

ADVANCED BANKRUPTCY AND TAX WORKSHOP

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“Tax Problem Resolution”

Bankruptcy- an indispensable tool

Bankruptcy

Often the best choice to a solve tax problem.

- Certain taxes are dischargeable.
- Even if not dischargeable, pay over time often without interest.
- Even if tax is not dischargeable, penalties may be.
- Often result is far more favorable than OIC or installment agreement.

Bankruptcy

Often the best choice for “global” solution.

- Deals with state taxes.
- Addresses other debts.
- Options relating to unfavorable contracts.
- Benefits relating to COD income-§108.
- Stops all creditors in their tracks.

Bankruptcy

- Pendulum clearly has swung back.
- Increased tax enforcement.
- More frustrating to deal with.





Knowledge of the benefits of bankruptcy distinguishes you from other “tax professionals”.

ADMINISTRATIVE OFFICES

Control: 76453-89
Notice : <CA6532>
Notice Date: April 9, 2010

Re: Settlement offer

Form: T-<2049>
Year: 2009
To call for Assistance:
1-866-362-7453

[REDACTED] -9300

|||||

Contact:
Administrative Offices

You must reply by **May 10, 2010**

1 Why are you getting this notice?

Our records indicated that your tax debt in the amount of \$536,680 may qualify for the 2009 tax settlement program.

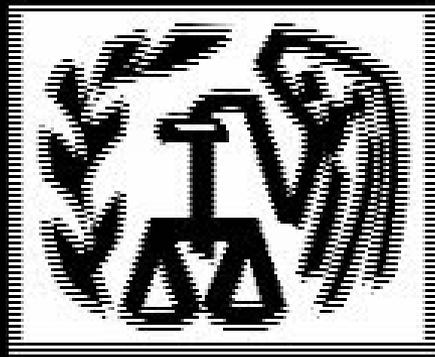
This new program may enable you to settle you current debt for a fraction of the amount.

Internal Revenue Code authorizes the IRS, to accept less than full amount of tax liability owed in any IRS civil or criminal case arising under the tax laws prior to the case's referral to the Department of Justice. For an Offer in Compromise to be accepted, the taxpayer must establish to the satisfaction of the IRS that the taxpayer either: has no means of paying the tax, or does not actually owe the tax.

The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost.

Summary of proposed settlement based on eligibility

Current Tax debt	Proposed settlement	Settlement rate
\$536,680	\$53,668	-90%



BANKRUPTCY

A QUICK OVERVIEW

CHAPTER 7 CASH LIQUIDATION

- Individual or corporations
- Trustee appointed- sells non-exempt assets to pay creditors in order set by Congress.
- Quick and relatively cheap.
- Goal- “fresh start”- discharge of debt.

CHAPTER 7 (Continued)

Limitations

- Some debts excepted from discharge.
 - Including “priority” taxes.
- Means Test- May require conversion to Chapter 13.
 - Note: Means test applies to cases that are “primarily consumer debt”.
 - Taxes are not considered consumer debt.

CHAPTER 13

- Individuals with “regular income”.
- Keep assets.
- Pay creditors through plan-up to 5 years.
- Secured creditors paid in full-with interest.
- Priority creditors paid in full (often without interest).
- Unsecured/general creditors-often paid small percentage.

CHAPTER 13 (Continued)

- Unsecured creditors receive:
 1. Amount they would get in a Chapter 7.
 2. Excess disposable income.
- Debt limitations:
 1. Unsecured debt limit.
- Unsecured- \$360,475
- Secured- \$1,081,400

CHAPTER 11

- Individual or corporation.
- No debt limit.
- Keep assets, pay creditors through plan.
- Complex and expensive.

Terms Applicable to Bankruptcy

- Estate
- Automatic Stay-§362
- Turnover
- Adequate protection
- Preference

Type of Pre-Petition Bankruptcy Claims

- Secured
- Priority- §507
- General unsecured

BANKRUPTCY & TAX

The “Basics”



Types of Pre-Petition Tax Claims

- Secured
- Priority
- Unsecured

Secured Claims

Negative Impact of NFTL

- Only if equity in assets
- If IRS is secured, dischargeable taxes & penalties will be secured 1st, before later priority taxes- can require payment of both.
 - Ex. 2004-2006- (Dischargeable)-\$35k tax, \$15k pen.
 - 2007-2009- (Nondischargeable)- \$50k
 - \$50k equity in liquid assets
- Solution- Designate! Designate! Designate!



ANDOVER MA 05501-0030

In reply refer to: [REDACTED]
Sep. 27, 2006 LTR 3064C EO
[REDACTED] 200012 30 000 1
10629
BODC: SB

[REDACTED]
% DEBORAH J MUHLBAUER ATTY
333 INTERNATIONAL DR STE B4
WILLIAMSVILLE NY 14221-5726

01209

Taxpayer Identification Number: [REDACTED]
Tax Period(s): Dec. 31, 2000 Dec. 31, 2001

Form: 1040

Dear Taxpayer:

Thank you for your correspondence dated 08232006.

When in an Installment Agreement to pay your taxes, the payments are credited to the earliest tax year because it is to your benefit to pay the earliest year first, as far as interest and penalties accrue.

Impact of NFTL on Exempt Assets

- Exemptions don't apply to IRS

BUT-Exemptions apply in bankruptcy.

Impact:

Example 1- Dischargeable (non-priority) tax
=\$50k.

IRA = \$50k. No NFTL. BK discharges \$50k-
T.P. keeps IRA.

Example 2

Dischargeable (non-priority) tax = \$50k.

NFTL filed. Tax discharged, BUT lien stays on IRA- IRS can take it.

§507 Priority Claims...

- (8) Eight, allowed unsecured claims of governmental units; only to the extent that such claims are for-
 - (A) A tax on or measured by income or gross receipts for a taxable year ending on or before the date of filing of the petition.

(i): for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii): assessed within 240 days before the date of filing of the petition, exclusive of –

(I) Anytime during which an offer in compromise with respect to that tax was pending or in effect during the 240-day period, plus 30 days: and

(II) Anytime during which a stay of proceedings against collection was in effect in a prior case under this title during that 240-day period, plus 90 days.

(iii): other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

TRUST FUND TAXES

(C) A tax required to be collected or withheld and for which the debtor is liable in whatever capacity.

RECAP

Priority Tax Claims

[§507(a)(8)(A) Income Tax]

- Return due w/in 3 yrs., plus extension
- Tax assessed w/in 240 days, if OIC time + 30
- Tax not assessed, but legally assessable
 - except- if unfiled return
 - late return w/in 2 yrs.
 - fraud
- Trust fund taxes

Tolling Provisions of §507(a)(8)

*An otherwise applicable time period specified in **this paragraph** shall be suspended for any period during which a government unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a **request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor**, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.*

Exception to Discharge [§523(a)]

- Priority taxes
- Unfiled or late return w/in 2 years
- Fraud



RECAP

- Secured- Ch 7- IRS entitled to property or value.
 - Lien stays on exempt assets after BK.
 - Ch 13 & 11- Paid in full (including penalties) through plan + interest.
- Priority- Ch 7- Not discharged
 - Ch 13- Income tax pd. In full w/o interest.
 - TFRP in full with interest
 - Penalties dischargeable.
 - Ch 11- Pd in full with interest.

CAVEATS:

1. “Equitable tolling”
2. Laws constantly changing.
3. Reliance on transcripts or client.

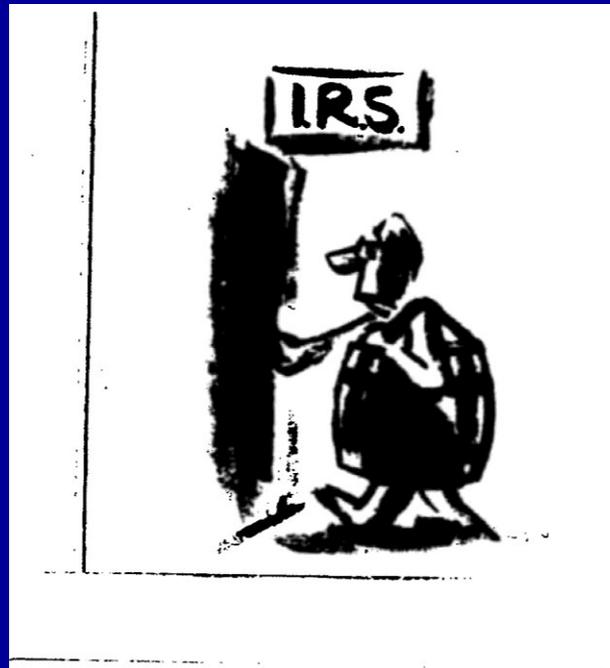
Updates

- 401(k) issue and assessment lien.
- SFR and late returns.
- Late returns- no SFR.

Other Key Points:

- Interest is part of the tax.
- Unsecured penalties are non-priority in a Chapter 13.
- 941 liabilities: non-TFRP, non-priority after 3 years.
- Timing between BKs.
 - * 8 yrs. Between discharges in 7.
 - * 4 yrs. Between 7 & 13.
 - * 2 yrs. Between 13s.

§108- COD Income Former Owner of Investment Real Estate After the Crash



A Former Owner of Investment Realty After the IRS Got Through With Him



§108 Debt Forgiveness Income

Ex.: Fla. investment property

Purchase Price = \$1 million

Mtg. = \$800k

Cash, -Foreclosure – Net \$400k

COD income = \$400k

Assets = \$15k bank account
\$750k 401(k), \$60k IRA
\$50k equity in residence

Other debts= \$55k

Insolvent? §108 exclusion?

Effect of BK?

Bankruptcy Part 2

Bankruptcy Problems

For these problems, assume tax liability assessed on date return filed.

Unless stated otherwise, assume NO fraud.

BK Problem 1

Tax Yr. 2007, return filed on 4/15/2008.

Priority?

Dischargeable?

BK Problem 2

Tax yr. 2006, return filed 10/16/2007, on extension to 10/15/07.

Priority?

Dischargeable? As of When?

BK Problem 3

Tax yr. 2006, return filed 10/16/2007, no extension.

Priority?

Dischargeable? As of When?

BK Problem 4

Tax yr. 2006, filed, 1/2/2009.

Priority?

Dischargeable?

BK Problem 5

Tax yr. 2005, audit and petition to U.S. Tax Court-Lost., Assessed 8/10/2010.

Priority?

Dischargeable?

BK Problem 6

Tax yr. 2005, audit, signed extension of statute until 1/15/2011.

Priority?

Dischargeable?

BK Problem 7

Tax yr. 2003, audited and tax assessed
4/10/2006, fraud penalty.

Priority?

Dischargeable?

BK Problem 8

Tax yr. 2006, return filed, on extension
10/15/2007, OIC submitted 8/20/2009;
pending until 10/11/2010.

Priority?

Dischargeable?

BK Problem 9

Tax yr. 2006, return filed 10/15/2007, on extension
CDP filed on 8/10/2010, appeal denied, levy
action sustained on 10/01/2010.

Priority?

Dischargeable?

Same facts, but Equivalency Hearing instead of
CDP.

BK Problem 10

2005 return unfiled, 09/03/2008 SFR filed.

Priority?

Dischargeable?

BK Problem 11

2005 SFR filed 07/10/2008, 10/10/2008 T.P.
files tax return.

Priority?

Dischargeable?

BK Problem 12

2005 return filed 04/15/2008, NFTL filed
10/15/2008, no assets.

Priority?

Dischargeable?

BK Problem 13

941 return 3Q 2005 filed timely, TFRP assessed against T.P.

Priority?

Dischargeable?

Part 2- More Hypotheticals

#1

- Client sells business in 2006. Substantial amount of money generated by sale, which creates large tax liability. Client invests all the money and loses it. Gets scared and doesn't file tax return. Sees commercial on tv that all his problems can magically be erased and his taxes wiped away. He pays this company \$20,000 to do an OIC. They then advise him he needs to file his outstanding return to do an OIC. They charge him an additional fee to prepare the return. They prepare a joint return, telling his spouse that she has to sign the return to resolve the problem. The return was submitted with no payment October 1, 2009. Then company did nothing. Client comes to you immediately after receiving a Final Notice of Intent to Levy dated October 14, 2010. What are the options?
- **Key Points:**

#2

- Client is under audit for 2008, the return was timely filed 4/15/09. There was an 872 consent to extend the statute to assess until 12/31/13. RAR proposes a tax liability of \$100,000. You believe you may be able to contest part of the adjustment, potentially lowering it by \$10,000-\$15,000. Client can't pay either amount and inquires about filing bankruptcy.
-
- Do you appeal? – Protest or petition Tax Court?
- When will tax be dischargeable?
- **Key Points:**

#3

IRS does SFR for 2004, liability \$40k, NFTL filed. 2005 and 2006 were timely filed, liability \$80k, no NFTL filed. 2007 liability is \$20k. Client has \$50k in bank accounts and stock and an IRA worth \$100k. Home with no equity. Leased car. Client's net monthly income, pursuant to 433 standards, is \$750 a month.

- a. How well does an offer in compromise work in this case?
- b. What if he filed a Chapter 7 right now? What if he waits?

What pre-bankruptcy strategy would help?

Key Points:

#4

Client owes \$60,000 2008 income taxes (\$20k of which is penalties). Also owes \$80,000 in credit card debt. Has no equity in any assets. Has net monthly income on 433-A of \$850 per month. Monthly credit card payments equal \$900 per month.

OIC? Chapter 7? Chapter 13?

Key Points:

#5

Client owes \$100,000 in credit card debt, filed Chapter 7 and received discharge 12/15/06. Owed income taxes for '03, '04, '05;; \$80,000, \$50,000, and \$10,000 respectively. All returns were filed timely. Client received Final Notice of Intent to Levy on 10/15/10. OIC won't work.

What years are priority?

Can client file Chapter 7 and discharge any of the years? What about a Chapter 13?

Can client do a CDP and then file BK when the timing is right?

What would you do?

Key Points:

Part 3- Workshop Problems

Assume state Homestead Exemption equals \$50,000, \$100,000 jointly,
IRAs and ERISA Qualified Plans are exempt.

Problem #1

H&W- income tax 2005 and 2006, \$210,000.

Returns filed 06/05/2008- no NFTL.

Credit card debt = \$25,000.

Assets- House FMV = \$250,000, Mtg. = \$150,000.

Car-leased.

Income-joint annual = \$96,000, net mo. (IRS standards) = \$1,200,

OIC = \$250,000 X 80% minus \$150,000.

IRA= \$65,000

+ \$1,200 X 48

Bankruptcy Analysis-Chapter 7

- No Means Test (debt not primarily consumer debt).
- Eliminate credit cards.
- IRA exempt, no NFTL, client keeps.
- Tax discharge
- Client pays 0.

Same Facts, but:

- TFRP assessed 02/10/2008, \$25,000.
- No equity in home, \$65,000 IRA, \$35,000 TFRP and NFTL filed for income tax.
- Equity in home + NFTL

Problem #2

Client owes income tax for 2006 (\$80k), 2007 (\$70k) and 2008 (\$50k).

Returns timely filed.

Credit card debt = \$30,000, paying \$600 per month.

Assets: house FMV = \$200,000, mtg. = \$50,000 (\$100,000 Homestead Exemption)

\$30,000 cash assets.

Income-net income (433-A) = \$500 per month.

OIC = \$200,000 (\$160,000) - \$50,000 mtg. = \$110,000 + \$30,000 cash = \$140,000.

Income- \$500 X 48 = \$24,000.

Total OIC RCP = \$164,000 cash offer.

Problem 2 (continued)

Chapter 7- now

2006 and 2007 (non-priority dischargeable)

2008 priority, nondischargeable, but would lose non-exempt assets, trustee would sell house for equity-\$110,000, and take cash-\$30,000.

Even if delayed Chapter 7 until '08, if dischargeable, still would lose house and cash.

Chapter 13 now- 2006 and 2007, general unsecured paid at “pennies” on the dollar.

2008 priority, paid in full with no interest (not secured).

Problem #2 (continued)

Chapter 13 allows no accrual of interest or penalties and accrued penalties would also be paid at a small percentage on the dollar. Therefore, the amount owed for 2008 can be spread out and only the tax and interest accrued through the petition date would have to be paid in full.

Will keep all assets.

Required payments approximately \$500 per month for priority tax and trustee commission.

Get rid of all debt for less than what client was making on credit cards alone.

Problem #2 (continued)

Chapter 13 later

Not worth waiting for '08 to be non-priority.

Would just increase payments to unsecured creditor pool-due to Chapter 7 test and disposable income test.

Problem #3

2006 tax assessed 10/14/2010 for \$175,000; \$100,000 tax and interest, \$75,000 fraud penalty.

OIC won't work due to house FMV of \$200,000, mtg. of \$100,000 and 433-A excess income = \$2,000/mo.,

OIC = $\$160,000 - \$100,000 = \$60,000 + (\$2,000 \times 48) = \$96,000 = \$156,000$: in 5 mo. from acceptance.

-Ch 7- useless

-Ch 13- fraud penalty is dischargeable.

Ch 13 BK= \$100k priority

Ch 7 test = \$60k (less if Homestead exemption).

Disp. income test = \$120,000 over 5 yrs. ($\$2k \times 60$)

\$75k pen = small % on the \$. ("Pennies on the dollar".)