SHARED CHALLENGES IN BANKRUPTCY AND TAX: EQUITY, EFFICIENCY, AND ADMINISTRABILITY

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BANKRUPTCY BASICS

- Chapters 1, 3 and 5 of Title 11 set up structure of bankruptcy cases
- Chapters 7, 11 and 13 (plus occasionally 9, 12 and 15) set up operational bankruptcy provisions

CANCELLATION OF DEBT INCOME (COD)

Receipt of loan proceeds does not constitute income because of the obligation to repay

If the loan is forgiven, the debtor has income at the time of forgiveness. § 61(a)(12)

COD INCOME *EXCLUDED* WHEN:

Debt forgiven in a bankruptcy proceeding. § 108(a)(1)(A)

Debt forgiven when taxpayer is insolvent (up to the amount of the insolvency). § 108(a)(1)(B)

TAX CONSEQUENCES OF INCOME EXCLUSION

Tax attributes reduced. § 108(b)

- NOLs
- Business tax credits
- Capital loss carryovers

Basis of assets reduced § 1017

TAX CLAIMS IN BANKRUPTCY

- Secured
  1. IRS must have filed a Notice of Federal Tax Lien **and** equity must exist to which lien has attached
  2. IRS has offset of pre-petition debt against pre-petition refund
- Unsecured
  1. Administrative – liability accruing during operation of bankruptcy
  2. Priority – relatively recent taxes and trust fund taxes
  3. General unsecured – older taxes and penalties

DISCHARGE OF TAXES IN INDIVIDUAL BANKRUPTCY

- Taxes excepted from discharge
  1. Priority taxes
  2. Taxes where taxpayer has not filed a return
  3. Taxes where taxpayer filed a late return within two years of filing bankruptcy (*exception* in First, Fifth and Tenth Circuits preventing any taxes on late return from discharge)
  4. Taxes where taxpayer committed fraud

CREDITOR CHALLENGES IN BANKRUPTCY

1. Timely inputting petition information to avoid violation of automatic stay
2. Timely objecting to plan of reorganization
3. Correctly inputting discharge to avoid violation of discharge injunction
4. Responding to calls from debtors

DEBTOR CHALLENGES IN BANKRUPTCY

1. 1. Properly timing the bankruptcy to maximize the discharge
2. 2. Making sure tax authorities get paid through bankruptcy with estate assets for any non dischargeable taxes
3. 3. Understanding the presence, impact and scope of an IRS secured claim
4. 4. Carefully evaluating non-bankruptcy alternatives, such as offer in compromise, before filing bankruptcy because of limitations on multiple bankruptcies