Will My Tax Debt Be Discharged In Bankruptcy?

If I had a nickel for every time I am asked this question, I would have a lot of nickels. The elimination of tax debt in bankruptcy can be a little tricky, and I often like to meet with clients to go over the necessary documents together before I make the assessment of whether or not this debt can be discharged. However, there are a few pieces of information that I can share, which may help clarify the issue for you.

The two most common types of tax debt that I am presented involve liens due to unpaid property taxes and unpaid income taxes.

Property liens generally follow the adage "first in time, first in line." This means that all liens against a specific piece of property are assigned a place in line. When liens are paid upon sale of the property, they are paid in this order. For example, a primary mortgage acquired at the time of home purchase is likely paid ahead of a tax lien acquired at a later date due to subsequent back taxes.

Tax liens in bankruptcy are generally only secured to the extent of remaining value in the property, after higher priority liens are paid. As with all liens, tax liens generally pass through the bankruptcy intact unless specific actions are taken to avoid them.

Unpaid income taxes follow a different set of rules, which are often somewhat difficult to understand. In general, such taxes may only be discharged in chapter 7 bankruptcy if they meet a specific set of parameters.

First off, tax debt must be at least three years old. This is determined by the date on which the tax return was due. To eliminate tax debt, it must pertain to a tax return originally due at least three years before filing for bankruptcy protection. This due date includes any extensions.

Second, you must have filed a tax return for this debt. This return must have been filed at least 2 years prior to the date of filing, in order for the debt to be discharged. This time frame is determined from the actual date your return was filed.

In addition, the tax debt must have been assessed by the IRS at least 240 days prior to filing in order for the debt to be discharged. This assessment may be initiated by an IRS final audit determination, an IRS proposed assessment, or a self-reported balance due.

Finally, the tax return may not be fraudulent or evasive. That is as the filer, you must not have made willful attempts to avoid taxes such as using a false social security number. The tax return cannot be frivolous or fraudulent.

I should also note that certain tax debts cannot be discharged, regardless of whether or not the above parameters are met. Thus I always recommend that you speak with a competent bankruptcy attorney regarding the discharge of your tax debt. If you are in the Phoenix area, feel free to contact me with your questions regarding filing bankruptcy in Arizona and discharging tax debt in Arizona bankruptcy.