

Bankruptcy: Can I discharge my tax debt if I file bankruptcy?

Doug and Linda have fallen on hard times the last few years. Doug had back surgery two years ago and his once profitable landscaping business has failed due to the time he had to take off to recover from the back surgery. Linda's employer has recently stopped her mandatory overtime and she fears her job position may be eliminated at some point in the future as well.

Notwithstanding these hardships, Doug and Linda have substantial tax debt from the past years and while they have a repayment plan set up with the IRS, they haven't been able to pay the last few months and now Sam the IRS Taxman has started to hound them to make a payment. Doug has been looking into options to find financial relief and recently read that he and Linda may be able to discharge some of their tax debt by filing bankruptcy. Can Doug and Linda discharge their tax debt by filing bankruptcy?

There is not an absolute "yes" or "no" answer to whether Doug and Linda can discharge all their tax debt by filing bankruptcy. A Chapter 7 filing provides for a full discharge of allowable tax debts. A Chapter 13 filing provides a payment plan to repay some tax debts, with the remainder of debts discharged upon completion of either a three or five year repayment plan. Under the new bankruptcy laws enacted in 2005, tax debts are treated the same way in both Chapter 7 and Chapter 13 bankruptcy filings. Doug and Linda's old tax debt will only be discharged by filing bankruptcy, if their tax debt meets the following five criteria.

Five Rules to Determine Tax Debt Dischargeability in Bankruptcy

If Doug and Linda's income tax debt meets all five of these rules, then filing a Chapter 7 or Chapter 13 bankruptcy may be a good option to give them the relief they need to get a fresh start on their finances.

1. The due date for filing a tax return is at least three years ago.
2. The tax return was filed at least two years ago.
3. The tax assessment is at least 240 days old.
4. The tax return was not fraudulent.
5. The taxpayer is not guilty of tax evasion.

Rule 1: Income Tax Return Must Have Been Due At Least Three Years Ago

Doug and Linda's tax debt must be related to a tax return that was due at least three years before they file for bankruptcy. The due date includes any extensions.

Rule 2: Income Tax Return Must Be Filed At Least Two Years Ago

Doug and Linda's income tax debt must be related to an income tax return that was filed at least two years before they file for bankruptcy. The time is measured from the date Doug and Linda actually filed the return.

Rule 3: IRS Income Tax Assessment Must Be At Least 240 Days Old

The IRS must assess have assessed Doug and Linda's tax debt at least 240 days (8 months) before they file for bankruptcy. The IRS assessment may arise from a self-reported balance due, an IRS final determination in an audit, or an IRS proposed assessment which has become final.

Rule 4: Income Tax Return Cannot Be Fraudulent or Frivolous

Doug and Linda's IRS income tax returns cannot be fraudulent or frivolous.

Rule 5: Taxpayer Cannot Be Guilty of Tax Evasion

Doug and Linda cannot be guilty of any intentional act of evading the tax laws.

Other Rules That May Not Allow For Discharge of Old Tax Debt

Tax debts that arise from unfiled tax returns are not dischargeable. The IRS routinely assesses tax on unfiled returns. These tax liabilities cannot be discharged unless the taxpayer files a tax return for the year in question.

Other Tax Issues in Bankruptcy

All federal and state tax returns should be filed before the filing of a Chapter 7 or Chapter 13 bankruptcy petition, in order to be prepared for the bankruptcy proceedings and ensure a smooth process. The bankruptcy trustee appointed to your bankruptcy case will also require you provide copies of your two most recent income tax returns. Creditors may also request a copy of the income tax returns.

As one can see, Doug and Linda's questions regarding tax debt are not so easily answered. There are certain steps beyond the five rules discussed in this article that should be taken to ensure successful dischargeability of qualifying tax debt in a Chapter 7 or Chapter 13 bankruptcy filing. To find out what your options may be when considering filing bankruptcy, contact a bankruptcy attorney at the Dana Law Firm who will be able to properly address your questions and concerns.

Article By: Whitney G. Coats

Whitney G. Coats is an attorney who works Of Counsel with the Dana Law Firm in its Consumer Bankruptcy Department.