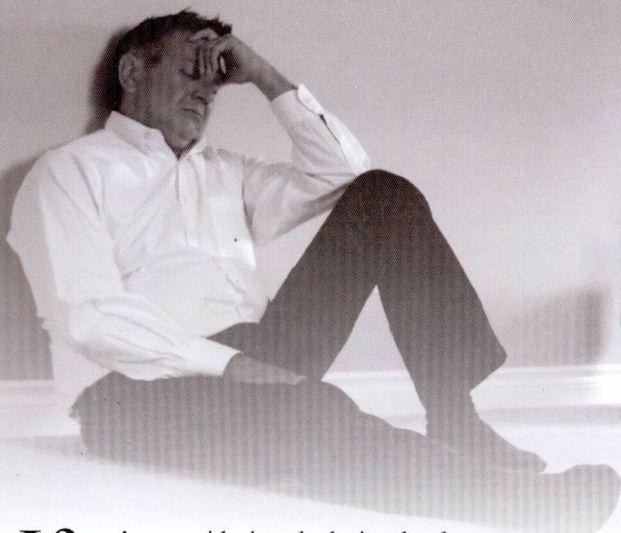


Dischargeability of Income Taxes in Bankruptcy

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If you're considering declaring bankruptcy, or are already in the process of doing so, you may be interested in whether or not past tax liabilities may be discharged. Below we've outlined the issues you will face when trying to get those liabilities discharged.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCA") did not affect the dischargeability of income taxes in a chapter 7 bankruptcy proceeding. However, "Bad boy" conduct under Section 523(a)(1)(B) and (C) that was dischargeable in a chapter 13 proceeding are no longer dischargeable due to the BAPCPA.

If the following five conditions are met, State or Federal income taxes will be dischargeable and not priority. Note further, however, that you must have filed to receive the discharge.

With one limited exception, the five points outlined below apply for both a chapter 13 and chapter 7 bankruptcy proceeding.

First, the most recent due date for filing the return must be more than three years old. This three-year period is computed from the most recent date the tax return is due and an extension to file the return will delay the start of the three-year period. 11 U.S.C. Section 507(a)(8)(A)(i). Note that currently an IRS extension skips over August 15 and goes to October 15. In addition, be mindful of due dates that fall on holidays or weekends.

Second, a tax return or equivalent report or notice, if required, must have been filed or given by the taxpayer for the tax year in question at least more than two years preceding the filing date of bankruptcy. 11 U.S.C. 523(a)(1)(B). The BAPCPA broadens the meaning of the term "return" to include a report or notice; however, the definition is further narrowed by statute providing that a return is whatever the IRS says a return is.

Given the second point discussed above it is important to determine what is considered a tax return or equivalent report or notice. For example, a state Report that is required to be sent to the state taxing agency following a new IRS assessment is considered a "return." Arguably, this will trigger a new 2-year period and a new 3-year due date discussed above. However, a Substitute for Return ("SFR") is not considered a return for discharge purposes. Note, however, that a return filed after a SFR may be considered a "return." Most cases hold it if filed prior to assessment. Fewer cases consider it a return if filed after the assessment; however, such a return that corrects an incorrect IRS assessment may still be deemed a return.

Third, the tax claim must have been assessed at least more than 240 days preceding the filing date of the bankruptcy. 11 U.S.C. Section 507(a)(8)(A)(ii). A subsequent assessment will start a new 240-day period as to the additional tax assessed. If the tax falls within the 240-day period, the interest does too – it does not matter when the interest is dated.

When dealing with IRS taxes, determining when the assessment was made is simple – IRS taxes use the term "assessment." Many State taxing entities, however, do not. When dealing with State taxing entities, therefore, a tax is deemed "assessed" when it is final or can no longer be appealed administratively.

Fourth, the tax in question must be free of fraud. 11 U.S.C. Section 523(a)(1)(C). The IRS has the burden of proving the existence of any fraud.

Lastly, the taxpayer must not have engaged in activity deemed a willful attempt to defeat or evade the tax. 11 U.S.C. Section 523(a)(1)(C). Any evasion found must apply to the year in question and the guilt of one spouse will not be imputed to the other spouse.