

IRS explains which tax claims are nondischargeable in Chapter 13 bankruptcy cases

Chief Counsel Advice 201005029

In Chief Counsel Advice (CCA), IRS has examined which tax claims are nondischargeable in Chapter 13 bankruptcy cases filed on or after Oct. 17, 2005 (the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)) where a taxpayer properly completed the plan and received a discharge. The CCA also concluded that interest on nondischargeable tax claims is nondischargeable and that all nonpecuniary tax penalties and the interest on them are dischargeable.

Background. Chapter 13 provides a procedure for eligible individuals with regular income to pay all or a portion of their debts through plan payments over an extended period. Only those portions of regular income that are not necessary to pay living expenses are used to pay claims.

Before the effective date of BAPCPA, debtors received a superdischarge if they completed all payments required under the plan. Any tax debts provided for under the plan would be discharged. BAPCPA modified this discharge so that certain tax debts excepted from discharge under 11 U.S.C. §523 are no longer discharged.

After filing the Chapter 13 petition, the debtor files a Chapter 13 plan which proposes to pay creditors, including IRS, over a period of up to five years, typically in monthly installments. (Internal Revenue Manual (IRM) 5.17.11.2)

Nondischargeable debts. The CCA concluded that for bankruptcy cases filed on or after Oct. 17, 2005, debts for withheld taxes, taxes for which a return was not filed, taxes for which a return was late-filed within two years of the bankruptcy case, taxes for which the debtor filed a fraudulent return, and taxes that the debtor attempted to evade or defeat, are not subject to the Chapter 13 discharge.

BAPCPA substantially narrowed the scope of the Chapter 13 discharge by excepting from the discharge a number of tax debts. The debts excepted from the general discharge are listed in 11 U.S.C. §1328(a). The CCA noted that the four exceptions to discharge that are most likely to apply to tax debts at issue in a Chapter 13 proceeding are:

(1) The §507(a)(8)(C) exception for employment taxes withheld from employees wages and the trust fund recovery penalty under Code Sec. 6672. IRS noted that while a claim for such liabilities is entitled to priority status, and must be paid in full under the terms of a Chapter 13 plan, the discharge exception allows IRS to collect these liabilities even if it wasn't able to identify the liability in time to file a claim, e.g., where IRS couldn't identify the debtor as a responsible officer under Code Sec. 6672 in time to file a claim.

(2) The §523(a)(1)(B) exception for taxes for which no return was filed, and taxes for which a return was late-filed within two years before the bankruptcy petition date.

(3) The §523(a)(1)(C) exception for a tax with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the tax.

(4) The §523(a)(3)(A) exception for debts that are neither listed nor scheduled under §521(a)(1) with the name of the creditor to whom the debt is owed in time to permit a proof of claim to be timely filed, unless the creditor had notice or actual knowledge of the case in time to file a timely proof of claim. This exception applies where the debtor fails to list IRS on its schedule of liabilities or otherwise notify IRS of the bankruptcy case. However, if IRS learns of the bankruptcy proceeding in time to file a timely claim, this exception won't apply. (Even in pre-BAPCPA cases, courts had held that a Chapter 13 debtor didn't receive a discharge of a debt if the creditor didn't have notice of the bankruptcy case in time to file a timely claim.)

RIA observation: Chief Counsel Advice 201005029 noted that the Ninth Circuit has held in *In re Pardee* (9 th Cir. 1999), 193 F.3d 1083 that a plan that was confirmed without objection to a provision purporting to discharge an otherwise nondischargeable claim was binding on the parties. The terms of the plan made a nondischargeable debt dischargeable.

Prepetition interest. The CCA concluded that if the tax debt is dischargeable in Chapter 13, then the associated prepetition and postpetition interest is dischargeable. However, if the underlying tax liability isn't dischargeable, then the associated prepetition and postpetition interest liability is also not dischargeable. Since BAPCPA created a number of tax debts that are now nondischargeable, debtors will owe postpetition interest on the nondischargeable tax obligations. The CCA notes that Congress recognized this when drafting BAPCPA and also added §1322(b)(10), which allows a Chapter 13 plan to provide for the payment of postpetition interest on nondischargeable claims, except that such interest may be paid only to the extent that the debtor has disposable income available to pay the interest after making provision for full payment of all allowed claims.

Penalties. The CCA concluded that all nonpecuniary tax penalties and the interest that accrues on them were dischargeable. BAPCPA didn't alter the dischargeability of penalties. IRS also noted that under Code Sec. 6658, penalties under Code Sec. 6651, Code Sec. 6654, and Code Sec. 6655 for failure to make timely payments of tax incurred by the debtor before the bankruptcy case do not accrue during the bankruptcy case.

RIA Research References: For income taxation of individual debtors in bankruptcy, see FTC 2d/FIN ¶ C-9800; United States Tax Reporter ¶ 13,984; TaxDesk ¶ 578,000.

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