



AMERICAN
BANKRUPTCY
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ABI/UMKC Midwestern
Bankruptcy Institute

Consumer: Tax Aspects in Bankruptcy Practice

Sponsored by Baird Holm LLP

Najah J. Shariff

U.S. Attorney's Office | Los Angeles

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Tax Aspects in Bankruptcy Practice

ABI's 2022 Midwestern Bankruptcy Workshop

October 6-7 Kansas City, MO

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Disclaimer: AUSA Najah J. Shariff currently serves in the Tax Division of the United States Attorney's Office for the Central District of California. The views expressed in this presentation by AUSA Shariff are solely those of hers and do not necessarily represent the positions of the U.S. Department of Justice.

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Najah J. Shariff*

- Assistant United States Attorney (AUSA) with United States Attorney's Office, Tax Division, in Los Angeles (May 2015 to the Present)
- AUSA Shariff represents the United States, on behalf of the IRS, in some of the biggest and most complex cases involving bankruptcy tax and civil tax litigation matters in the United States Bankruptcy Court, the United States District Court, and the Superior Court of California.
- Former Special Assistant United States Attorney (SAUSA) and Senior Tax Attorney with the IRS Office of Chief Counsel (March 2006 to May 2015) where she tried numerous cases in Bankruptcy Court and the United States Tax Court, involving complex, novel, and high-profile tax and bankruptcy issues.
- Ms. Shariff has developed an expertise in bankruptcy tax law, tax litigation, refund litigation, tax deficiency litigation, the assessment and collection of taxes, federal tax liens and levies, collection due process, summons enforcement, FBAR cases, surplus funds cases, foreclosure actions, complaint-in-interpleader actions, disclosure, privacy and FOIA issues.
- Ms. Shariff received her LL.M. in Tax from Georgetown University Law Center and her J.D. from Boston University Law Center.

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Steven L. Walker



Mr. Walker advises clients on tax controversies and litigation with the Internal Revenue Service (IRS), Franchise Tax Board (FTB), and state and local taxing agencies and handles bankruptcy tax matters.

Former attorney IRS Office of Chief Counsel, Dept. of Treasury

Adjunct Professor of Law, University of SF, LLM Taxation Program (Bankruptcy tax and civil and criminal penalties)

Fellow, American College of Tax Counsel

Certified Taxation Law Specialist, State Bar of California

Past Chair, Taxation Section, State Bar of CA (now CA Lawyers Assn)

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Agenda

- IRS Field Insolvency and role of U.S. Attorney's Office
- Resources and IRS Transcripts
- IRS Proof of claim
- Should I litigate my tax case in Bankruptcy Court?
- Discharging taxes in bankruptcy (late-filed returns, delinquent returns, and payroll taxes)
- Does the IRS have a secured claim?
- Notice of Federal Tax Liens
- Questions

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Commonly Encountered Tax Compliance Issues

- Failing to make estimated tax payments
- Unreported income/false deductions
- Unfiled or delinquent tax returns
- Not paying payroll taxes
- Improperly classifying workers as independent contractors
- Using S corporation as a personal “piggy bank”
- Not issuing Form 1099s and improper classification of workers

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U.S. Attorney’s Office

- What is our role?
- When do we get involved in your case?
- We work with IRS Field Insolvency and IRS Office of Chief Counsel (in-house counsel for IRS)



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IRS Insolvency



- Responsible for administering the coordination of tax and bankruptcy law for collecting tax debts through the bankruptcy court.
- **Field Insolvency**
 - Consists of four territories through the country
- **Centralized Insolvency Operation (CIO)**
 - CIO is located in Philadelphia Campus

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Field Insolvency



- Prepares and files all proof of claim
- Works on bankruptcy cases except some Chapter 7 no asset cases
- Review plans and schedules, as appropriate
- Refers cases to U.S. Attorney, Dept. of Justice (DOJ), or Area Counsel, as necessary
- Make collection determinations and negotiates with debtors.

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Resources Page

- **IRS website.** www.irs.gov.
- **IRS Publication 908** - This publication explains the basic federal income tax aspects of bankruptcy. www.irs.gov/pub/irs-prior/p908--2022.pdf
- **Publication 5082**, What You Should Know About Chapter 13 Bankruptcy and Taxes. <https://www.irs.gov/pub/irs-pdf/p5082.pdf>
- **IRS Practitioner Priority Service.** 866-860-4259
- **Internal Revenue Manual, Part 5.9** - discusses Bankruptcy and Other Insolvencies. www.irs.gov/irm/part5/irm_05-009-001r#idm140114856124720

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Resources Page

- **Taxpayer Advocate Service.** The Taxpayer Advocate Service (TAS) is your voice at the IRS. We help taxpayers whose problems with the IRS are causing financial difficulties; who have tried but have not been able to resolve their problems with the IRS; and those who believe an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can call the TAS toll free number at 1-877- 777-4778. For more information, go to www.irs.gov/uac/TaxpayerAdvocate-Service-6 or look at IRS Publication 1546,
- **Low Income Taxpayer Clinics** - Serve individuals who need help resolving a tax problem with the IRS and whose income is below a certain level. Publication 4134, Low Income Taxpayer Clinic List, provides information on clinics in your area. It is available at www.irs.gov.

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IRS Transcripts – How to get and read them

- **Step 1.** Complete a Form 2848 (Power of Attorney), or Form 8821 (Tax Information Obligation)
- **Step 2** – Upload the completed form to the IRS website and wait about two weeks
- **Step 3** – Request transcripts online
 - You will need to create an IRS account
- **Step 4** – Read the transcript and create a worksheet
 - summ

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Step 1. Complete Form 8821

- Simple form that your client signs
- Most debtors owe Form 1040 taxes for several years.
- Make sure to read the IRS correspondence so you cover all of the tax years, tax forms, and types of taxes.

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8821		Tax Information Authorization	
Form 8821 (Rev. January 2017) Department of the Treasury Internal Revenue Service		Go to www.irs.gov/Form8821 for instructions and the latest information. Don't sign this form unless all applicable lines have been completed. Don't use Form 8821 to request copies of your tax returns or to authorize someone to represent you. See instructions.	
1 Taxpayer information. Taxpayer must sign and date this form on line 5. Taxpayer name and address _____ _____ _____		Taxpayer identification number(s) _____ Daytime telephone number _____ Fax number (if applicable) _____	
2 Designee(s). If you wish to name more than two designees, attach a list to this form. Check here if a list of additional designees is attached. <input type="checkbox"/>		Check if to be sent copies of notices and communications <input type="checkbox"/>	
Name and address _____ _____ _____		CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____	
Name and address _____ _____ _____		Check if new Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/> CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____	
Check if to be sent copies of notices and communications <input type="checkbox"/>		Check if new Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>	
3 Tax information. Each designee is authorized to inspect and/or receive confidential tax information for the type of tax, form, period, and specific matters you list below. See the line 3 instructions. <input type="checkbox"/> By checking here, I authorize access to my IRS records via an Intermediate Service Provider.			
10 Type of Tax Information Request (Income, Payroll, Social Security, etc.)	20 Tax Form Identifier (1040, 991, 990, etc.)	30 Year(s) or Period(s)	40 Specific Tax Matters
4 Specific use not recorded on the Centralized Authorization File (CAF). If the tax information authorization is for a specific use not recorded on CAF, check this box. See the instructions. If you check this box, skip line 5. <input type="checkbox"/>			
5 Retention/revocation of prior tax information authorizations. If the line 4 box is checked, skip this line. If the line 4 box isn't checked, the IRS will automatically revoke all prior tax information authorizations on the dates you check the line 5 box and attach a copy of the tax information authorization(s) that you want to retain. <input type="checkbox"/> To revoke a prior tax information authorization(s) without submitting a new authorization, see the line 5 instructions.			
6 Taxpayer signature. If signed by a corporate officer, partner, guardian, partnership representative or designated individual, if applicable, executor, receiver, administrator, trustee, or individual other than the taxpayer, I certify that I have the legal authority to execute this form with respect to the tax matters and tax periods shown on line 3 above. IF NOT COMPLETED, SIGNED, AND DATED, THIS TAX INFORMATION AUTHORIZATION WILL BE RETURNED. DON'T SIGN THIS FORM IF IT IS BLANK OR INCOMPLETE.			
Signature _____ Print name _____		Date _____ Title or position _____	
For Privacy Act and Paperwork Reduction Act Notice, see the instructions. Form 8821 (Rev. 01-2017)			

Step 2. Submit Form 2848 or 8821

IRS

Help | News | English | Charities & nonprofits | Tax tips

File | Pay | Refunds | Credits & Deductions | Forms & Instructions

Home / Tax tips / Submit Forms 2848 and 8821 Online

Submit Forms 2848 and 8821 Online

Enrolled Agents

Annual Filing Season Program Participants

Enrolled Retirement Plan Agents

Certified Professional Employer Organization (CPEO)

Enrolled Actuaries

E-File Providers

Modernized e-File

You can safely upload and submit your client's third-party authorization forms:

- Form 2848, [Power of Attorney and Declaration of Representative](#) (PDF)
- Form 8821, [Tax Information Authorization](#) (PDF)

Log In to Submit

Before You Get Started

- Ensure you have authenticated the identity of your client.
- Make sure the form is signed by all parties either electronically or with an ink signature. Refer to the [Frequently Asked Questions](#) below for more information on electronic signatures.

Submit Your Form

From any web browser:

- Log in with your username, password, and multi-factor authentication.
- Answer a few questions about the form that will be submitted. You can only submit one form at a time.
- Upload a completed version of a signed Form 8821 or Form 2848. Do not submit a form online if you've already submitted it by fax or mail.
- To submit multiple forms, select "submit another form" and answer the questions about the authorization.

If you are unable to establish a Secure Access account or submit the forms online, you can [submit forms by fax or mail](#).

Step 3 – Request transcripts online

IRS

Help | News | English | Charities & nonprofits | Tax tips

File | Pay | Refunds | Credits & Deductions | Forms & Instructions

Home / Tax | Statistics | Your information | See forecasts

Get Your Tax Record

English | español | 中文(简体) | 中文(繁體) | हिन्दी | বাংলা | বাংলা | বাংলা | বাংলা

Individuals

- Who Should File
- How to File
- When to File
- Where to File
- Your Information
- Tax Record (Transcript)**
- Third Party Authorization
- Students
- Employees
- Parents
- Military
- Seniors & Retirees

Businesses and Self-Employed

Charities and Nonprofits

International Taxpayers

Governmental Liaisons

Order copies of tax records including transcripts of past tax returns, tax account information, wage and income statements, and verification of non-filing letters.

Access Tax Records in Online Account

You can view your tax records now in your Online Account. This is the fastest, easiest way to:

- Find out how much you owe
- Look at your payment history
- See your prior year adjusted gross income (AGI)
- View other tax records

Visit or create your [Online Account](#).

The method you used to file your tax return (e-file or paper) and whether you had a balance due affects your [current year transcripts availability](#).

Request Online

Request your transcript online for the fastest result.

What You Need

If you don't have an existing IRS username or ID.me account, have your photo identification ready.

What You Get

- All [current year](#) transcripts are available online.
- View, print, or download your transcript.
- Verify your identity once and you can easily return later to get a transcript or use other IRS online services.

Get Transcript Online

Caution: This service is for individual taxpayers to retrieve their own transcripts for their own purposes. Use by any other entities is prohibited.

Page 1 of 4

Internal Revenue Service
United States Department of the Treasury

What Product Can/Can't Receive Taxpayer Data

Account Transcript

Request Date: 09-10-2017
Response Date: 09-10-2017
Tracking Number:

FILE NUMBER: 1346
TAX PERIOD: 0401 01, 2017

TAXPAYER IDENTIFICATION NUMBER:
SPOUSE TAXPAYER IDENTIFICATION NUMBER:

This transcript covers Form 1040 for the year 2007. There is a separate transcript for each tax period. Make sure your POA covers all forms and all period!

***** OWNER OF ACCOUNT/TAX INFORMATION AUTHORIZATION (OIA/TAO OR FTA) *****
*** ARE MONIES SHOWN BELOW DEPOSITED A CREDIT AMOUNT ***

ACCOUNT BALANCE: 109,477.64
ACCOUNT INTEREST: 26,479.32 AS OF Oct. 02, 2017
ACCOUNT DEBIT: 0.00 AS OF Oct. 02, 2017

ACCOUNT BALANCE PLUS MONIES (THIS IS NOT A PAYOFF AMOUNT): 209,952.48

** INFORMATION FROM THE RETURN OR AS ADJUSTED **

EXEMPTION:
FILING STATUS:
ADJUSTED GROSS INCOME:
TAXABLE INCOME:
TAX PER RETURN:
AS TAXABLE INCOME TAXPAYER:
AS TAXABLE INCOME SPOUSE:
TOTAL OVER PAYMENT REFUND:

This tells you the balance due, but it's not the payoff amount.

The IRS received the tax return on Nov. 10, 2008, and processed the return on Dec. 29, 2008. (This may not be the filing date.)

RETURN DUE DATE OR RETURN RECEIVED DATE (WHICHEVER IS LATER): Nov. 10, 2008
PROCESSING DATE: Dec. 29, 2008

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TRANSACTION				
CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
100	Tax return filed	0000100	12-29-2008	26.36
101	W-2 or 1099 withholding			
102	Withholding allowance claimed - (extra monies)			
103	Adjusted tax return or claim forwarded for processing			
104	Adjusted return filed		12-29-2008	26.36
105	Adjusted tax return processed at the taxpayer's request		12-29-2008	26.36
106	Adjusted to your account		04-10-2009	-65,100.00
107	Additional tax assessed return pending		12-29-2008	46.44
108	Refund issued (SP 2008)		12-29-2008	26.36
109	Credit transferred not to (SP 2008)		04-10-2009	26.36
110	Refund issued (SP 2008)			
111	Refund additional amount return			
112	Refund issued		02-10-2009	262,477.64
113	Refund issued to your account		02-10-2009	262,477.64
114	W-2 or 1099 withholding		04-10-2009	46,477.64
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307	Refund additional amount return			
308	Refund issued		02-10-2009	262,477.64
309	Refund issued to your account		02-10-2009	262,477.64
310	W-2 or 1099 withholding		04-10-2009	46,477.64
311	Additional tax assessed		02-10-2009	26.36
312	Refund issued (SP 2008)		02-10-2009	46.44
313	Adjusted tax return or claim forwarded for processing		12-29-2008	46.44
314	Adjusted return filed		12-29-2008	26.36
315	Adjusted return processed at the taxpayer's request		12-29-2008	26.36
316	Adjusted to your account		04-10-2009	-65,100.00
317	Additional tax assessed return pending		12-29-2008	46.44
318	Refund issued (SP 2008)		12-29-2008	26.36
319	Credit transferred not to (SP 2008)		04-10-2009	26.36
320	Refund issued (SP 2008)			
321	Refund additional amount return			
322	Refund issued		02-10-2009	262,477.64
323	Refund issued to your account		02-10-2009	262,477.64
324	W-2 or 1099 withholding		04-10-2009	46,477.64
325	Additional tax assessed		02-10-2009	26.36
326	Refund issued (SP 2008)		02-10-2009	46.44
327	Adjusted tax return or claim forwarded for processing		12-29-2008	46.44
328	Adjusted return filed		12-29-2008	26.36
329	Adjusted return processed at the taxpayer's request		12-29-2008	26.36
330	Adjusted to your account		04-10-2009	-65,100.00
331	Additional tax assessed return pending		12-29-2008	46.44
332	Refund issued (SP 2008)		12-29-2008	26.36
333	Credit transferred not to (SP 2008)		04-10-2009	26.36
334	Refund issued (SP 2008)			
335	Refund additional amount return			
336	Refund issued		02-10-2009	262,477.64
337	Refund issued to your account		02-10-2009	262,477.64
338	W-2 or 1099 withholding		04-10-2009	46,477.64
339				

[illegible]

Step 4 – Prepare a worksheet that you can review with our client. This is your “key work product”

Total: \$ 175,000.00

IRS Proof of Claim

- Identifies the amount of tax debt
- Secured
- Priority
- Unsecured general

2012 Official Form 101 (04/12)		PROOF OF CLAIM
UNITED STATES BANKRUPTCY COURT		
Name of Debtor	Case Number	
NOTE: Do not use this form to make a claim for an administrative expense that arises after the bankruptcy filing. This form is required for payment of an administrative expense according to 11 U.S.C. § 503.		
Name of Creditor (the person or other entity to whom the debt is owed)		
Address and address where services should be sent:		
Telephone number:	area:	
Name and address where personal checks should be sent (if different from above):		
Telephone number:	area:	
1. AMOUNT OF CLAIM IF THIS CASE TYPE		
If all or part of the claim is secured, complete items 4.		
If all or part of the claim is entitled to priority, complete item 5.		
2. Basis for Claim (See instruction 4.)		
3. Last four digits of any number by which creditor identifies debtor:		
3a. Debtor name have scheduled account at:		
3b. Uniform Claim Identifier (optional):		
4. Secured Claim (See instruction 4d)		
Check the appropriate box if the claim is secured by a lien on property or a right of offset. Attach required documents, and provide the required information.		
5. Amount of Claim Entitled to Priority under 11 U.S.C. § 507 (a). If any part of the claim falls into one of the following categories, check the box specifying the priority and state the amount.		
6. Creditors. The amount of all payments on this claim has been credited for the purpose of making this proof of claim. (See instruction 4d)		

19



Getting a Second Bite of the Apple - Determining Tax Liability in Bankruptcy Court.

- The court may determine the amount or legality of any tax, fine or penalty, whether or not the IRS has not assessed the taxes or the taxes were paid. [11 USC 505(a)(1)]
- The court may not determine the amount of a tax, fine or penalty if such amount or legality was **contested before and adjudicated by a judicial or administrative tribunal** of competent jurisdiction before the commencement of the case under this title." [11 USC 505(a)(2)]
- So, if the **Tax Court** decided the issue, you can't relitigate it.
- **It's almost like a second or third bit of the apple!**

20

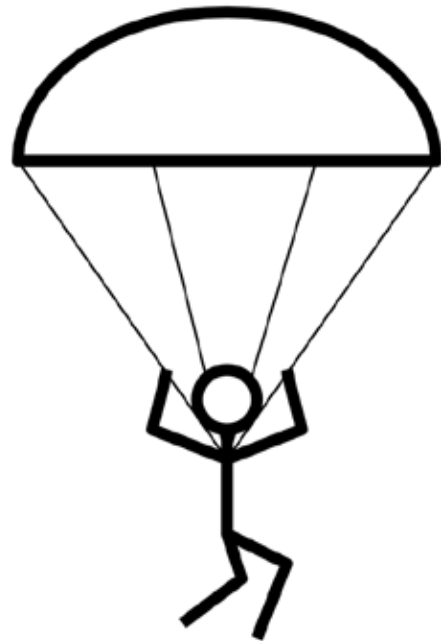
The Debtor... Michael

- Michael is talking about bankruptcy. How would bankruptcy help Michael?
- **\$50,000** for year 2014 (IRS filed their SFR prior to the client filing their tax return)
- **\$25,000** per year, from 2016 through 2020
- **\$25,000** trust fund recovery penalty, 1st Qtr 2018
- **Total liability: \$200,000**



Nondischargeable Taxes in Chapters 7, 11

- A **Chapter 7** discharge does not include certain debts are nondischargeable under § 523. [B.C. § 727(b)]
- A discharge under **Chapter 11** “does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title.” [11 USC § 1141(d)(2)]



Nondischargeable Taxes in Chapter 13

- Section 1328 provides that a court shall grant a debtor a discharge of all debts provided for by the plan except a debt for **trust fund taxes** [§ 507(a)(8)(C)], **unfiled or late-filed returns** [§ 523(a)(1)(B)], and **fraudulent returns** [§ 523(a)(1)(C)].
- Section 1322 provides that the plan shall provide for **full payment**, in deferred cash payments, of all claims entitled to **priority under § 507**. This means that you must determine whether the IRS has a priority claim, and if so, the plan must full pay the balance due.

23

Nondischargeable debts under 523(a)(1)

Section 523(a) sets forth the exceptions to a discharge in a Chapter 7, Chapter 11, and a hardship discharge under Chapter 13. [11 USC § 523(a), § 1141(d)(2), § 1328(b)].

- **Eighth Priority Taxes.** For a tax of the kind specified in § 507(a)(8), whether or not the debtor filed a return or filed the return late. [11 USC § 523(a)(1)(A)]
- **Unfiled Returns.** [11 § USC 523(a)(1)(B)(i)]
- **Late-Filed Returns.** For a tax with respect to which a return, or equivalent report or notice, if required was not filed, or was filed after the due date, and after two years before the date of the filing of the petition. [11 § USC 523(a)(1)(B)(ii)]
- **Fraudulent Returns.** For a tax with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the tax. [11 USC § 523(a)(1)(C)]

24

The first issue is whether the IRS has a priority claim for income taxes.

1. The Three-Year Rule
2. The 240-Day Rule
3. Tax liabilities that are assessable, but not yet assessed.

- We are talking about prepetition income or gross receipts taxes, 11 USC 507(a)(8)(a). Not property taxes or payroll taxes.
- **Key Point:** If the IRS satisfies any of one of these, the claim is 8th priority.
- **First step:** Get your client's IRS account transcripts and also request transcript from the state tax agencies as well.



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1st Rule: The Three-Year Rule

- The required tax return was last due (including extensions) within three years of the petition date [11 USC § 507(a)(8)(A)(i)]. To determine whether an unsecured tax claim qualifies under the three-year rule, ask the following questions:
- What is the due date for filing the return?
- What is the three-year lookback period?
- Does the due date for the return fall within the lookback period?

Key Points

- Did the debtor obtain a valid **extension of time** to file the return? If so, the due date for filing the return is October 15.
- If the due date falls on a **weekend or holiday**, the due date moves forward to the next day.
- The IRS extended the due date for filing returns during **COVID-19**.

26

Michael is looking to file bankruptcy in early 2022

Which years meet the 3-year rule (extensions filed)?

Year	Amount	Due Date of the Return	3 year rule (look for tolling events on transcripts)
2014 1040	\$50,000	10/15/2015	Met.
2016 1040	\$25,000	10/15/2017	Met.
2017 1040	\$25,000	10/15/2018	Met.
2018 1040	\$25,000	10/15/2019	Not yet.
2019 1040	\$25,000	10/15/2020	Not yet.
2020 1040	\$25,000	10/15/2021	Not yet.
1 st Qtr 2018 6672	\$25,000	NA	NA. Will discuss later.



2nd Rule: The 240-Day Rule

Even if the governmental unit passes the Three-Year Rule, the tax claim nevertheless may be classified as eighth priority if the claim satisfies the 240-day rule.

Any income taxes and gross receipts taxes assessed within 240 days prior to the filing of a petition will be classified as eighth priority, nondischargeable tax liabilities in Chapter 7 and 11. 11 USC 507(a)(8)(A)(ii).

Here is the analysis:

- Calculate the 240 Day lookback period from the filing date of the petition, taking into consideration any tolling.
- During the 240-day look back period, determine whether the governmental unit made any tax assessments.

Example

- IRS issued Statutory Notice of Deficiency on January 1, 2018. Taxpayer fails to respond, and IRS assesses the taxes on **May 1, 2018**. Chapter 13 petition filed June 1, 2019, and case dismissed on July 31, 2019. Chapter 7 petition filed February 2, 2020.
- **240-day lookback period:** February 2, 2020 to January 8, 2019 (Petition Date – 390 days (240 days + 90 days + 60 days))
- No priority status under § 507(a)(8)(A)(iii). But, IRS claim could still be entitled to priority status if the three-year rule is met.



29

Michael is looking to file bankruptcy in early 2023

- Which years meet the 240-day rule?

Year	Amount	Assessment Date	240-day rule
2014 1040	\$50,000	5/15/2017	Met.
2016 1040	\$25,000	11/21/2017	Met.
2017 1040	\$25,000	12/7/2018	Met.
2018 1040	\$25,000	11/7/2019	Met.
2019 1040	\$25,000	11/15/2020	Met.
2020 1040	\$25,000	11/18/2021	If filing early 2022, not yet.



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3rd Rule: Tax Liabilities that are Assessable, but Not Yet Assessed (think audit)

- The third rule under 11 USC 507(a)(8)(A) grants priority status to an unsecured governmental unit claim for taxes that were not assessed but are assessable (under applicable law or by agreement) after the filing of the petition, other than a tax liability for unfiled or late-filed returns, fraudulent returns, and tax evasion.
- **Examples**
 - IRS civil examinations and administrative appeals
 - FTB audits, protests, and appeals before the California Office of Tax Appeals
 - Trust fund recovery investigations by the IRS. [26 USC 6673]
 - Responsible person investigations for withholding taxes by the Employment Development Department. [Cal. Unemp. Ins. Code 1735]
 - Personal liability of corporate officers for sales and use taxes. [Cal. Rev. & Tax Code 6829]

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Penalties

- Tax penalties are dischargeable if the penalty relates to a tax liability that does not fall within the exception to discharge under § 523(a)(1) (gap taxes, 8th priority taxes, no tax return filed, delinquent tax return, fraudulent return, willful attempt to evade or defeat tax). [11 USC 523(a)(7)(A)]
- Tax penalties also are discharged if they relate to a tax year more than three years before the filing of the bankruptcy petition. [11 USC § 523(a)(7)(B)]
- Note: Penalties may be dischargeable while tax is non-dischargeable.

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Delinquent tax returns

- The next issue is whether Michael has any delinquent tax returns.
- A late-filed return is a tax return that is filed after the due date and expiration of any extension of time to file the return and the return is filed **two years** before the filing of bankruptcy petition. [11 USC 523(a)(1)(B)(ii)].

33



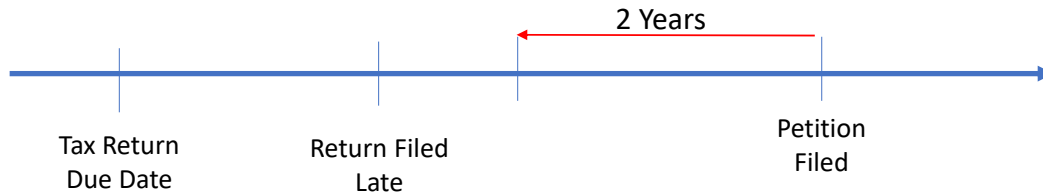
Example

- IRS issued Statutory Notice of Deficiency on January 1, 2018. Taxpayer fails to respond, and IRS assesses the taxes on **May 1, 2018**. Chapter 13 petition filed June 1, 2019, and case dismissed on July 31, 2019. Chapter 7 petition filed February 2, 2020.
- **240-day lookback period:** February 2, 2020 to January 8, 2019 (Petition Date – 390 days (240 days + 90 days + 60 days))
- No priority status under § 507(a)(8)(A)(iii). But, IRS claim could still be entitled to priority status if the three-year rule is met.

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Delinquent Returns

- Pull the IRS Account Transcripts for the past 6 years and check whether there are any late-filed returns.



35

Treatment of Late Filed Returns in a Bankruptcy

- Will vary **VERY differently** depending on where the debtor is located
 - Return filed **one day late** → not eligible for dischargeability
 - ***Colson v. United States*, 446 F. 3d 836 (8th Cir. 2006)**
 - ***McCoy v. Miss. State Tax Comm'n (In re McCoy)***, 666 F.3d 924 (5th Cir. 2012).
 - ***Mallo v. IRS (In re Mallo)***, 774 F.3d 1313 (10th Cir. 2014).
 - ***Fahey v. Mass. Dep't of Revenue (In re Fahey)***, 779 F.3d 1 (1st Cir. 2015).
 - ***Justice v. United States (In re Justice)***, 817 F.3d 738 (11th Cir. 2016).
 - **Default rule:**
 - Return filed after the IRS assesses a Substitute for Return (SFR) → the tax amount up to the SFR amount is not eligible for dischargeability; any excess of tax above the SFR amount could be dischargeable
 - ***Smith v. United States IRS (In re Smith)***, 2016 U.S. App. LEXIS 12859 (9th Cir. July 13, 2016)
 - Return filed late, but before the IRS finalizes a SFR → can be dischargeable

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What is a Substitute for Return? How to know if one was filed on behalf of your client?

- If a debtor fails to timely file a return, the IRS can prepare a “substitute for return” (SFR) and assess the taxes typically based on information received from 3rd parties (i.e. wage and income transcripts).
- A tool that the IRS (and taxing agencies in general) have to deal with taxpayers who do not file required tax returns.
- Account transcripts will reflect a “SFR” indicator if a client has been selected for an SFR to be filed. Look to see if/when an actual return was filed. May need to submit a FOIA

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Michael is looking to file bankruptcy in early 2023

- Which years meet the 2-year rule?

Year	Amount	Filing Date	Two Year Rule (look for late filed/SFRs)
2014 1040	\$50,000	5/4/2017	Would have been met but Michael filed late and after an SFR was filed. Not met.
2016 1040	\$25,000	10/15/2017	Met.
2017 1040	\$25,000	10/15/2018	Met.
2018 1040	\$25,000	10/15/2019	Met.
2019 1040	\$25,000	10/15/2020	Not met.
2020 1040	\$25,000	10/15/2021	Not met.
1 st Qtr 2018 6672	\$25,000	NA	NA. Will discuss later.



Michael

- Michael is having a problem because he has unfiled tax returns and tax returns that he filed late.
- How is this going to impact his bankruptcy?



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Unfiled Tax Returns

- **Unfiled returns are not dischargeable.** Remember, even if the debtor late-files the return, the Bankruptcy Court could hold that the return is not an honest and reasonable attempt to comply with the law and therefore NOT A TAX RETURN!
- A tax with respect to which a return, or equivalent report or notice, if required, was not filed or given, is nondischargeable in a Chapter 7, 11 or 13. [11 USC 523(a)(1)(B)(i)]

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IRS Litigation Guidance

- The IRS provided guidance on the application of the discharge exception under section 523(a)(1)(B)(i) of the Bankruptcy Code for a debt with respect to which a return was not filed in cases in which the taxpayer filed a Form 1040 after the due date. (IRS Chief Counsel Notice CC-2010-016, Sept. 2, 2010)
- A Form 1040 is not disqualified as a “return” under section 523(a) solely because it was filed late.
- Regardless of whether a Form 1040 filed after assessment is a “return” for tax purposes, **the portion of a tax that was assessed before the Form 1040 was filed is nondischargeable** under section 523(a)(1)(B)(i).



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What should you do if your client has unfiled returns?

- **IRS:** Generally, has a six-year lookback period
- **State Taxing Agencies:** Can go back much farther because of 20-year collection statute.
- Obtain the IRS account transcripts and contact the FTB to determine how big the problem is.
- Do not file returns without having an accountant calculate, with reasonable certainty, the tax, penalties and interest owed.
- And, have a plan of action after the IRS/FTB begin sending notices. Payment plan? Offer in compromise? Bankruptcy?

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Fraudulent Tax Return

- Any tax with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax. [11 USC 523(a)(1)(C)]
- Look for civil fraud penalty under 26 USC 6663. Check the IRS Account Transcripts.
- The IRS must show that the taxpayer intended to commit fraud, which has been described as an "**intentional wrongdoing** * * * motivated by a **specific purpose** to evade a tax **known or believed** to be owing." [Citations omitted] The elements to be shown are (1) an underpayment of tax, and (2) that some part of this underpayment was due to fraud. *Hebrank v. Commissioner*, 81 T.C. 640, 642 (1983).

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Payroll Taxes

- Michael holds himself out as the boss and is the person who signs the checks for payroll and for the vendors such as the rent. But his official is manager.
- Michael uses the limited cash to pay creditors to keep the company operating and only pays net wages to employees without setting aside the trust fund portion.
- Michael took this action with the expectation that things would turn around, and the IRS would be paid.
- Was Michaels' action willful?



44

Personal Liability

- The IRS and state taxing agencies may investigate the case and can hold the responsible persons personally liable for the failure to collect and pay over the taxes. [26 USC § 6672]
- Failing to pay the payroll taxes places the client at risk for significant personally liability (taxes, interest, failure to deposit penalties up to 15%, failure to file penalties up to 25%, and failure to pay penalties up to 25%).
- In addition, the willful failure to collect or pay over tax is a felony, if the client's ticks gets punched. [26 U.S.C. 7202]

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Not all liabilities are dischargeable even if all timeliness rules are met

- Trust fund recovery penalty taxes (IRC section 6672) has been determined to be a tax, not a penalty, that is entitled to priority claim status pursuant to section 507(a)(8)(C), and is thus, non-dischargeable under section 523(a)(1).
 - See *In re Mosbrucker*, 227 B.R. 434 (B.A.P. 8th Cir. 1998) (citing *United States v. Sotelo*, 436 U.S. 268 (1978)), aff'd, 198 F.3d 250 (8th Cir. 1999); *IRS v. Campbell (In re Campbell)*, 242 B.R. 327 (W.D. Vir. 1999).
 - IRS General Litigation Bulletin 1999 GLB LEXIS 3 *6 (Jan. 1999) (citing *In re Mosbrucker*).

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Bankruptcy Analysis: 8th Priority Unsecured Claims

- **Federal:** Civil penalties under IRC 6673 are not dischargeable. [26 USC 6672(a); 11 USC 507(a)(8)(C)]
- Some states have responsible person statutes that can hold an individual liable. For example:

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Strategies

- Avoid an investigation by IRS.
- Make designated payments to trust fund portion of the taxes. See Internal Revenue Manual 5.1.2.8 (06-20-2013); Rev. Proc. 2002-26 (Apr. 15, 2002), Section 3.
- Enter into an installment agreement and make balloon payments, if the business can pay. If not, make voluntary payments.
- File a request for penalty abatement using IRS Form 843, Claim for Refund and Request for Abatement.
- If the company lacks the means to full or partial pay, consider a collection alternative such as an offer in compromise based upon doubt as to liability and/or collectability; both avenues may be appropriate.

48

What can Michael expect post-bankruptcy?

Year	Amount	3 yr rule	2 yr rule	240-day rule
2014 1040	\$50,000	Yes.	No b/c filed late and after SFR.	Met.
2016 1040	\$25,000	Yes.	Yes.	Met.
2017 1040	\$25,000	Yes	Yes.	Met.
2018 1040	\$25,000	Not yet.	Yes.	Met.
2019 1040	\$25,000	Not yet.	Not met.	Met.
2020 1040	\$25,000	Not yet.	Not met.	Not yet.
1st Qtr 6672	\$25,000	Priority claim. Never dischargeable.		



What if Michael owes penalties?

- **Example:** Michael owes late-filing and late payment penalties to the IRS for 2014 Form 1040 and 2015 Form 1040. Are they discharged?
- Tax penalties are dischargeable if the penalty relates to a tax liability that does not fall within the exception to discharge under § 523(a)(1) (gap taxes, 8th priority taxes, no tax return filed, delinquent tax return, fraudulent return, willful attempt to evade or defeat tax). [11 USC 523(a)(7)(A)]
- Tax penalties also are discharged if they relate to a tax year more than three years before the filing of the bankruptcy petition. [11 USC § 523(a)(7)(B)]

Michael Post-bankruptcy

- All discharge eligibility rules must be met
- Of the \$200K owed by Michael, on a best case scenario, only \$50K of the \$200K would be dischargeable in a bankruptcy filed in early 2022
- **Analysis doesn't end there:**
 - Michael could try waiting until more of the 1040 liabilities (2018-2020) are eligible for discharge which would then result in \$125K of the \$200K being eligible for discharge
 - Michael can look to the other collection alternatives (i.e. IA, hardship, OIC) in the interim or long term
 - If there's a dispute that a tax should have been discharged, an adversary proceeding can be filed

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Tax Lien Survives the Bankruptcy

- Not all taxes are forgiven!
- Discharge does not apply to in rem
 - *In re Snyder*, 343 F.3d 1171, 1176-77 (9th Cir. 2003).
 - *In re Isom*, 901 F.2d 744 (9th Cir. 1990)
- So, if there is pre-petition property that survives the bankruptcy, and the taxes are not paid, even though the taxpayer technically has a discharge, the IRS can enforce the lien.
- For example, the taxpayer has exempt property such as a retirement account. IRS can take enforcement action outside of the bankruptcy and collect against the retirement account or house.

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Does the IRS have a Secured claim?

- Under 11 USC § 506(a), the IRS has a **secured claim** when:
 - It has properly filed a pre-petition Notice of Federal Tax Lien (NFTL), and there is equity in the debtor's property to which the lien attaches; or
 - It has a tax claim that is subject to setoff under 11 USC § 553. See IRM 5.17.8.14 (04-13-2020).
- The IRS claim is **unsecured** to the extent the debt exceeds the collateral's value. 11 USC 506(a).
- For purposes of determining the IRS's secured claim, the federal tax lien attaches to the debtor's property that became estate property as of the commencement of the case, including property exempted under 11 USC § 522. (See 11 USC § 522(c)(2)(B)); IRM 5.17.8.14 (04-13-2020)).

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How and When the Tax Lien Arises

- “If any person liable to pay any tax neglects or refuses to pay the same **after demand**, the amount (including any interest, additional amount, addition to tax or assessable penalty, together with any costs that may accrue in addition thereto) **shall be a lien** in favor of the United States upon **all property and rights to property**, whether real or personal, belonging to such person.” IRC § 6321.
- For federal tax law purposes, a “**person**” is defined to include individuals, trusts, estates, partnerships, associations, companies, and corporations. IRC § 7701(a)(1).

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How and When the Tax Lien Arises

- The lien is effective from the date the Government assesses the tax. Thus, if the taxpayer neglects or refuses to pay the assessed tax, then the lien is deemed to relate back to the assessment date. IRC § 6322.
- The Service is not required to file a Notice of Federal Tax Lien (NFTL) in order for the tax lien to attach.
- The Service may need to file a NFTL in order to have priority over the taxpayer's other creditors. See IRM 5.17.2.2.1 (09-19-2018)
- The act of filing protects the Government's right of priority as against certain third parties, typically a purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor. IRC § 6323(a).

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What if the Debtor Transfers Property?

- After the federal tax lien attaches to property, it remains on that property until the lien has expired, is released, or the property has been discharged from the lien. See *United States v. Bess*, 357 U.S. 51, 57 (1958); IRM 5.17.2.2.3 (01-08-2016).
- The transfer of property subsequent to attachment does not affect the lien. *Id.*

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Duration of the Federal Tax Lien

- The federal tax lien **continues until the liability** for the amount assessed is **satisfied** or becomes **unenforceable** by reason of lapse of time, i.e., passing of the collection statute expiration date (CSED). IRC § 6322.
- Generally, after assessment, the Service has **ten years** to collect the tax liability. IRC § 6502.
- However, there are some circumstances which may **extend or suspend** the ten-year collection period. See IRM 5.17.2.2.2 (03-27-2012).

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Place of Filing of the NFTL

- IRC § 6323(f) and state law determine the correct place to file a NFTL.
- For **real property**, the NFTL is filed in the office of the recorder of the county. [Cal. C.C.P. § 2101(b)]
- For an individual's **personal property** -> County clerk's office in the county in which the individual resides. [Cal. C.C.P. § 2101(c)(4)]
- But, for NFTLs upon personal property, if the person is a **corporation, LLC, partnership, trust, estate of a decedent**, -> Office of the Secretary of State. [Cal. C.C.P. § 2101(c)(1), (2), and (3)]
- **Practice Tip:** Confirm that the IRS filed the NFTL with the CA secretary of state if you are dealing with business assets.

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These are the issues that we focus on when reviewing a NFTL:

1. Did the IRS properly file the lien?
2. Has the NFTL expired?

Recording Released By Internal Revenue Service. When recorded mail to:

INTERNAL REVENUE SERVICE
PO BOX 348885, ST. LOUIS, MO 63134-8885
CHICAGO, IL 60650-5555

DOCUMENT: 20985480 Page: 1

Fee: 0.88
Tax: 0.00
Copy: 0.00
AMT. PAID: 15.00

REGINA ALONSOZAS
SANTA CLARA COUNTY RECORDERS
Recorded at the request of
Internal Revenue Service
For Official Use by Recording Office

Form 504 (Y10) 1018 Department of the Treasury - Internal Revenue Service
Notice of Federal Tax Lien

Area: SMALL BUSINESS/SELF-EMPLOYED ADSD, ST. Louis, MO 63134-8885
Lien Unit Phone: (800) 829-1503

As provided by sections 6321, 6322, and 6323 of the Internal Revenue Code, we are giving a notice that taxes (including interest and penalties) have been assessed against the following named taxpayer. We have made a demand for payment of this liability, but it remains unpaid. Therefore, there is a lien in favor of the United States on all property and rights to property belonging to this taxpayer for the amount of these taxes, and additional penalties, interest, and costs that may accrue.

Name of Taxpayer: [REDACTED] IRC 6025(d)(1)(A) - In the case of a certificate of release, such certificate shall be conclusive that the lien referred to in such certificate is extinguished.

Residence: [REDACTED]

IMPORTANT RELEASE INFORMATION: For each assessment listed below, unless notice of the lien is waived by the taxpayer in column (a), this notice shall, on the day following each date, operate as a certificate of release as defined in IRC 6325(d).

Kind of Tax (a)	Tax Period Ending (b)	Identifying Number (c)	Date of Assessment (d)	Last Day for Refiling (e)	Unpaid Balance of Assessment (f)
1040	12/31/2006	[REDACTED]	03/14/2009	04/15/2010	21915.12
1040	12/31/2007	[REDACTED]	04/04/2009	05/04/2010	4726.10
1040	12/31/2008	[REDACTED]	11/09/2009	12/09/2010	1062.54

The 10-year collection statute may have run.

Lien for all three years are past their last day for refiling. Did the IRS re-file the NFTL?

Place of Filing: COUNTY RECORDER, SANTA CLARA COUNTY, SAN JOSE, CA 95110

Total: \$ 11763.76

This notice was prepared and signed at: OAKLAND, CA, on the 17th day of NOVEMBER, 2010.

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Example

- Michael filed a Chapter 7 and discharged his Form 1040 taxes for tax years 2013, 2014, 2015 and 2016.
- IRS send a Letter 4068 (soft letter) to the debtor stating that the IRS plan to collect the discharged taxes from certain property that the debtor owned when the bankruptcy case was filed.
- Now what? Michael thought this was over . . .



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IRS Can Take Collection Action

- A discharge of debt in bankruptcy relieves the debtor of any personal liability for the debt. However, the debt may still be collected from property encumbered by a pre-bankruptcy tax lien that remains enforceable after the case. IRM 5.9.17.2.
- The Service can collect discharged tax, discharged penalty and/or discharged interest from exempt, abandoned or excluded property (EAEP) after discharge. IRM 5.9.17.2.
- In our example, a Field Insolvency Caseworker will investigate the case and contact the debtor about taking steps to collect against the retirement funds and trust distributions.

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Example: Trustee sells debtor's home

- This issue happens a lot where the trustee sells property and the debtor claims homestead exemption
- Example: Debtor is expecting to receive \$100,000 as homestead exemption.
- If the IRS filed NFTL pre-bankruptcy, the money comes to the IRS and not the debtor.
- If you have a case where the IRS takes enforcement action after bankruptcy, read Internal Revenue Manual 5.9, Bankruptcy and Other Insolvencies. The Manual explains how to handle the case.

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Example (continued)

- Michael should make a settlement offer to the IRS.
- The IRM sets forth factors that IRS must take into consideration in evaluating the offer (e.g., equity in the EAEP). The settlement offer may be a payment proposal.
- The IRM states that attempts to collect from retirement plans should be made “**only when attempts to collect from non-retirement plan assets would have not been productive.**” IRM 5.9.17.5.4.
- “The Service’s position is that retirement accounts will only be levied when the debtor’s conduct in failing to pay has been ‘**flagrant**’ as defined in IRM 5.11.6.3.”

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Questions



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