

What Every Bankruptcy Practitioner Should Know About IRS Taxes:  
Claims, Payment and Discharge  
By Suzana K. Koch<sup>1</sup>

I. Notice

A. Law

1. 11 U.S.C. ' 342(f)(1) - AAn entity may file with any bankruptcy court a notice of address to be used . . . by particular bankruptcy courts, as so specified by such entity at the time such notice is filed, to provide notice to such entity in all cases under chapters 7 and 13 pending in the courts with respect to which such notice is filed, in which such entity is a creditor.@
2. Fed. R. Bankr. P. 5003(e) - United States and state governmental units may designate service addresses on a mailing register kept by the clerk of court.
3. Fed. R. Bankr. P. 2002(j) - ACopies of notices required to be mailed to all creditors under this rule shall be mailed . . . (3) in a chapter 11 case, to the Internal Revenue Service at its address set out in the register maintained under Rule 5003(e) for the district in which the case is pending; [and] (4) if the papers in the case disclose a debt to the United States other than for taxes, to the United States attorney for the district in which the case is pending and to the department, agency, or instrumentality of the United States through which the debtor became indebted . . . .@
4. Fed. R. Bankr. P. 7004(b)(4) - Service may be made by first class mail postage prepaid as follows: Au]pon the United States, by mailing a copy of the summons and complaint to the civil process clerk at the office of the United States Attorney for the district in which the action is brought and by mailing a copy of the summons and complaint to the Attorney General of the United States at Washington, District of Columbia, and in any action attacking the validity of an order of an officer or agency of the United States not made a party, by also mailing a copy of the summons and complaint to that officer or agency.@
5. Fed. R. Bankr. P. 7004(b)(5) - Service may be made by first class mail postage prepaid as follows: Au]pon any officer or agency of the United States, by mailing a copy of the summons and complaint to the United States as prescribed in paragraph (4) of this subdivision and also to the officer and agency.@

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<sup>1</sup> This is not an official statement of the United States of America, United States Attorney's Office for the Northern District of Ohio, United States Department of Justice, or Internal Revenue Service. The information contained herein and the oral presentation of it is provided solely for informational purposes and is intended to be used strictly as a basis for discussion. It is not intended to be a complete overview of the subject matter nor should it be construed as legal advice.

6. Fed. R. Bankr. P. 9014(b) - Contested matters are served in the same manner as an adversary proceeding under Fed. R. Bankr. P. 7004. Therefore, the agency, the United States Attorney and the Attorney General of the United States must be served with contested matters. See *I.R.S. v. Patriot Contracting Corp.*, 2007 WL 433392 (Bankr. D.N.J. 2007) (AIn short, Rules 9014(b) and 7004(b)(4) provide that motions brought in contested matters must be served by mailing a copy of the motion to the particular agency, the local United States Attorney's Office and the Attorney General of the United States.©).
7. "Notice or knowledge of an Assistant United States Attorney cannot, as a general proposition, be imputed to the particular agency to which a debt is owing.© *United States, Small Business Administration v. Bridges*, 894 F.2d 108, 112 (5th Cir. 1990) (holding that notice or actual knowledge of one United States government agency will not be imputed to another agency); *In re H. & C. Table Co.*, 457 F.Supp. 858, 860 (W.D. Tenn. 1978) (AThe United States is a monstrous government and one agency will not always know what another agency is doing; when the appropriate representative of the government is not notified, the rights of the United States may be jeopardized (citation omitted).©); *U.S. Metal Products Co. v. United States*, 302 F. Supp. 1263, 1270 (E.D.N.Y. 1969) (discussing that notice or actual knowledge of one portion of an agency not imputed to another portion of the same agency); *United States v. Yale Transport Corp.*, 184 F.Supp. 42, 47 (S.D.N.Y. 1960) (A[N]otice of bankruptcy proceedings should be reasonably calculated to come to the attention of that branch of the Government familiar with the claims involved and which exercises functions with respect thereto.©); *U. S. v. Golenburg*, 175 F.Supp. 415, 418 (N.D. Ohio 1959) (holding that imputing notice or knowledge from one government agency to another is obviously Aunreasonable©).
8. Summary
  - a. Where the IRS is a creditor, provide notice to the IRS at its designated addresses.
  - b. Where another federal agency is a creditor, provide notice to the agency and the United States Attorney.
  - c. Serve adversary proceedings on the agency (IRS if taxes are implicated), the United States Attorney, and the Attorney General.
  - d. Serve contested matters (objections to claim, motions, plans, etc.) on the agency (IRS if taxes are implicated), the United States Attorney, and the Attorney General.

- B. The IRS has listed the address on the Northern District of Ohio's Bankruptcy Court's register as:

Internal Revenue Service  
P.O. Box 7346  
Philadelphia, Pennsylvania 19101-7346  
FAX: (855) 235-6787

In addition, you may also send information to the local branch:

Internal Revenue Service  
Insolvency Group 6  
1240 East Ninth Street, Room 493  
Cleveland, Ohio 44199

- C. What Address to Use to Serve the United States Attorney with Adversary Proceedings and Contested Matters (Objections to Claim, Motions, Plans, etc.) in Akron, Canton, Cleveland, and Youngstown court cases?<sup>2</sup>

Office of the United States Attorney  
Attn: Bankruptcy Section  
Carl B. Stokes United States Court House  
801 West Superior Avenue, Suite 400  
Cleveland, Ohio 44113-1852

- D. What Address to Use to Serve the Attorney General of the United States with Adversary Proceedings and Contested Matters (Objections to Claim, Motions, Plans, etc.)?

For IRS Matters:

Attorney General of the United States  
U.S. Department of Justice Tax Division  
Civil Trial Section, Northern Region  
P.O. Box 55, Ben Franklin Station  
Washington, D.C. 20044

For Non-IRS Matters:

Attorney General of the United States  
Main Justice Building  
10th & Constitution Avenue, N.W.  
Washington, D.C. 20530

Practice Pointer - Include both the U.S. Attorney and the Attorney General on your mailing matrix

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<sup>2</sup> Different addresses apply to Toledo court cases.

to ensure that service of a plan which significantly affects the interest of the United States (e.g., provides for the valuation of a secured claim, seeks an injunction, materially modifies terms of the form plan, etc.) is proper.

## II. Secured Tax Claims

### A. Bankruptcy Code Section 506 provides:

A(a)(1) An allowed secured claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor=s interest in the estate=s interest in such property or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of the creditor=s interest or the amount subject to setoff is less than the amount of such allowed claim....@

### B. Types of IRS Secured Claims - the IRS will assert two different types of secured claims in bankruptcy based upon (a) a federal tax lien, notice of which was properly filed; and/or (b) a right of setoff.

### C. Characteristics of a Federal Tax Lien.

#### 1. Creation of Federal Tax Lien - A federal tax lien is a statutory lien that arises automatically upon assessment of the underlying tax liability. Section 6321 of the Internal Revenue Code provides:

AIIf an person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal belonging to such person.@

#### 2. Property Encumbered by Federal Tax Lien - A federal tax lien arises on the date of assessment and attaches to all property and rights to property acquired by a taxpayer during the life of the lien. 26 U.S.C. ' ' 6321, 6322; *Glass City Bank v. United States*, 326 U.S. 265, 268 (1946). A tax lien encumbers both real and personal property.

(a) Federal Tax Lien Secured Taxes Owed by One Spouse Against Tenants by the Entireties Property. In *United States v. Craft*, 535 U.S. 274, 278 (2002), the United States Supreme Court determined that a federal tax against one spouse attached to the spouse=s interest in property held as tenants by the entirety. After examining the Abundle of sticks@ held by each spouse under State law,

the Court held:

We therefore conclude that respondent=s husband=s interest in the entirety property constituted Aproperty@ or Arights to property@ for the purposes of the federal tax lien statute. We recognize that Michigan makes a different choice with respect to state law creditors: A[L]and held by husband and wife as tenants by entirety is not subject to levy under execution on judgment rendered against either husband or wife alone.@ *Sanford v. Bertrau*, 204 Mich. 244, 247, 169 N.W. 880, 881 (1918). But that by no means dictates our choice. The Interpretation of 26 U.S.C. ' 6321 is a federal question, and in answering that question we are in no way bound by state courts= answers to similar questions involving state law. As we elsewhere have held, A>exempt status under state law does not bind the federal collector.=@ *Drye v. United States*, [528 U.S. 49, 59, 120 S.Ct. 474 (1999)]. See also [*United States v. Rodgers*, 461 U.S. 677, 701, 103 S.Ct. 2132 (1983)](clarifying that the Supremacy Clause Aprovides the underpinning for the Federal government=s right to sweep aside state-created exemptions@).

*Id.* at 288-89 (emphasis added). In this situation, the IRS is entitled to collect the value of the taxpayer spouse=s interest in the tenants by the entirety property.

(b) Joint and several tax liabilities assessed against a husband and wife (such as joint income tax liabilities and similar trust fund recovery penalties assessed pursuant to 26 U.S.C. ' 6672) may be fully collected from tenants by the entirety property. *Tony Thornton Auction Service v. United States*, 791 F.2d 635, 638 (8th Cir. 1986) (finding that unpaid employment taxes owed by both spouses can be satisfied from property held by the entirety); *Augello v. United States*, 1993 WL 330472 (M.D. Pa. Jun. 4, 1993) (discussing that federal tax liens relating to virtually identical trust fund recovery penalties assessed against a husband and wife could be collected from tenants by the entirety property); *United States v. Ragsdale*, 206 F. Supp. 613, 616 (W.D. Tenn. 1962) (AIt seems that the interest of both spouses as tenants by the entirety may be sold to satisfy their joint liability.@); *Whitaker v. Kavanaugh*, 100 F.Supp. 918, 920 (E.D. Mich. 1951) (finding real property held as tenants by the entirety is not immune from collection of joint income tax liability).

3. Term of Federal Tax Lien - A tax lien continues Auntil the liability for the amount

so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time. 26 U.S.C. § 6322. Unless a tax liability is reduced to judgment, the IRS generally has 10 years from the date of assessment to collect it. 26 U.S.C. § 6502. However, the period for collection will be extended by certain events, such as the period during which the IRS is prohibited from collecting the tax liability because of a bankruptcy case, plus an additional six months. 26 U.S.C. § 6502(h)(2).

4. Filing of Notice of Federal Tax Lien.

(a) Unless a person falls within a class protected by Section 6323 of the Internal Revenue Code, a federal tax lien has priority over that person's interest in property of the taxpayer without a notice of federal tax lien being filed. In this situation, a federal tax lien is commonly referred to as a secret lien. Early tax lien cases generally held that a federal tax lien was enforceable against parties without recording. In 1893, the United States Supreme Court held that an unrecorded federal tax was valid against a purchaser without notice of the lien. *United States v. Snyder*, 149 U.S. 210 (1893). This decision led Congress to amend the tax lien statute to provide protection for certain persons. *United States v. Bond*, 279 F.2d 837 (4th Cir. 1960). Today, these protections are embodied in 26 U.S.C. § 6323. Section 6323 of the Internal Revenue Code was enacted to improve the position of certain creditors and purchasers competing with federal tax liens. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 738 (1979). However, if a person does not fall within the strict confines of Section 6323, an unrecorded tax lien will be enforceable against it. *See e.g., Reed v. Civiello*, 297 F. Supp. 2d 1008, 1013 (N.D. Ohio 2003) ("[T]here is a statutory exception to the common law rule of 'first in time, first in right.'"); *In re South Independence, Inc.*, 256 B.R. 861 (Bankr. E.D. Va. 2000) (finding that because recorded Virginia fuel tax liens were not judgment liens under federal tax lien statute, unrecorded federal tax liens had first priority to taxpayer's assets).

(b) A federal tax lien does not have priority over any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until a notice of the federal tax lien has been filed. 26 U.S.C. § 6323(a). A bankruptcy trustee has the status of a bona fide purchaser for value. Therefore, a tax lien must be filed prior to the bankruptcy case for a tax lien to be valid in bankruptcy.

(c) Place of filing. The notice of federal tax lien must be filed in the office of the county recorder of the county in which the property subject to the lien is situated. *See* Ohio Rev. Code Ann. § 317.09.

5. Priority of Federal Tax Liens Versus Other Creditors - Section 6321 of the Internal Revenue Code provides for the imposition of a federal lien on all property and

rights to property<sup>6</sup> belonging to a delinquent taxpayer. Pursuant to Section 6322 of the Code, such a tax lien arises automatically upon assessment and attaches to property owned or subsequently acquired by the taxpayer. *Glass City Bank v. United States*, 326 U.S. 265, 267-68 (1945); *Wukelic v. United States*, 544 F.2d 285, 291 (6th Cir. 1976) (AWe know of no reason why the undischarged tax debt here involved may not be the basis for a government lien upon property acquired by the bankrupt after bankruptcy.<sup>7</sup>). The scope of Section 6321 is broad and reveals . . . that Congress meant to reach every interest in property that a taxpayer might have.<sup>8</sup> *United States v. National Bank of Commerce*, 472 U.S. 713, 719-720 (1985). As the Supreme Court noted in *Glass City Bank*, 326 U.S. at 267, A[s]tronger language could hardly have been selected to reveal a purpose to assure the collection of taxes.<sup>9</sup> State law defines whether a taxpayer has rights to property. *United States v. Craft*, 535 U.S. 274, 278 (2002). Once it is determined that a delinquent taxpayer has property or rights to property under State law, a court must turn to federal tax lien statute to determine the federally defined consequences attached to the property or rights to property. *Id.* Accordingly, the priority of federal tax liens is governed by federal law. *Aquilino v. United States*, 363 U.S. 509, 513-514 (1960). The priority of federal tax liens vis-a-vis other perfected liens generally is based upon the rule of first in time is first in right. *United States v. City of New Britain*, 347 U.S. 81, 85-86 (1954). To compete successfully against a federal tax lien, a lien against a taxpayer=s property must be Achoate<sup>10</sup> when the tax lien arose. That is to say, the amount of the competing lien, the identity of the lienor, and the property subject to the lien must be specific and certain. *New Britain*, 347 U.S. at 86.

#### D. Bankruptcy Code Provisions and Cases Affecting Federal Tax Liens.

1. Lien Avoidance - the Trustee may avoid a federal tax lien if a notice of federal tax lien was not properly filed. 11 U.S.C. ' 545(2).
2. Exempt property remains subject to federal tax liens. 11 U.S.C. ' 522(c)(2)(B). *See also In re Barbier*, 896 F.2d 377 (9th Cir. 1990) (a federal tax lien attaches to all of the equity in a debtor=s assets, regardless of exemptions available under bankruptcy law).
3. Levy Exemptions Do Not Operate Against a Federal Tax Lien. Although Internal Revenue Code Section 6334 provides that certain property owned by a taxpayer may be exempt from administrative collection through an IRS levy, a federal tax lien is not affected by Section 6334 and is secured by property which is not subject to levy outside of bankruptcy. *See e.g., In re Barbier*, 896 F.2d 377 (9th Cir. 1990).
4. An ERISA qualified pension plan, being excluded from property of the estate, does not serve to secure an IRS claim in bankruptcy. *In re Keyes*, 255 B.R. 819 (Bankr.

E.D. Va. 2000). In *Keyes*, while the court held that the pension plan could not be used in determining the value of the IRS secured claim, it lifted the automatic stay to allow the IRS to pursue its nonbankruptcy remedies. See also *Eisen v. Thompson*, 370 B.R. 762 (N.D. Ohio Bankr. 2007) (It is undisputed that a bankruptcy estate has no interest in retirement accounts. Cf. *In re Wingfield*, 284 B.R. 787 (E.D. Va. 2002) (holding that a debtor's interest in a 401(k) plan was not property of the estate for purposes of establishing the IRS's secured claim)

5. The filing of a notice of federal tax lien is not avoidable as a preference. 11 U.S.C. ' 547(c)(6).
6. Section 522(f) - Debtors may not use Section 522(f)(1) to avoid a federal tax lien because a federal tax lien is a statutory lien which arises by operation of law. See 26 U.S.C. ' 6321; 11 U.S.C. ' 101(36) (definition of judicial lien); 11 U.S.C. ' 101(53) (definition of statutory lien); *In re Carolina Resort Motel, Inc.*, 51 B.R. 447 (Bankr. S.C. 1985); *In re J.B. Winchells, Inc.*, 106 B.R. 384 (Bankr. E.D. Pa. 1989).
7. Chapter 7 debtors may not use Section 506(d) to avoid or strip down an undersecured lien. *Dewsnup v. Timm*, 502 U.S. 410 (1991); *Talbert v. City Mortg. Servs. (In re Talbert)*, 344 F.3d 555 (6th Cir. 2003); *Hargrove v. United States*, 133 B.R. 765 (E.D. Va. 1991).
8. Tax liens remain valid and attach to property acquired postpetition if the underlying tax is not discharged. *In re Dishong*, 188 B.R. 51 (Bankr. M.D. Fla. 1995); *In re Olsen*, 154 B.R. 276 (Bankr. N.D. Ohio 1993). A Chapter 7 discharge does not avoid a federal tax lien. While a Chapter 7 discharge removes a debtor's personal liability, the IRS may still take collection action against the debtor's prepetition property. *In re Isom*, 901 F.2d 744 (9th Cir. 1990). In Chapter 13, a lien will be avoided if the underlying tax debt is provided for in the plan, the tax debt is dischargeable, the plan is completed, and a discharge is entered. 11 U.S.C. ' 1325(a)(5)(B)(i). But see *In re Deutchman*, 192 F.3d 457, 461 (4th Cir. 1999) (a Chapter 13 plan which did not deal with or provide for federal tax lien did not extinguish the lien). In a Chapter 11 case, the lien can be extinguished if the property to which the lien is attached is dealt with in the plan and the plan does not specifically provide for the retention of the lien. *Universal Suppliers v. Regional Building Systems, Inc.*, 254 F.3d 528 (4th Cir. 2001).
9. The government is entitled to receive postpetition, pre-confirmation interest on its allowed, non-consensual, over-secured claim. *United States v. Ron Pair Ent., Inc.*, 489 U.S. 235 (1989).

E. Tax Claims Secured by Setoff Rights.

1. In addition to being secured by tax liens, the IRS may be secured by the right of setoff. The IRS has both a common law and statutory right of setoff. *See* 26 U.S.C. ' 6402 (statutory setoff right).
  
2. Setoff is expressly authorized by Section 553. Notwithstanding any other provision of the Bankruptcy Code except for Sections 362 (automatic stay) and 363 (adequate protection), Section 553(a) allows a creditor to setoff a prepetition claim owed by a debtor against a prepetition debt owed by the creditor to the debtor. To be permitted to setoff under Section 553, the debts must be mutual, that is owed by the same parties. Clearly, there is mutuality between a tax liability and a tax overpayment. There also is mutuality between different federal agencies for setoff purposes. *See e.g., United States v. Maxwell*, 157 F.3d 1099 (7th Cir. 1998); *HAL, Inc. v. United States (In re HAL), Inc.*, 122 F.3d 851 (9th Cir. 1997); *Turner v. Small Business Admin. (In re Turner)*, 84 F.3d 1294 (10th Cir. 1996); *Aetna Cas. & Sur. Co. v. LTV Steel Co., Inc. (In re Chateaugay Corp.)*, 94 F.3d 772, 778-79 (2nd Cir. 1996); *Miller v. United States*, 422 B.R. 168, 171-72 (W.D. Wis. 2010); *In re Shortt*, 277 B.R. 683, 690-92 (Bankr. N.D. Tex. 2002); *In re Stewart*, 253 B.R. 51, 53 n. 2 (Bankr. E.D. Ark. 2000); *In re Hanssen*, 203 B.R. 149, 150 (Bankr. E.D. Ark. 1996) (all allowing inter-agency setoff). *See also Cherry Cotton Mills v. United States*, 327 U.S. 536 (1946) (holding in a nonbankruptcy case that the United States is a unitary creditor); *Doe v. United States*, 58 F.3d 494, 498 (9th Cir. 1995) (discussing that for purposes of sovereign immunity and setoff, all agencies of the United States, except those acting in private capacity, are a single governmental unit).
  
3. Setoff Versus Exemptions. Under general exemption law, a claim of exemption generally will trump a right of setoff. *See In re Thompson*, 182 B.R. 140, 153 (Bankr. E.D. Va. 1995), *aff=d unpub. op.*, 92 F.3d 1182 (4th Cir. 1996) (exemption rights have priority over setoff rights); *In re Monteith*, 23 B.R. 601, 602 (Bankr. N.D. Ohio 1982). However, because of the reductions mandated by 26 U.S.C. ' 6402, there is no property to exempt when a tax overpayment is reduced to pay other debts owed for taxes or to other federal agencies. Courts that have considered the issue have held that setoffs effectuated under the Treasury Offset Program pursuant to 26 U.S.C. ' 6402 have priority over a debtor=s exemption rights with regard to a tax overpayment because the debtor has no property to exempt in light of the reductions mandated by the Internal Revenue Code. *See United States v. Gould (In re Gould)*, 401 B.R. 415, 424-25 (9th Cir. BAP 2009), *aff=d*, 603 F.3d 1100 (9th Cir. 2010); *Internal Revenue Service v. Luongo (In re Luongo)*, 259 F.3d 323 (5th Cir. 2001); *Beaucage v. Internal Revenue Service*, 342 B.R. 408, 410-11 (D. Mass. 2006); *Jones v. Internal Revenue Service (In re Jones)*, 359 B.R. 837, 840-41 (Bankr. M.D. Ga. 2006); *In re Pigott*, 330 B.R. 797, 801-02 (Bankr. S.D. Ala. 2005) (all concerning setoff of tax overpayments against tax liabilities). *See also Harrison v. United States Dep=t of Agric. Rural Dev. (In re*

*Harrison*), 383 B.R. 398, 402 (Bankr. W.D. Ky. 2008) (IRS tax overpayment setoff against Rural Development debt); *In re Baucom*, 339 B.R. 504, 507 (Bankr. W.D. Mo. 2006) (IRS tax overpayment setoff postpetition against Rural Housing Development debt); *In re Shortt*, 277 B.R. 683, 692-93 (Bankr. N.D. Tex. 2002) (IRS tax overpayment setoff postpetition against AAFES debt). However, certain decisions hold that a claim of exemption prevails over a right of setoff. See *Sexton v. Dep't of Treasury (In re Sexton)*, 508 B.R. 646, 663 (Bankr. W.D. Va. 2014), *appeal dismissed*, 529 B.R. 667 (W.D. Va. 2017) (holding that overpayment was property of the estate, in a case where the Government setoff a tax overpayment against a non-IRS debt while the automatic stay was in effect); *Addison v. U.S. Dep't of Agric. (In re Addison)*, 533 B.R. 520, 529-30 (Bankr. W.D. Va. 2015), *aff'd*, No. 1:15CV00041, 2016 WL 223771 (W.D. Va. Jan. 19, 2016) (adopting the analysis in *Sexton*); *Porter v. IRS (In re Porter)*, 562 B.R. 658, 661 (Bankr. E.D. Va. 2017) (following *Sexton* and finding that a debtor retained a legal right in an overpayment sufficient to bring a Section 553(b) turnover motion, but denying such motion); *Copley v. United States (In re Copley)*, 547 B.R. 176, 185 (Bankr. E.D. Va. 2016) (following *Sexton* and *Addison*); *In re Buttrill*, 549 B.R. 197 (Bankr. E.D. Tenn. 2016) (following *Sexton* and *Addison*).<sup>3</sup>

4. Tax Setoff Exception to Automatic Stay. The setoff of a prepetition income tax refund against a prepetition income tax liability does not violate the automatic stay. 11 U.S.C. ' 362(b)(26). This exception only applies to income taxes.

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<sup>3</sup> There is no binding guidance in the Fourth or Sixth Circuit. However, the holdings of those opinions were rejected and severely undermined by a Western District of Virginia opinion. See *Benson v. United States (In re Benson)*, 566 B.R. 800 (Bankr. W.D. Va. 2017).

### III. Priority Tax Claims - Section 507(a)(8)

The following federal government tax claims are entitled to priority claims status:

- A. Three Year Rule. Income taxes for which a return is last due, considering extensions, within 3 years of the date of the filing of the bankruptcy case. 11 U.S.C. § 507(a)(8)(A)(i). The operative date is the due date (as extended) for such return, not the actual filing date.
- B. 240 Day Rule. Income taxes assessed within 240 days of the petition date. 11 U.S.C. § 507(a)(8)(A)(ii). The 240-day period is extended in two situations. First, it is extended by the time which an offer in compromise was pending or in effect during the 240-day period, plus 30 days. Second, it is extended by the time a stay against collection proceeding was in effect during the 240-day period, plus 90 days.
- C. Still Assessed Rule. 11 U.S.C. ' 507(a)(8)(A)(iii). If an income tax has not been assessed, but is still assessable, then it is entitled to priority status unless the statute of limitations is still open because of a late or unfiled return or the taxpayer=s fraud. Congress did not want to penalize creditors for a debtor=s bad acts. However, the rule applies if the statute of limitations on assessment is open for some other reason, such as a consent to extend the statute executed by the debtor or pending Tax Court litigation.
- D. Withholding Taxes. A tax required to be collected or withheld and for which the debt is liable in whatever capacity is a priority tax claim. 11 U.S.C. ' 507(a)(8)(C).
- E. Employment Taxes - Three Year Rule. Employment taxes for which a return is last due, considering extensions, within 3 years of the date of the filing of the bankruptcy case. 11 U.S.C. ' 507(a)(8)(D). This category covers Form 940 and 941 taxes.
- F. Excise Taxes. There are two types of excise taxes which are entitled to priority claim status: (1) excise taxes on prepetition transactions for which a return is last due considering extensions within three years of the filing of the bankruptcy case, and (2) Excise taxes for which a return is not required and which relate to a transaction which occurred within three years of the filing of the bankruptcy case. 11 U.S.C. § 507(a)(8)(E).
- G. Customs Duties. Certain customs duties are entitled to priority claims status. 11 U.S.C. ' 507(a)(8)(F).
- H. Compensatory Loss Penalties. A penalty related to a Section 507(a)(8) claim which is compensation for actual pecuniary loss is entitled to priority claims status. 11 U.S.C. § 507(a)(8)(G).
- I. Other Important Points About Priority Tax Claims.

1. Interest which accrues on a prepetition tax claim is entitled to the same priority as the underlying tax claim. *In re Larson*, 862 F.2d 112, 119 (7th Cir. 1988); *In re Stonecipher Distributors, Inc.*, 80 B.R. 949 (Bankr. W.D. Ark. 1987).
2. Tolling. Amended § 507(a)(8) (hanging paragraph) codifies and extends the Supreme Courts holding in *Young v. United States*, 535 U.S. 43 (2002) (serial bankruptcies toll tax priority time periods). Specifically, the time periods for determining whether a tax is a priority claim is tolled for the following time periods:
  - (a) the time during which a collection due process request, hearing, and appeal prevented collection, plus 90 days; plus
  - (b) the time during which the automatic stay was in effect or during which one or more confirmed plans prohibited collection, plus 90 days.
  - (c) Erroneous Refunds - have the same priority status as the tax to which they relate. 11 U.S.C. ' 507(c).

#### IV. Administrative Tax Claims - Section 507(a)(2)

These are claims which arise during the pendency of the bankruptcy case. The claim is allowable under Section 503. In Chapter 13, the IRS has the option of filing a claim under Section 1305(a)(1). The debtor does not have the option of filing a Section 1305(a) claim on behalf of the IRS. *In re Dickey*, 64 B.R. 3 (Bankr. E.D. Va. 1985); *see also In re Hudson*, 158 B.R. 670, 674 (Bankr. N.D. Ohio 1993). The IRS makes its determination based upon the size of the claim, whether the IRS holds other prepetition claims, the debtor=s willingness to amend the plan to pay the Section 1305(a) claim and the availability of other assets. If the IRS files a Section 1305(a) claim, it is treated as a priority claim.

Interest on administrative claims is an administrative expense. *In re Mark Anthony Constr., Inc.*, 886 F.2d 1101 (9th Cir. 1989). Penalties related to administrative taxes are also entitled to administrative priority. 11 U.S.C. ' 503(b)(1)(C); *In re Friendship College*, 737 F.2d 430 (4th Cir. 1984).

V. Payment

A. Chapter 7.

In a Chapter 7, secured claims against liquidated property must be paid first. Section 724(b) governs distributions on secured tax claims. In short, when other liens exist against property, an amount equal to Section 507(a)(1)-(7) priority claims is carved out of the proceeds which would otherwise be paid toward the secured tax claim. This is to ensure that private secured creditors receive what they would have received had the bankruptcy case not been filed and to avoid a claim of a 5th Amendment taking. Proceeds are distributed under Section 724(b) as follows:

First, lien claims which are senior to the tax liens are satisfied under Section 724(b)(1).

Second, a distribution is made to Section 507(a)(1)-(7) priority claims up to the amount of the tax lien. 11 U.S.C. ' 724(b)(2).

Third, a distribution is made to the secured tax claim to the extent the amount of the secured tax claim exceeds amount distributed to Section 507(a)(1)-(7) priority claimants. 11 U.S.C. ' 724(b)(3).

Fourth, lienholders junior to the secured tax claim are paid. 11 U.S.C. ' 724(b)(4).

Fifth, property is distributed to the secured tax claimant to the extent it was not fully paid under Section 724(b)(3). 11 U.S.C. ' 724(b)(5).

Sixth, any remaining property is distributed to the estate. 11 U.S.C. ' 724(b)(6).

After payment of secured claims, Section 726 establishes how funds are distributed to unsecured claimants. The proceeds are distributed as follows:

1. Priority claims under Section 507:

(a) for which timely proofs of claim were filed; and

(b) relating to late filed priority claims (such as claims for certain taxes) will be paid according to their normal priority if they are filed the earlier of: (i) 10 days after the trustee mails a summary of the final report, or (ii) the date the trustee commences distribution. 11 U.S.C. ' 726(a)(1).

2. Allowed unsecured claims that were timely filed or were tardily filed by a creditor who did not have knowledge of the bankruptcy. 11 U.S.C. ' 726(a)(2).

3. Late filed unsecured claims filed by creditors with notice or actual knowledge of the bankruptcy. 11 U.S.C. ' 726(a)(3).
4. Noncompensatory fines, penalties and forfeitures. 11 U.S.C. ' 726(a)(4).
5. Postpetition interest on the above claims at the legal rate. 11 U.S.C. ' 726(a)(5).
6. To the debtor. 11 U.S.C. ' 726(a)(6).

B. Chapter 11.

1. Administrative Claims - must be paid in full and in cash on the effective date of the plan. 11 U.S.C. ' 1129(a)(9)(A).
2. Priority Claims. BAPCPA significantly amended the rules governing payment of priority tax claims in a Chapter 11 case. *See* 11 U.S.C. ' 1129(a)(9)(C). Priority tax claims must receive regular installment payments in cash equal to the total value of the claim as of the effective date of the plan. The payments must be made over a five-year period beginning with the petition date (rather than a 6-six year period from the assessment date). The payment schedule must be no less favorable than the payment schedule of the most favored class of nonpriority unsecured claims provided for by the plan (other than a class of nuisance claims).
  - (a) Interest on priority tax claims is fixed at the Internal Revenue Code rate in effect on the date of confirmation. 11 U.S.C. ' 511.
  - (b) Regular Payments. The one of the few courts to consider the issue has held that 11 U.S.C. ' 1129(a)(9)(C)'s requirement of Aregular payments@ in a Chapter 11 case did not mandate that equal monthly payments be made to the IRS. Instead, the Court found that monthly payments followed by a balloon were sufficient. *United States v. F.G. Metals, Inc.*, 2008 WL 4097592 (M.D. Fla. Sept. 4, 2008); *see also In re Jerath Hospitality, LLC*, 484 B.R. 245 (Bankr. S.D. Ga. 2012).
3. Secured Claims Otherwise Entitled to Priority Claims Status. The payment schedule for unsecured priority tax claims also applies to tax claims secured by a lien that, if unsecured, would otherwise be described in section 507(a)(8). 11 U.S.C. ' 1129(a)(9)(D). Such claims must be paid in regular cash installments over a period not to exceed 5 years from the petition date. Interest on secured tax claims is fixed at the Internal Revenue Code rate in effect on the date of confirmation. 11 U.S.C. ' 511.
4. Secured Claims Not Otherwise Entitled to Priority Claims Status - are paid as provided for in Section 1129(b)(2)(A) and are subject to cram down. Accordingly, there are three ways such claims can be paid. First, the plan must provide for the retention of

the tax lien and the payment of deferred cash payments equal to the value, as of the effective date of the plan, of the secured tax claim. 11 U.S.C. 1129(b)(2)(A)(i). Second, the plan can provide for the sale of the property free and clear of the tax lien with the tax lien attaching to the proceeds. 11 U.S.C. 1129(b)(2)(A)(ii). Third, the plan can provide for the realization by the secured tax claimant of the indubitable equivalent of its claim. 11 U.S.C. 1129(b)(2)(A)(iii). Interest on secured tax claims is fixed at the Internal Revenue Code rate in effect on the date of confirmation. 11 U.S.C. ' 511. Look to the nature of the collateral to determine repayment period.

C. Chapter 13.

- A. Payment through a Prepetition Installment Agreement in Good Standing Under Section 1322(b)(5). Section 1322(b)(5) allows a debtor to cure a default and maintain payments on any claim where the final payment on the debt is due after the completion of the plan. Taxes are due and payable immediately and in almost every circumstance will not be susceptible of being paid under Section 1322(b)(5). An exception exists where the debtor has a formal installment agreement with the IRS, which was not terminated prepetition. *See In re Gordon*, 217 B.R. 973 (Bankr. S.D. Ga. 1997). However, if Section 1322(b)(5) is properly utilized, the entire tax secured, priority and general debt, including penalties and interest, included within the agreement will be nondischargeable pursuant to Section 1328(a)(1). Installment agreements also have provisions which allow the IRS to increase the payments if the taxpayer=s financial circumstances change and to terminate the agreement if the taxpayer fails to file or pay future taxes. If a debtor has a prepetition installment, the plan should assume the installment agreement as an executory contract and specifically provide that the tax debt is nondischargeable. Postpetition installment agreements cannot be obtained from a local Internal Revenue Service office because such offices do not have authority over a debtor=s tax account once bankruptcy is filed; authority rests with the Insolvency Unit upon the filing of a bankruptcy case. Further, if a debtor=s tax liability is referred to the Department of Justice for litigation, the IRS loses authority to enter into an installment agreement as settlement authority then rests with the Department of Justice. 26 U.S.C. ' 7122(a). Stated another way, if the United States Attorney objects to confirmation of a plan, the debtor may not approach the IRS to obtain an installment agreement and the IRS is without authority to enter into one.
- B. Priority Tax Claims - must be paid in full in deferred cash payments through the plan unless the IRS (or the Department of Justice if the matter is referred for litigation) agrees to a different treatment. Payments on priority claims must be made through the Chapter 13 plan. *In re McDonald*, 437 B.R. 278, 284 (Bankr. S.D. Ohio 2010); *In re Driskell*, 2000 WL 1902253 (Bankr. M.D. Ga. Nov. 20, 2000); *In re Ballard*, 4 B.R. 271, 278 (Bankr. E.D. Va. 1980).
- C. Secured Tax Claims - may be dealt with in three ways.

1. The IRS accepts the plan. 11 U.S.C. ' 1325(a)(5)(A). The IRS typically requires that its secured claim be paid in full over the life of the plan.
2. Full Payment over the Life of the Plan. 11 U.S.C. ' 1325(a)(5)(B). The plan must provide for:
  - (a) The IRS to retain its tax lien until the earlier of the payment of the secured tax claim or discharge, provided that the lien will be retained if the case is converted or dismissed without completion of the plan.
  - (b) The IRS is paid the value of its secured claim, as of the effective date of the plan. Interest on secured tax claims is fixed at the Internal Revenue Code rate in effect on the date of confirmation. 11 U.S.C. ' 511.
  - (c) If periodic payments are to be paid toward the secured tax claims, such payments shall be in equal monthly amounts which are not less than an amount sufficient to provide adequate protection to the IRS.
3. Surrender. 11 U.S.C. ' 1325(a)(5)(C). A debtor may not compel an unwilling creditor to accept a surrender of collateral. *In re Service*, 155 B.R. 512 (E.D. Mo. 1993). The Fourth Circuit has held that debtors who proposed in their plan to surrender property subject to a federal tax lien to the IRS had not effectuated a surrender because such property was exempt from levy under the Internal Revenue Code. *IRS v. White*, 487 F.3d 199 (4th Cir. 2007).
4. Section 1326(a)(1)(C) does not require that pre-confirmation adequate protection payments be made to the IRS. This is because the IRS does not hold a purchase money security interest.

## VI. Discharge

- A. Chapter 7. Under Chapter 7, an individual receives a discharge for all prepetition debts which are not excepted from discharge by Section 523. A debtor who is not an individual does not receive a discharge.
- B. Chapter 11. Under Section 1141(d), an individual receives a discharge for all prepetition debts which are not excepted from discharge by Section 523. A corporation or other entity which is not liquidating is eligible for a discharge.
- C. Chapter 13 Hardship Discharge. Under Section 1328(b), a debtor who does not complete all payments under a plan is entitled to a hardship discharge if: (1) the failure to complete the payments is due to circumstances for which the debtor should not be justly accountable, (2) the amount of property distributed under the plan equals or exceeds that which would have been distributed in a Chapter 7 case, and (3) modification of the plan is not

practicable. If the requirements of Section 1328(b) are met, a debtor receives a discharge of all debts except for those debts excepted from discharge by Section 523 or provided for in the plan pursuant to Section 1322(b)(5).

D. Chapter 13 Super Discharge. If the debtor completes his plan, Section 1328(a) provides that the debtor is discharged from all debts, except for certain excepted debts. The tax debts excepted from discharge are:

1. Obligations provided for under Section 1322(b)(5). This exception would relate to prepetition installment agreements which are assumed by the debtor.
2. Trust fund taxes.
3. Tax liabilities based upon unfiled or late-filed returns. A return includes returns prepared by the IRS and the taxpayer under Section 6020(a) of the Internal Revenue Code, but does not include a substitute for return prepared solely by the IRS under Internal Revenue Code Section 6020(b). 11 U.S.C. ' 523(a) (hanging paragraph).
4. Tax liabilities which are based on a fraudulent tax return or which the debtor willfully attempted to evade or defeat.

E. Section 523(a) Tax Exceptions to Discharge.

1. Priority Tax Claims under Section 507(a)(8). 11 U.S.C. ' 523(a)(1)(A).
2. Tax liabilities based upon unfiled tax returns. 11 U.S.C. ' 523(a)(1)(B)(i). A return includes returns prepared under Section 6020(a) of the Internal Revenue Code, but does not include returns prepared under Section 6020(b) of the Internal Revenue Code. 11 U.S.C. ' 523(a) (hanging paragraph).
3. Tax liabilities based upon tax returns which are filed late within two years of the date of the bankruptcy case. 11 U.S.C. ' 523(a)(1)(B)(ii). A return includes returns prepared under Section 6020(a) of the Internal Revenue Code, but does not include returns prepared under Section 6020(b) of the Internal Revenue Code. 11 U.S.C. ' 523(a) (hanging paragraph). When a case is converted, the original filing date, not the conversion date, is used in calculating the two-year period. *In re Darden*, 202 B.R. 715 (Bankr. E.D. Va. 1996).
4. Tax liabilities which are based on a fraudulent tax return or which the debtor willfully attempted to evade or defeat. 11 U.S.C. ' 523(a)(1)(C).
5. Penalties which relate to a nondischargeable tax and to a transaction that occurred within 3 years of the petition date. 11 U.S.C. ' 523(a)(7).

- F. Prepetition interest is nondischargeable if the underlying tax is nondischargeable. *In re Treister*, 52 B.R. 735 (Bankr. S.D.N.Y. 1985).
- G. Postpetition interest and penalties on nondischargeable taxes, although not collectible during the bankruptcy case, may be collected from the debtor despite a discharge. *In re Hanna*, 872 F.2d 829 (8th Cir. 1989). *See also Bruning v. United States*, 376 U.S. 358 (1964) (postpetition interest on nondischargeable taxes).
- H. Post-Discharge Setoff. Discharged prepetition claims may be setoff against prepetition debts owed to the debtor after the discharge order is entered. *See e.g., In re Luongo*, 259 F.3d 323 (5th Cir. 2001); *In re Dominguez*, 67 B.R. 526 (N.D. Ohio 1986); *In re Conti*, 50 B.R. 142, 149 (Bankr. E.D. Va. 1985).