

# Bankruptcy and Tax Debts

## Rules for Discharging Tax Debts in Bankruptcy

Gary W Lundgren, EA - Mar 11, 2011

**Income tax debts may be eligible for discharge** under Chapter 7 or Chapter 13 of the Bankruptcy Code. Filing for bankruptcy is one of 5 ways to resolve tax debt (see end), but taxpayers should consider bankruptcy only if they meet the requirements for discharging their taxes. There may be other consumer debt considerations and some taxes may survive the bankruptcy.

The current bankruptcy laws were enacted and signed by President George W Bush on Apr 20, 2005. Prior to that the laws were unchanged since 1978. The biggest difference now is the "Means Test." Determining if the debtor has the means to reasonably pay their debt, and not just weasel out of it.

Chapter 7 provides for full discharge of allowable debts. Chapter 13 provides a payment plan to repay some debts, with the remainder of debts discharged. Under the new bankruptcy laws, tax debts are treated the same way in both Chapter 7 and Chapter 13 petitions. (Previously they were not!) Not all tax debts are capable of being discharged in bankruptcy. Only "Individual Income Taxes." The bankruptcy petitioner must have tax debts that meet five criteria for discharge.

Tax debts are associated with a particular tax return and tax year. The bankruptcy law lays out specific criteria for how old a tax debt should be.

~~~~~

### **Five Rules to Discharge Tax Debts**

If the income tax debt meets all five of these rules, then the tax debt is dischargeable in Chapter 7 and Chapter 13 bankruptcy petitions.

#### **1. Return Due At Least Three Years Ago**

The tax debt must be related to a tax return that was due at least three years before the taxpayer files for bankruptcy. The due date includes any extensions.

#### **2. Return Filed At Least Two Years Ago**

The tax debt must be related to a tax return that was filed at least two years before the taxpayer files for bankruptcy. The time is measured from the date the taxpayer actually filed the return.

#### **3. Tax Assessment At Least 240 Days Old**

The IRS must assess the tax at least 240 days before the taxpayer files 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.

#### **4. Tax Return was Not Fraudulent**

The tax return cannot be fraudulent or frivolous.

#### **5. Taxpayer Not Guilty of Tax Evasion**

The taxpayer cannot be guilty of any intentional act of evading the tax laws.

## **Some Tax Debts Not Dischargeable**

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. SFRs filed under IRC 6020(b) are not dischargeable unless the taxpayer provided sufficient information to allow for a computation of tax. (CCH IRS Collection Procedures par.1110.04)

## **Other Tax Issues in Bankruptcy**

Before a Chapter 7 or Chapter 13 bankruptcy can be granted, the bankruptcy petitioner is required to prove that the four previous tax returns have been filed with the IRS. The four previous tax returns must be filed no later than the date of the first creditors' meeting in a bankruptcy case.

Additionally, bankruptcy petitioners are required to provide a copy of their most recent tax return to the bankruptcy court. Creditors can also request a copy of the tax return, and petitioners must provide a copy to them.

## **Tax Liens Can Survive The Bankruptcy**

While unsecured debt may get discharged in a chapter 7 or 13, the tax lien can survive because it is a secured debt even though it is not secured by a mortgage or a UCC filing. The tax lien survives beyond other secured creditors because tax liens have special consideration in bankruptcy beyond that of other secured creditors. Other secured creditors are limited to what they can get from the non-exempt assets of the bankruptcy estate. Government gets more consideration by law and reaches beyond that. A tax lien can survive, and grow to be worth even more! If, for example, a taxpayer comes out of a bankruptcy and keeps his home. Let's say there is a Federal tax lien of \$50,000. If that home has \$10,000 of exempt equity value to it, the tax lien attaches to that \$10,000. Additionally, if the equity grows over the next few years due to declining principal balance and appreciation in value, the lien also attaches to that increased value.

## **How To Defeat A Tax Lien In Bankruptcy**

The IRS files tens of thousands of tax liens every year. **There are a lot of errors.** Tax liens are filed by name, not by property. Tax liens attach to property the taxpayer owns now, and acquires in the future, within the jurisdiction in which the tax lien is filed.

Primarily the tax lien must be perfected by correctly identifying the taxpayer. If the **correct legal name is not used**, that could spoil the perfection of the tax lien. If the tax lien is **filed in the wrong jurisdiction**, that can spoil perfection also. (Filing rules can vary in each jurisdiction.) If the **name is not correct** and defeats search logics (computer based) that can invalidate a lien. E.g. a person changes their name (women who marry/re-marry.) The IRS needs to track that and correct/re-file their tax lien. There may be some argument as to whose responsibility it is to facilitate that.

The taxpayer is required to let the IRS know of name and address changes. The IRS computers should also note these changes when a tax return is filed and there is a different name with the SSN. Or SSA should note it when the name is changed in marriage. Who is responsible? That can be subjective. A lot is dependent on timing, when tax debt is incurred, when other legal actions are effective.

**These errors and changes happen a lot. Do not assume the tax lien is perfected!** This is where bankruptcy attorneys fail their clients because the bankruptcy attorney who is not familiar with this will assume the government is right. It is a disservice to the client. If the challenge is not brought up during the bankruptcy proceeding, then the taxpayer loses. An operation of law. An unwitting acceptance by the taxpayer.

## Which Taxes May Survive The Bankruptcy?

Obviously, anything that is not an "Individual Income Tax" debt. That includes business taxes, employment taxes, excise taxes, estate taxes, gift taxes, and anything else outside that definition. Also, any taxes that do not fall within the time limitations above. That includes post-petition taxes (taxes due and filed after the bankruptcy petition date).

**Jurisdictions.** Tax liens are generally filed at the County Recorders office for individuals, and the Secretary of State's office for businesses. This can vary by state.

**Julian Date Calendar.** Use a Julian date calendar as attached to make sure you don't miss a deadline or time limit by a single day that can blow your whole case. Not all months are 30 days. I learned that the hard way in one case decades ago. I only had to learn it once. On the attached calendar use the chart on the right for normal yrs. Leap yrs is on the left.

~~~~~

## Five Strategies For Getting Out Of Tax Debt.

1. **Installment Agreement:** (or SIA) a monthly payment plan for paying off the IRS.
2. **Partial payment installment agreement:** a fairly new debt management program where you have a long term payment plan to pay off the IRS at a reduced dollar amount. This is subject to review in case the taxpayer has a windfall or good fortune.
3. **Offer in Compromise:** a program where the taxpayer can settle tax debt for less than what is owed. Requires making a lump sum or short term payment plan to pay off the IRS at a reduced dollar amount.
4. **Not currently collectible:** a program where the IRS voluntarily agrees not to collect on the tax debt for a year or so. Usually up to two yrs then they review again.
5. **Bankruptcy:** discharge tax debts under the strict rules of a Chapter 7 or 13 bankruptcy petition.

~~~~~

## Gary W Lundgren, EA

Tax Debt Solutions  
Licensed by US Treasury  
Former Revenue Officer (MN)

[www.TaxBulldog.com](http://www.TaxBulldog.com)

**814-410-2900**

Resources:

[William Perez](#), About.com Guide

CCH, IRS Collection Procedures, Robert Schriebman, Ch 11



## Julian Day Calendar

Also available: [Julian Day / Calendar Day converter](#).

**Leap years:**

(1988, 1992, 1996, 2000, 2004, 2008, 2012, ...)

**Regular years:**

(2001, 2002, 2003, 2005, 2006, 2007, 2009, 2010, ...)

|    | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 1  | 1   | 32  | 61  | 92  | 122 | 153 | 183 | 214 | 245 | 275 | 306 | 336 |
| 2  | 2   | 33  | 62  | 93  | 123 | 154 | 184 | 215 | 246 | 276 | 307 | 337 |
| 3  | 3   | 34  | 63  | 94  | 124 | 155 | 185 | 216 | 247 | 277 | 308 | 338 |
| 4  | 4   | 35  | 64  | 95  | 125 | 156 | 186 | 217 | 248 | 278 | 309 | 339 |
| 5  | 5   | 36  | 65  | 96  | 126 | 157 | 187 | 218 | 249 | 279 | 310 | 340 |
| 6  | 6   | 37  | 66  | 97  | 127 | 158 | 188 | 219 | 250 | 280 | 311 | 341 |
| 7  | 7   | 38  | 67  | 98  | 128 | 159 | 189 | 220 | 251 | 281 | 312 | 342 |
| 8  | 8   | 39  | 68  | 99  | 129 | 160 | 190 | 221 | 252 | 282 | 313 | 343 |
| 9  | 9   | 40  | 69  | 100 | 130 | 161 | 191 | 222 | 253 | 283 | 314 | 344 |
| 10 | 10  | 41  | 70  | 101 | 131 | 162 | 192 | 223 | 254 | 284 | 315 | 345 |
| 11 | 11  | 42  | 71  | 102 | 132 | 163 | 193 | 224 | 255 | 285 | 316 | 346 |
| 12 | 12  | 43  | 72  | 103 | 133 | 164 | 194 | 225 | 256 | 286 | 317 | 347 |
| 13 | 13  | 44  | 73  | 104 | 134 | 165 | 195 | 226 | 257 | 287 | 318 | 348 |
| 14 | 14  | 45  | 74  | 105 | 135 | 166 | 196 | 227 | 258 | 288 | 319 | 349 |
| 15 | 15  | 46  | 75  | 106 | 136 | 167 | 197 | 228 | 259 | 289 | 320 | 350 |
| 16 | 16  | 47  | 76  | 107 | 137 | 168 | 198 | 229 | 260 | 290 | 321 | 351 |
| 17 | 17  | 48  | 77  | 108 | 138 | 169 | 199 | 230 | 261 | 291 | 322 | 352 |
| 18 | 18  | 49  | 78  | 109 | 139 | 170 | 200 | 231 | 262 | 292 | 323 | 353 |
| 19 | 19  | 50  | 79  | 110 | 140 | 171 | 201 | 232 | 263 | 293 | 324 | 354 |
| 20 | 20  | 51  | 80  | 111 | 141 | 172 | 202 | 233 | 264 | 294 | 325 | 355 |
| 21 | 21  | 52  | 81  | 112 | 142 | 173 | 203 | 234 | 265 | 295 | 326 | 356 |
| 22 | 22  | 53  | 82  | 113 | 143 | 174 | 204 | 235 | 266 | 296 | 327 | 357 |
| 23 | 23  | 54  | 83  | 114 | 144 | 175 | 205 | 236 | 267 | 297 | 328 | 358 |
| 24 | 24  | 55  | 84  | 115 | 145 | 176 | 206 | 237 | 268 | 298 | 329 | 359 |
| 25 | 25  | 56  | 85  | 116 | 146 | 177 | 207 | 238 | 269 | 299 | 330 | 360 |
| 26 | 26  | 57  | 86  | 117 | 147 | 178 | 208 | 239 | 270 | 300 | 331 | 361 |
| 27 | 27  | 58  | 87  | 118 | 148 | 179 | 209 | 240 | 271 | 301 | 332 | 362 |
| 28 | 28  | 59  | 88  | 119 | 149 | 180 | 210 | 241 | 272 | 302 | 333 | 363 |
| 29 | 29  | 60  | 89  | 120 | 150 | 181 | 211 | 242 | 273 | 303 | 334 | 364 |
| 30 | 30  |     | 90  | 121 | 151 | 182 | 212 | 243 | 274 | 304 | 335 | 365 |
| 31 | 31  |     | 91  |     | 152 |     | 213 | 244 |     | 305 |     | 366 |

  

|    | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec |
|----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 1  | 1   | 32  | 60  | 91  | 121 | 152 | 182 | 213 | 244 | 274 | 305 | 335 |
| 2  | 2   | 33  | 61  | 92  | 122 | 153 | 183 | 214 | 245 | 275 | 306 | 336 |
| 3  | 3   | 34  | 62  | 93  | 123 | 154 | 184 | 215 | 246 | 276 | 307 | 337 |
| 4  | 4   | 35  | 63  | 94  | 124 | 155 | 185 | 216 | 247 | 277 | 308 | 338 |
| 5  | 5   | 36  | 64  | 95  | 125 | 156 | 186 | 217 | 248 | 278 | 309 | 339 |
| 6  | 6   | 37  | 65  | 96  | 126 | 157 | 187 | 218 | 249 | 279 | 310 | 340 |
| 7  | 7   | 38  | 66  | 97  | 127 | 158 | 188 | 219 | 250 | 280 | 311 | 341 |
| 8  | 8   | 39  | 67  | 98  | 128 | 159 | 189 | 220 | 251 | 281 | 312 | 342 |
| 9  | 9   | 40  | 68  | 99  | 129 | 160 | 190 | 221 | 252 | 282 | 313 | 343 |
| 10 | 10  | 41  | 69  | 100 | 130 | 161 | 191 | 222 | 253 | 283 | 314 | 344 |
| 11 | 11  | 42  | 70  | 101 | 131 | 162 | 192 | 223 | 254 | 284 | 315 | 345 |
| 12 | 12  | 43  | 71  | 102 | 132 | 163 | 193 | 224 | 255 | 285 | 316 | 346 |
| 13 | 13  | 44  | 72  | 103 | 133 | 164 | 194 | 225 | 256 | 286 | 317 | 347 |
| 14 | 14  | 45  | 73  | 104 | 134 | 165 | 195 | 226 | 257 | 287 | 318 | 348 |
| 15 | 15  | 46  | 74  | 105 | 135 | 166 | 196 | 227 | 258 | 288 | 319 | 349 |
| 16 | 16  | 47  | 75  | 106 | 136 | 167 | 197 | 228 | 259 | 289 | 320 | 350 |
| 17 | 17  | 48  | 76  | 107 | 137 | 168 | 198 | 229 | 260 | 290 | 321 | 351 |
| 18 | 18  | 49  | 77  | 108 | 138 | 169 | 199 | 230 | 261 | 291 | 322 | 352 |
| 19 | 19  | 50  | 78  | 109 | 139 | 170 | 200 | 231 | 262 | 292 | 323 | 353 |
| 20 | 20  | 51  | 79  | 110 | 140 | 171 | 201 | 232 | 263 | 293 | 324 | 354 |
| 21 | 21  | 52  | 80  | 111 | 141 | 172 | 202 | 233 | 264 | 294 | 325 | 355 |
| 22 | 22  | 53  | 81  | 112 | 142 | 173 | 203 | 234 | 265 | 295 | 326 | 356 |
| 23 | 23  | 54  | 82  | 113 | 143 | 174 | 204 | 235 | 266 | 296 | 327 | 357 |
| 24 | 24  | 55  | 83  | 114 | 144 | 175 | 205 | 236 | 267 | 297 | 328 | 358 |
| 25 | 25  | 56  | 84  | 115 | 145 | 176 | 206 | 237 | 268 | 298 | 329 | 359 |
| 26 | 26  | 57  | 85  | 116 | 146 | 177 | 207 | 238 | 269 | 299 | 330 | 360 |
| 27 | 27  | 58  | 86  | 117 | 147 | 178 | 208 | 239 | 270 | 300 | 331 | 361 |
| 28 | 28  | 59  | 87  | 118 | 148 | 179 | 209 | 240 | 271 | 301 | 332 | 362 |
| 29 | 29  |     | 88  | 119 | 149 | 180 | 210 | 241 | 272 | 302 | 333 | 363 |
| 30 | 30  |     | 89  | 120 | 150 | 181 | 211 | 242 | 273 | 303 | 334 | 364 |
| 31 | 31  |     | 90  |     | 151 |     | 212 | 243 |     | 304 |     | 365 |

# **3 Rules to Discharge Tax Debts in Bankruptcy**



## **1. Return Due At Least Three Years Ago**

The tax debt must be related to a tax return that was due at least three years before the taxpayer files for bankruptcy. The due date includes any extensions.

## **2. Return Filed At Least Two Years Ago**

The tax debt must be related to a tax return that was filed at least two years before the taxpayer files for bankruptcy. The time is measured from the date the taxpayer actually filed the return.

## **3. Tax Assessment At Least 240 Days Old**

The IRS must assess the tax at least 240 days before the taxpayer files 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.

### **Additional Considerations**

#### **4. Tax Return was Not Fraudulent**

The tax return cannot be fraudulent or frivolous.

#### **5. Taxpayer Not Guilty of Tax Evasion**

The taxpayer cannot be guilty of any intentional act of evading the tax laws.