

Using the Bankruptcy Code to Take On the Tax Man

Part 4: Wrap Up of Individual Debtor Analysis

By Camille J. Iurillo and Sabrina C. Beavens

I. Analysis of Whether to File a Chapter 7, 13 or 11 bankruptcy case

In a perfect world, your client's taxes meet the tests discussed earlier in this article: a return was filed more than 2 years ago, the tax was due more than 3 years ago, the tax was assessed more than 240 days ago, the taxpayer did not file a fraudulent return or willfully evade paying the tax and the tax is not subject to assessment at the time of the bankruptcy filing. In addition, your client's assets do not exceed the allowable exemptions in a Chapter 7 bankruptcy. Your client will smile as you tell them that Chapter 7 is the best alternative for them, they will be permitted to keep all of their real and personal property and they may gleefully wave good-bye to the I.R.S. But what are the alternatives for the client if their situation is not perfect? As discussed below, a Chapter 7 may still be an alternative or the client may choose a repayment plan in a Chapter 13 or 11 bankruptcy.

A. Chapter 7

One of the first considerations in a Chapter 7 case is an analysis of your client's assets compared to the allowed exemptions in bankruptcy. If your client's tax debt is dischargeable, but he has non-exempt assets which he is unwilling to part with in exchange for discharging the taxes, his next alternative may be a Chapter 11 or 13, discussed herein. Occasionally, a client's assets may be exempt, he is not under pressure from the IRS (i.e., wage garnishment on the horizon), but the taxes are not "old" enough to discharge. In this instance, a client may choose to wait to file to let the taxes "age". When the waiting period expires, the client files his bankruptcy case and discharges the tax debt.

B. Chapter 13

If Chapter 7 is not an alternative for your client, another option may be a Chapter 13 bankruptcy. To be eligible for Chapter 13, a debtor must have a steady stream of income. Unsecured debts (credit cards, medical bills, student loans, taxes that have not been recorded as a lien) cannot exceed \$307,675. Secured debts (mortgages, car loans or taxes for which a lien has been recorded) cannot exceed \$922,975. 11 U.S.C. § 109. Priority taxes are paid without interest accruing after the filing of the bankruptcy. The debtor submits a plan which allocates all of his "disposable income" to the plan, pays secured and priority claims in full and pays percentage of unsecured claims (including those tax penalties relegated to this class as discussed in Part 3 of the Article). Due to recent changes in the Bankruptcy Code, including the addition of a means test, a debtor may pay more in a Chapter 13 case than under the old law. Over a period of three (3) to five (5) years, the debtor makes monthly payments to the Chapter 13 trustee who, in turn, pays the IRS and other creditors.

B. Chapter 11

As a last resort, an individual is permitted to file a Chapter 11 case without the debt limitations of a Chapter 13. Payment of priority tax claims in a Chapter 11 plan

must be made over a period not to exceed five years from the date of assessment of the tax of a value as of the effective date of the plan, equal to the allowed amount of the tax claim. However, interest accrues, unlike a Chapter 13 case, on the tax claim post-petition and through the life of the plan at a statutory rate.

C. Determination of Dischargeability of Debt in a Chapter 11 or 13 Case

In a Chapter 7 case, a debtor must take action after the filing to have the taxes deemed non-dischargeable—it *does not happen automatically upon entry of the discharge of debtor*. The debtor may file an adversary complaint under Rule 7001 of the Federal Rules of Bankruptcy Procedure to request that court to determine that the tax debt is nondischargeable (jurisdiction is concurrent with the appropriate non-bankruptcy forum). If you have properly completed your analysis, the IRS may agree to a judgment of non-dischargeability without litigation. However, if the IRS disagrees with your analysis, the case proceeds like any other litigation matter, including discovery and trial.

In a Chapter 11 or 13 case, the determination as to whether a debt is nondischargeable may be brought by objection to claim. Rule 3007 automatically treats this type of objection as an adversary proceeding without the necessity of filing an adversary proceeding.

II. Accurate Information is Key

Accurate information is key to performing an analysis of your client's tax issues under the Bankruptcy Code.

Information that you should obtain from your client is as follows:

1. Name, current home address, and Social Security numbers
2. Tax information - tax type, tax periods, and amount of tax delinquency;
3. Copies of all returns (determine if the returns were filed);
4. Tax correspondence, including:
 - audit reports;
 - tax liens and tax warrants;
 - demand for payment;
 - notice of deficiency or proposed assessments;
 - notice of intent to levy;
 - notice of seizure of property;
 - notice of garnishment;
 - copies of any court documents.
 - a complete history of any tax disputes;
 - any tax representatives; and
 - copies of any installment payments, settlement agreements, and statute of limitations extensions.

You should also obtain the information from the IRS to confirm the information provided by the client and to fill in any gaps in the information.

III. Conclusion

Part 4 concludes this article on using the Bankruptcy Code to take on the tax man. In sum, bankruptcy may provide relief to your client who is in arrears on his tax debt depending on the age of the taxes, the nature of the taxes, your client's conduct and whether a return was filed. The relief may be in the form of a complete discharge of the debt without repayment of any portion of the debt, may include a payment plan over a

certain period of time to pay priority and secured debts in full and a portion of unsecured tax related debts.

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