the funds received from the sale of the investment property will pay administrative expenses first, then the remainder will pay part of the tax claims. No payment will be made to general unsecured creditors. Husband will not be discharged from the remainder of the tax claims. There is the possibility of an OIC 'opportunity' after the close of the Chapter 7 case.

OIC's with short Statutes of Limitation on Collection, the Collection Statute Expiration

Date (CSED), present special calculation problems. The current IRS models assume there are at least 5 years remaining the CSED. Often, an OIC will be even more advantageous if there is less than 5 years remaining on a CSED. This is extremely important because the I.R.M. allows for a reduction in the amount collectible from future income, the Income Component of an OIC, from the standard calculation method. This reduction is allowed when a short statute is present.

PART THREE

SUMMARY OF INDIVIDUAL TAX CHANGES MADE BY THE ACT .

§701 of the Act amends §724 of the Code to provide that subordination of ad valorem tax liens is limited to the payment of: (1) claims for wages, salaries, and commissions entitled to priority under §507(a)(4); and (2) claims for contributions to employee benefit plans entitled to priority under §507(a)(5). Also, a Chapter 7 trustee must exhaust all other unencumbered estate assets and, with §506, recover reasonably necessary costs and expenses of preserving or disposing of such property before subordination.

§701(b) of the Act amends §505(a)(2) of the Code to provide the amount and legality of an *ad valorem* tax on real or personal property is incontestible in the bankruptcy court if the applicable period for contesting or redetermining the amount of the claim under nonbankruptcy law has expired.

§703 of the Act requires the Clerk of each district to maintain a list of addresses designated by governmental units for service of §505 requests and may include information concerning filing requirements specified by such governmental units. If a governmental entity does not designate an address and provide that address to the bankruptcy court clerk, any request made under §505(b) may be served at the address for the filing of a tax return or protest of the appropriate taxing authority of that governmental unit. Also, §715 of the Act resolves the nagging issue of the estate not being able to obtain a §505 (b) discharge available to the debtor and the trustee by adding the estate.

§704 of the Act provides the interest rate to be paid on all tax claims is to be determined under applicable nonbankruptcy law. As to confirmed plans the rate is that applicable to the month of confirmation.

§705 of the Act alters priority tax claims and is covered in the materials, *supra*.

§706 of the Act resolves the problem of many property tax statutes not using the term “assessed” as does the IRC, to raise a claim, by amending §507(a)(8)(B) by replacing the word “assessed” with “incurred”.

§707 of the Act amends §1328(a)(2) to prohibit the discharge of tax claims described in section 523(a)(1)(B) and (C) and trust fund taxes described in § 507(a)(8)(C).

§709 of the Act amends §362(a)(8) to limit the automatic stay to prepetition taxes of individuals.

§710 of the Act amends §1129(a)(9) to provide that the allowed amount of priority tax claims (as of the plan's effective date) must be paid in regular cash installments within 5 years from the entry of the order for relief, and the payment schedule may not be less favorable than that accorded the most favored nonpriority unsecured claim in the plan, with an exception for cash payments to a class of creditors under §1122(b). It requires the same payment treatment be accorded to a secured claim that would otherwise meet the description of a §507(a)(8) unsecured claim.

J. §711 of the Act prevents the avoidance of unperfected liens against anyone who meets the definition of “purchaser” under the federal tax lien exception statute, §6323.

K. §712(a) of the Act amends 28 USC §960 to provide postpetition taxes incurred in the ordinary course of business must be paid on or before when such tax is due under applicable nonbankruptcy law, except for the following: (1) if the obligation is a property tax secured by a lien against property that is abandoned under §554 within a reasonable time after the lien attaches, (2) if payment is excused under the Bankruptcy Code, (3) in 7's, if the tax was not incurred by the Trustee or the court finds the estate is administratively insolvent, payment of a tax claim may be deferred until final distribution, and, §712(b) of the Act amends §503(b)(1)(B)(i) to state this applies to tax claims that are secured, unsecured, and, property taxes notwithstanding the property tax liability is *in rem* or *in personam*.

L. §712(c) of the Act amends §503(b)(1) to exempt a governmental unit from the requirement to file a request for payment of an administrative expense.

M. §712(d)(1) amends §506(b) to provide that as to an oversecured claim, the claimant is entitled to interest and any reasonable fees, costs, or charges provided for under state law. In addition, §712(d)(2) amends §506(c) to permit a trustee to recover from a secured creditor the payment of all ad valorem property taxes (IRS and State tax agencies are going to LOVE this one).

N. §713 of the Act provides that tardy tax claims will be entitled to a distribution if the claim is filed the earlier of (1) the date that is 10 days following the mailing to creditors of the summary of the trustee's final report or (2) before the trustee commences final distribution.

O. §714 of the Act provides that signed income tax assessments or stipulations

under IRC §6020(a) or similar State or local law constitute a return for discharge purposes but returns prepared under IRC §6020(b) or similar State or local law continue to be deemed NOT a return.

P. §716(a) of the Act amends §1325(a) to require a Chapter 13 debtor to file all applicable Federal, state, and local tax returns as a condition of confirmation.

Q. §716(b) of the Act adds §1308 to require a chapter 13 debtor to be current on the filing of tax returns for the four _year period preceding the petition, and, if the returns are not filed by the first §341 meeting, the trustee may hold open that meeting for a reasonable period of time to allow the debtor to file any unfiled returns but not more than (1) 120 days or (2) beyond the date on which the return is due under the last extension of time for filing. The debtor, however, may obtain an extension of time from the court if the debtor demonstrates by a preponderance of the evidence that the failure to file was attributable to circumstances beyond the debtor's control (the “coma” defense” in the tax business). If the debtor fails to file or carry that burden, the court MUST dismiss the case or convert it to one under chapter 7, whichever is in the best interests of creditors and the estate, on request of a party in interest or the United States trustee, after notice and a hearing.

R. §716(d) amends §502(b)(9) to provide that in a 13, a tax claim based on a return filed under §1308 is timely if the claim is filed within 60 days from the return filing date.

S. §718 provides an exception to the automatic stay allowing a prepetition tax refund to be set off against a prepetition tax liability unless there is a pending action to determine the amount or legality of the liability, in which case the tax authority may hold the refund pending resolution of the action, unless the court, on motion of the trustee and after notice and a hearing, grants the tax authority adequate protection under §361.

T. §719 of the Act removed §728 and amended §346. Under prior law as to State and local tax law, partnerships in a chapter cases where a partner is also in a chapter case where income was not distributed to the partner required the State or local authority claim to income tax on behalf of the partner be collectible only against the partnership. §§346(b) and (c) now provide the partner is liable for any tax on income of the partnership that is distributed or considered distributed, and not the estate, even if a partner subject to this constructive distribution rule is also in a chapter case. The interplay of this change with the means test under §707 should be interesting. §346(d) also states (does not clarify) that the taxable period of a debtor terminates if and only if the taxable period also terminates under the IRC. This section does not resolve the issue of whether the filing of a petition by a member of a partnership terminates the partner’s taxable year in the partnership and

creates a new taxable period for the bifurcated ownership of the partnership interest between the prepetition debtor and the estate created by old §346(c)(1), as that section was removed. §346(e) provides the carryover of the debtor's accounting method only if the accounting method is an allowed one. Also, new §346(f) does not help out, as it merely states the deemed transfer of property from the debtor to the estate is not a disposition of the property unless the IRC treats the deemed transfer as a disposition. Old §346(e) has been removed, whereby a nondeductible tax claim or a capital expenditure that was not deductible was allowed as a business expense. The balance of the changes attendant the repeal of §728 and the changes to §346 are largely business related. The practitioner would be well advised to understand the subtle and not so subtle changes effected in §346 and by the repeal of §728 whether the case involves an individual or entity or both.

U. §720. Dismissal for Failure to Timely File Tax Returns. Under existing law, there is no definitive rule with respect to whether a bankruptcy Court may dismiss a bankruptcy case if the debtor fails to file returns for taxes incurred postpetition. This amends §521 to allow a taxing authority to request the court dismiss or convert a bankruptcy case if the debtor fails to file a postpetition tax return or obtain an extension. If the debtor does not file the required return or obtain the extension within 90 days from the time of the request by the taxing authority to file the return, the court must convert or dismiss the case, whichever is in the best interest of the creditors and the estate.