

# BANKRUPTCY

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## NOTES FROM BANKRUPTCY TAX BULLETIN

### **May 16, 2000**

- District court in Texas reversed B.K. holding that IRS was entitled to setoff prepetition tax refund against prepetition taxes. '93 tax was dischargeable, and '97 refund due for return filed 8/99. Case was filed on May 1998. Rationale was that the IRS retained right to setoff under IRS §6402(a) and §533(a). US v. Constance Luongo, 85 AFTR2d Par. 2000-652.

### - IRS Releases Litigation Guidelines for Bankruptcy Matters:

**GL-26** Discussion of IRS authority to collect post-petition debt after Ch 13 has been confirmed, but before the case is DM.

The Estate consists only of wages needed for the plan, plus after acquired property, per §1322(a)(1). Thus, the IRS can act against assets and file a notice of tax lien after the plan is confirmed for post-petition debt. Under §1327(b), all property vests with the Debtor upon confirmation, unless provided otherwise.

The significance of the "estate" definition under 541 and §1306(a) is that only the estate is protected under §362 automatic stay rules. Thus, any property, outside of the "estate", is not protected. This protection continues until the case is closed which is not until completion of payments under the plan (§350(a) and §1328 (a)).

The IRS can alternatively, move for relief from the stay, DM or Convert the case, or file a §1305(a) claim, which is a claim for taxes that become payable while the case is pending. These alternatives are in lieu of the above normal collection activities.

**GL-38** IRS rights and remedies in BKRTCY generally and when the IRS makes a prepetition levy on the D's assets.

The IRS must turnover assets per §542 even when the assets consists of cash and is already under their control and possession. The rule also applies to other cases besides Ch 11.

The Whiting Pools case, established the general framework in this area (*United States v. Whiting Pool, Inc.*, 462 US 198 (1983)). In *Whiting Pools*, the t/p filed Ch 11 and a day before the filing the IRS seized certain personal property. The Supreme Court ordered the turnover of the property.

§542 (a) in effect gives the estate a possessory interest in certain property of the D that was not in the Debtor's possession at the commencement of the case. The Court based its holding on the statutory provisions of §542(a) and §541(a)(1) whereby property of the estate is comprised of all property of the Debtor, whether or not the Debtor had a possessory interest at the time of filing.

The IRS has made arguments that this turnover should not apply to cash or cash equivalents in that cash does not need to be sold, cannot be redemmed, there is no need for a notice of sale, etc. Thus, the Debtor should be successful in having the cash turned over after a notice of levy, but before seizure.

The IRS has contended that the turnover rules should only apply in a reorganization case, since the property is necessary for the same, but not in other cases. However, most cases reject this analysis holding on pure property rights issues.

The IRS, however, should counter with adequate protection claims.

**GL-23** Discusses the requirement for a valid proof of claim, to whom it must be communicated, and under what circumstances it may be amended.

The IRS can amend a claim for the same period and the same type of tax of a prior timely filed POC.

A late filed claim for a different type of tax is usually not permitted to amend a timely filed POC. Only when the equities strongly favor the IRS does the IRS attempt to convince the courts to permit a late-filed claim for a different type of tax.

The Courts will use a facts and circumstances test when deciding on late filed POC's for the same type but different year. These equities can include the D failure to file returns, or attempts to evade the tax.

An informal POC consisting of some writing such as a Notice of Deficiency, Motion for Relief, etc, which has been sent to the BK court, maybe sufficient.

**GL-50** Guidance in defending a proof of claim when an objection is filed alleging that the estate's value isn't sufficient to secure all the listed liabilities.

### May 9, 2000

- The Supreme Court has granted certiorari to resolve a split in the circuits whether discharge of indebtedness income (DOI) of an insolvent S corp., which is excluded under §108, passes to the shareholders and increases their stock basis under §1367 or the IRC. Gitlitz v. Commissioner, S.Ct. Dkt. NO. 99-1295. The 10<sup>th</sup> Circuit held that attribute reduction principles of §108(b) must be applied at the corporate level and the must PRECEDE the passthrough, so that the corp's excluded DOI income is absorbed before it can pass to the shareholders.

### May 2, 2000

- In a case in Illinois, the court held that a couple's tax debts were non dischargeable, finding that their failure to file income taxes for 10 yrs was a willful attempt to evade paying taxes. In re Raymond J. Crawley, 85 AFTR2d Par. 2000-613. The Debtors filed Ch 7 in 1998, and in 1996 filed back returns for 1985-1994. The court noted that Debtors waited more than 2 yrs before filing for BKRTCY, and thus were aware if the benefits of the 2 yr rule.

### April 17, 2000

- The IRS in a legal Memorandum (ILM 200015037) had the following conclusions re. Offers in Compromise and BKRTCY:
  - 1) In Ch 13 cases, the IRS should file a proof of claim for the entire underlying tax liability, rather than the reduced amount accepted, but uncompleted in the offer. The rationale is that an uncompleted OIC is an executory contract. This claim should be noted as a "protective claim" in the event that the D does not complete the Ch 13. The IRS will object to the Plan if it does not either expressly assume the OIC or provide for full payment of priority and secured taxes.

Thus, the Debtor should pay the Offer in Compromise payments "outside of the Plan" and assume the Offer in Compromise with the plan.
  - 2) In a Ch 7 case, the D or trustee cannot accept the OIC contract. Thus, the IRS's claim should be treated as if the OIC never existed.
- The Court in a Texas case hold that the periods for determining dischargeability are "equitably tolled" because of D's repeated BK filings. In re Rosales v. IRS, No 95-22342-c-13. The court noted that the D filed 4 Bankruptcies, with the IRS as the sole creditor, and that the D was in Bk for all but 254 days since Oct, 1991.

### March 20, 2000

- In Legal memorandum (ILM 200011046), the IRS stated that it will no longer accept OIC's from t/p in bkrcty, but that offers before 2000, will be considered if the t/p gets to court to lift the automatic stay for that purpose.

**March 13, 2000**

- The Supreme court granted certiorari in Raleigh v. Illinois Dept. of Revenue, S.C. Dkt. No. 99-387, to determine whether a trustee or the state has the burden of proof on state tax claims. In this case, the state filed a proof of claim for sales taxes and the trustee objected to the claim, contending that the D was not a responsible officer.
- In a Legal Memorandum, ILM 200006013, the IRS concluded that the BK Court has jurisdiction to consider IRS §6015(b) innocent spouse relief.