AIRA
TAXATION OF INDIVIDUAL
BANKRUPTCY ESTATES AND DEBTORS
FILING A PETITION UNDER CHAPTER 7 OR 11
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TAXATION OF INDIVIDUAL BANKRUPTCY ESTATES & DEBTORS
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A. RULES GOVERNING TAX ISSUES - The tax treatment of entities is governed by a combination of:

1. 26 U.S. Code - Internal Revenue Code (I.R.C.)
2. 11 U.S. Code - U.S. Bankruptcy Code (11 U.S.C)
3. Case law, and
4. Local rules - including standing orders

The above authorities do not necessarily provide for consistent treatment among various jurisdictions although BAPCPA brings the state tax rules more in line with the federal provisions.

B. INDIVIDUAL BANKRUPTCY ESTATES

1. New tax entity created - estate

The filing of a petition by an individual under either chapter 7 or chapter 11 of the U.S. Bankruptcy Code results in the creation of a new taxable entity for federal tax purposes.

For state and local tax purposes chapter 12 also creates a new taxable entity.

The new entity created by the filing of a petition under one of these chapters is referred to as the bankruptcy estate, while the individual is referred to as the debtor. Upon filing the petition, the estate is created and the taxpayer’s nonexempt property becomes property of the estate.

2. Tax returns filed by the estate

The estate files Form 1041, U.S. Income Tax Return for Estates and Trusts, with the Internal Revenue Service. Form 1040, U.S. Individual Income Tax Return, is attached to the Form 1041 as a supplementary schedule.

Taxable income and tax liability are computed and reported on Form 1040. The tax liability is then transferred to Form 1041. On the top of Form 1040, the preparer should write, “Attachment to Form 1041 - Do Not Detach.”

Paper filing is still required for these tax returns.
3. **Income filing threshold**

The bankruptcy trustee or debtor in possession must file a Form 1041 for the bankruptcy estate for any tax year in which the estate in bankruptcy has gross income that equals or exceeds the standard deduction for married persons filing separately (I.R.C. § 6012). For 2019 that amount is $12,200.

4. **Manner of computing tax of the estate**

I.R.C. §1398(c) provides that, except as otherwise provided in §1398, the taxable income of the estate shall be computed in the same manner as an individual would compute taxable income. The tax on the taxable income of the estate shall be determined using the regular tax rates and standard deduction applicable for the year for a married individual filing a separate return. It would appear that the federal Alternative Minimum Tax provisions do not apply to the estate because the tax rate is determined under Section 1 of the Code.

State income taxes are to be imposed at rates generally applicable to the same types of entities under such state or local law (11 U.S.C. §346(g)). The estate may be subject to state Alternative Minimum Tax provisions. State filing thresholds are often different than federal levels. Application of Bankruptcy Code tax rules in conjunction with state income tax law can be challenging.

5. **Separate returns required for joint bankruptcy filing**

Generally, the IRS requires that two separate returns be filed for the estate of a husband and wife who filed joint bankruptcy. See *In re Knobel*, 167 B.R. 436 (Bankr. W.D. Tex. 1994). Separate tax identification numbers must be obtained. The tax attributes of the married couple must be appropriately divided between the two new taxable estates. The minimum tax return filing requirements, standard deduction and personal exemption provisions apply separately to each return.

**Practical Note:** A joint bankruptcy estate is assigned an EIN by the bank upon first deposit into a bank account. The IRS always assigns this number to the debtor's estate that is listed first.

To prevent IRS correspondence, apply on-line at [www.IRS.gov](http://www.IRS.gov) for an EIN for the second debtor's estate.
6. **Income taxable to the estate**

Income of the estate in chapter 7 and 11 (and chapter 12 for state and local purposes) cases shall be taxable to the estate and not to the debtor (I.R.C. §1398(c) and 11 U.S.C. §346(b)(1)).

With the likely exception of partnership and S Corporation income, gross income generally does not include amounts received or accrued by the debtor before the petition date.

**Ownership Interests in Partnerships and S-Corporations**

In Private Letter Ruling 9304008 (Jan. 29, 1993), the IRS held that all items of income, gain, loss, deduction, or credit of a partnership for the year in which the individual partner files a bankruptcy petition are allocable to the bankruptcy estate (i.e. they were not pro-rated for pre- and post-petition amounts) noting that the transfer does not close the taxable year under I.R.C. § 706(c)(2)(A)(i). However, it has been argued that this interpretation is not correct and that a pro-ration under 706(d) is not inconsistent with I.R.C. § 1398(f)(1).

Subsequently, the Tax Court has ruled that all allocable partnership and S Corporation items are reported by the holder as of the end of the pass-through entity’s tax year. See the findings, In re Gulley, Michael H., (2000) TC Memo 2000-190 and Williams, Lawrence G., (2004) 123 TC 144.

**Chapter 11 - Debtor's Earnings**

The provisions of BAPCPA, Title 11 Section 1115(a)(2), bring an individual debtor’s post-petition earnings into the estate during the chapter 11 period.

Allocation of petition and closing year W-2 earnings are addressed in IRS Notice 2006-83. When a Trustee is appointed in an individual chapter 11 case, the Trustee must obtain the amount of debtor’s earnings and include them in monthly operating reports and otherwise administer this property. If income tax withholding is insufficient and the earnings are not set off by a deduction for amounts paid or retained by the debtor, the estate could be left with an unfunded administrative income tax liability. Thus, it may be desirable in some cases to obtain an order authorizing the debtor to receive or retain some or all of the post-petition earnings, possibly inclusive of tax withholding, as an administrative expense. Alternately, when appropriate, a Trustee can obtain more certainty by promptly converting the case to chapter 7 and thus terminating the debtor income inclusion.
The Notice provides guidance on allocating W-2 earnings in the year of commencement and the year of conversion, dismissal or closing. However, note that I.R.C. § 1398, which provides for the creation of separate taxable entity for chapter 11 and 7 individual cases, is not applicable to cases that are dismissed.

Finally, in a converted case, the Trustee may still be left with a tax filing burden and an administrative tax liability arising from the debtor’s earnings during the chapter 11 period even if no other transactions take place.

Although a bankruptcy estate does not recognize income from debt cancellation under I.R.C. §108, attribute reduction under I.R.C. §108 can arise from numerous events including compromises, settlements, chapter 11 plan provisions and pass through items from entity interests held by the estate.

Also see the discussion at Section 19 regarding inclusion of deferred compensation receipts.

7. **Deduction of administrative expenses allowed**

I.R.C. §1398(h) provides that any administrative expense under section 503 of the Bankruptcy Code and any fees or charges assessed under chapter 123 of title 28 of the U.S. code (Court fee and costs) are deductible expenses of the estate. These expenses are allowed even though some of them may not be considered trade or business expenses.

Administrative expenses are, however, subject to disallowance under other provisions of the I.R.C., such as §263 (capital expenditures), §265 (expenses relating to tax-exempt interest), or §275 (certain taxes). It would appear that the administrative expenses would also be subject to the disallowance of personal interest expense under I.R.C. §163. The administrative expenses would include the actual, necessary cost of preserving the estate including wages, salaries, and commissions for services rendered after commencement of the case.

Compensation awarded a professional person, including accountants and attorneys for post-petition services, is an administrative expense (11 U.S.C. §503(b)(4)). These expenses are deducted as a negative item on line 21 of the Form 1040 and identified as “Section 1398(h) Administrative Expenses.”

Any amount of administrative, liquidating, and reorganization expenses not used in the current year may be carried back three years and carried forward seven years. The unused administrative expenses can only be carried back or carried over to the taxable years of the estate.
I.R.C. §1398(h)(2)(D) also provides that the expenses that are deductible solely because of the provision of §1398(h)(1) are allowable only to the estate. Thus, the administrative expenses are only deductible by the estate, and any unused administrative expenses cannot be carried forward to the debtor once the bankruptcy proceedings are concluded.

A. The restriction on carryback or carryover of administrative expenses to the estate applies only to the deductions that are allowed solely by reason of §1398(h)(1) of the I.R.C. Thus an expense (even though it is an administrative expense in a bankruptcy case) that would normally be classified as an operating cost could be carried forward to the debtor, once the estate is terminated, as an item in the net operating loss carryover. Included would be salary, wages, and other costs necessary to operate a business in a chapter 11 case. However, costs such as attorneys’ fees for a wage earner, court filing costs, and other types of administrative costs that are not normally deductible, except for the fact that they are administrative costs, are allowed only to the estate and would be classified as administrative expenses. In *W. Ainsworth* (T.C. Memo, 1987-398) the tax court refused to allow the individual to deduct legal fees the individual paid related to the taxpayer’s personal bankruptcy. The court noted that there was insufficient evidence of a proximate relationship between the taxpayer’s business activities and the personal bankruptcy.

B. The administrative expense carryback or carryforward is considered after the net operating loss.

First, a separate §172(b)(2) net operating loss computation is made, and then the administrative expense deduction is carried forward after the net operating loss has been used. The finance committee of the senate observed: “These carryovers are ‘stacked’ after the net operating loss deduction (allowed by I.R.C.. §172) for the particular year.”

8. Deduction of administrative expenses - IRS challenges

In the past, the IRS has focused on two common positions taken by bankruptcy estates regarding the deduction of administrative expenses:

a. **Above the Line vs. Below the Line** - In Chief Counsel Advice 2006-30016, the IRS determined that deductions for administrative expenses incurred because of the bankruptcy filing are allowable in computing AGI. The issue at hand is whether administrative expenses of the bankruptcy estate should be allowed as a deduction “for” Adjusted Gross Income (“AGI”) or, on the other hand, as a deduction “from” AGI in the form of a miscellaneous itemized deduction. (As of February 2019, IRS Publication 908 still makes reference to administrative expenses being allowed on Form 1040, Schedule A, as
miscellaneous itemized deductions, which were eliminated by the Tax Cuts and Jobs Act.)


The general rule regarding deductions available to a bankruptcy estate is I.R.C. §1398(e)(3):

\[
[E]xcept \text{ as otherwise provided in this section, the determination of whether or not any amount paid or incurred by the estate is allowed as a deduction shall be made as if the amount were paid by the debtor as if the debtor were still engaged in the trade or businesses, and in the activities, the debtor was engaged in before the commencement of the case. (emphasis added)}
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Since I.R.C. §1398(e)(3) makes available to a bankruptcy estate those types of deductions which might ordinarily arise only in the life or business of an individual, it obviously does not contemplate the concept of an administrative expense - an expense which would not arise but for the filing of a bankruptcy petition. The Internal Revenue Code provides a specific exception to the general rule in I.R.C. §1398(h)(1)- deduction of administrative expenses of the bankruptcy estate.

In determining the proper type and nature of the administrative expense deduction to which the bankruptcy estate is entitled, the court analyzed the provisions of I.R.C. §67. While I.R.C. §67(a) sets for the general two-percent rule, the section contains exceptions to that general rule. One such exception is set forth in I.R.C. §67(e), Determination of Adjusted Gross Income in Case of Estates and Trusts, which provides, in part that:

For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that -

(1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate . . .

. . . shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the
application of part I of Sub-chapter J of this chapter to take into account the provisions of this section.

The court found that as to any other type of estate or trust, such as a probate estate, this provision allows an estate to take an “above-the-line” deduction for the payment of the expenses which it incurred as a direct result of the administration of such estate. The court accepted the Trustee’s argument that such a rationale equally applies to the administrative expenses incurred by bankruptcy estates and, applying a plain language construction of I.R.C. §67(e), held that the provision applies to a bankruptcy estate as well.

b. Proper Timing of the Deduction for Administrative Expenses - The U.S. Bankruptcy Court requires that before a chapter 7 trustee can file a Final Report and prepare for a final distribution of funds to creditors in order to close the case, any required final tax returns must be filed and tax clearance from the IRS and other taxing authorities should be obtained.

Typically, the Trustee’s final fees and the final fees of his/her professionals are among the claims to be approved and paid as part of the Final Report and Distribution. Although it is clear that such expenses are properly deductible by the estate, the IRS has challenged the deduction of such amounts on the final tax return of a cash basis bankruptcy estate since at the time the tax return is filed the amounts have not yet been approved by the court and, therefore, have not yet been paid. The IRS claims that such fees and expenses cannot be deducted on the estate’s tax return until such time as the court approves the Trustee’s Final Report and the fees and expenses are actually paid.

The Problem
Louella Miller filed a voluntary petition under chapter 7 of the Bankruptcy Code on March 11, 1997. Trustee’s fees and other administrative fees were deducted in the final tax return filed by the Trustee. The IRS selected the final tax return of the estate for audit and disallowed the deduction of such administrative fees and expenses due to the fact that the fees had not been approved by the court, not had they been paid.

In discussions with the Trustee the IRS indicated that an amended return would need to be filed by the estate once the final fees had been approved by the court and paid. The Trustee pointed out that the problem raises by this solution is that additional professional fees would be incurred to prepare and file the amended return, thus requiring the approval of the court for payment of additional professional fees, resulting in the need to file another amended return to deduct these additional fees - a vicious cycle.
A second proposal set forth by the IRS was for the estate to completely forgo the deduction of such final fees and expenses. For obvious reasons the Trustee could not accept this proposal.

**A Solution**

After much discussion, and to its credit, the Internal Revenue Service ultimately agreed that the practical problems raised by the Trustee had merit. The parties agreed to a procedure that would allow the Trustee to take the deduction in the estate’s final tax return for the Trustee’s fees and expenses prior to formal court approval and payment, subject to amendment if the amounts allowed would affect the reported deductions and resulting tax liability.

Sometimes administrative expenses will be paid at the beginning of January or February and income for the estate was in December of the prior year. If the trustee wants to close the estate, consider preparing a final return for the case as of December of the prior year and including the following disclosure:

“Administrative expenses have been deducted on line 21 in the amount of $-- -------. The Trustee has not yet paid the expenses, however, the expenses will be paid during 2—. Since there will be negligible interest income that is less than the standard deduction and exemption earned in 2—, we believe the payment of these expenses will generate excess administrative costs that could be carried back to the 2---- return pursuant to I.R.C. Section 1398(h)(2)(B). In an effort to minimize administrative expenses of the estate, we have deducted the costs on this return.”

The returns have been accepted by Special Procedures and this has been an effective way to deal with an excessively costly vicious cycle.

**9. Estate succeeds to tax attributes of debtor**

Both the Internal Revenue Code and the U.S. Bankruptcy code include provisions specifying that the estate succeeds to certain tax attributes of the debtor as of the first day of the tax year in which the bankruptcy case commences. I.R.C § 1398(g) lists the following specific attributes to which the estate succeeds:

a. Net operating losses under I.R.C § 172
b. Charitable contributions carryovers under I.R.C §170 (d)(1)
c. Recovery of tax benefit items under I.R.C. §111 (relating to bad debts, prior taxes and delinquency amounts.)
d. Credit carryovers and all other items which, but for the commencement of the case, would be required to be taken into account by the debtor with respect to any credit
e. Capital loss carryover under I.R.C §212
f. Debtor’s basis in, holding period for, and the character in the debtor’s hand of any asset acquired (other than by sale or exchange) from the debtor

g. Method of accounting, and

h. Other tax attributes of debtor, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purpose of §1398 of the internal Revenue Code.

1. Treasury Regulation §1.1398-1 provides that the bankruptcy estate succeeds to the unused passive activity losses under section 469.

2. Treasury Regulation §1.1398-2 provides that the bankruptcy estate succeeds to the unused losses from at-risk activities under section 465.

3. Treasury Regulation §1-1398-2(d) indicate that an abandonment of property is not a taxable event. The unused losses follow the property – if the property is abandoned, the estate doesn’t get to use the losses.

4. Treasury Regulation §1.1398-3 provides that the bankruptcy estate succeeds to and takes into account the §121 exclusion of gain from the sale or exchange of a debtor’s principal residence.

This attribute list cannot be extended absent specific authority, such as by treasury regulation.

a. Prior to issuance of the §1398 regulation, in Private Letter Ruling 9304008, the service held that the estate does not succeed to any unused passive activity losses of the debtor, since this tax attribute is not listed in section 1398. (Letter ruling issued prior to the effective date for Treas. Reg. § 1.1398-1) The district court in In re Rueter, 158 B.R. 163 (N.D. Cal. 1993), held that the courts are not empowered to read additional attributes into the statute. See also In Re Antonelli, 150 B.R. 364 (Bankr. D.Md. 1992), superseded by § 1.1398-1.

b. Taxpayer Relief Bill of 1997 provides for a $500,000 ($250,000 non-joint return) exclusion of gain realized on the sale or exchange of a principal residence. In In re: Luciano Popa, 81 AFTR2d Par. 98-567, No. 96 B 22630 (Bankr. N.D. Ill. Mar. 10, 1998), the bankruptcy court held that a bankruptcy trustee is entitled to use the current version of I.R.C. §121 to exclude gain on the debtor’s residence.

c. Absent further regulations, the bankruptcy estate does not succeed to depletion and investment interest expense carryovers of the debtor.
10. **Allowable carrybacks to pre-petition tax years**

For tax years ending before 2018, an estate of an individual under chapter 7, 11 (or 12 in the case of state and local taxes) can carry back any operating loss of the estate to the corresponding taxable year of the debtor if such year is prior to commencement of the case (I.R.C. §1398(j)(2)(A) and 11 U.S.C. § 346(i)(3)).

Trustees have been successful in setting aside a debtor’s pre-petition I.R.C. § 172(b)(3) irrevocable election to forego the NOL carryback rights as a fraudulent conveyance of a valuable asset. Upon setting aside the election, the Trustee is free to recover the NOL carryback refund claim. See the decision in *Kapila v. United States (In re Taylor)*, 386 B.R. 381 (Bankr. S.D.Fla.2008) and in *United States v. Sims (In re Feiler)*, 218 F.3d 948 (9th Cir.2000).

Before abandoning real property with no equity, a trustee should consider whether foreclosure will generate a tax loss that can be used to offset other gains or generate an NOL refund.

The 2017 Tax Cuts and Jobs Act amended section 172 to eliminate net operating loss carrybacks and limit the application of carryforward losses, arising in tax years beginning in 2018, to 80% of taxable income. Additionally, NOLs generated in 2018 and subsequent years could be carried forward indefinitely.

The 2020 Coronavirus Aid, Relief and Economic Security Act (CARES Act) amended §172(b)(1) to provide for a carryback of any net operating loss (NOL) arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, to each of the five taxable years preceding the taxable year in which the loss arises (carryback period). Section 172(b)(1)(D). As a result of that amendment, taxpayers take into account such NOLs in the earliest taxable year in the carryback period, carrying forward unused amounts to each succeeding taxable year.

Revenue Procedure 2020-24 provides guidance to taxpayers with net operating losses that are carried back under the CARES Act by providing procedures for:

- waiving the carryback period in the case of a net operating loss arising in a taxable year beginning after Dec. 31, 2017, and before Jan. 1, 2021,
- disregarding certain amounts of foreign income subject to transition tax that would normally have been included as income during the five-year carryback period, and
- waiving a carryback period, reducing a carryback period, or revoking an election to waive a carryback period for a taxable year that began before Jan. 1, 2018, and ended after Dec. 31, 2017.
In Notice 2020-26, the IRS grants a six-month extension of time to file Form 1045 or Form 1139, as applicable, with respect to the carryback of a net operating loss that arose in any taxable year that began during calendar year 2018 and that ended on or before June 30, 2019. Individuals, trusts, and estates would file Form 1045 and corporations would file Form 1139.

For example, in the case of an NOL that arose in a taxable year ending on December 31, 2018, a taxpayer normally would have until December 31, 2019, to file the Form 1045 or Form 1139, as applicable, but due to this relief, will now have until June 30, 2020, to file the Form 1045 or Form 1139, as applicable. For this same taxpayer, if the taxpayer is a corporation, the deadline to claim a minimum tax credit described in § 53(e)(5) is December 30, 2020, but in order to file one application for a tentative refund and claim both the NOL carryback and the minimum tax credit at the same time, the taxpayer must do so by the earlier of the two deadlines.

To take advantage of the extension of time for requesting a tentative refund based on an NOL carryback, the taxpayer must perform the following actions: (a) File the applicable form no later than 18 months after the close of the taxable year in which the NOL arose (that is, no later than June 30, 2020, for a taxable year ending December 31, 2018); and (b) Include on the top of the applicable form “Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment.”

The IRS conducts a limited examination of the application and makes the resulting credit or refund within 90 days of filing the application.

Claims filed via Forms 1139 and 1045 may only be filed by paper. Given the backlog of returns building up and limitations on staffing, there are legitimate concerns as to whether the IRS has the staffing to process these returns within the 90-day time frame. However, taxpayers still need to file these returns within the specified time.

TAX PLANNING: Taxpayers that did not have an NOL in 2018 or 2019 could now have one as a result of the CARES Act changes.

WARNING: Don’t be a procrastinator. Courts are divided as to whether the postmark rule applies to tax returns seeking a refund of taxes paid. Some have ruled that those returns are deemed to be filed when the IRS receives the return. Look for the Supreme Court to settle this dispute.

TAX PLANNING: The bankruptcy estate can elect a fiscal tax year; say, beginning December 1, to maximize the reach of losses eligible for carryback. Losses incurred through November 2021 by a bankruptcy estate with a fiscal year ending November 30, 2021 could go back five years (for cases filed before 2021).
To take that one step further, if the bankruptcy estate has a passthrough loss from a failing entity causing such entity to wind up and issue a short-year-end K-1 by November 2021, that loss would drop into an individual bankruptcy estate with a November 2021 year end, and thus enable a five-year carryback.

In addition to the NOL adjustments, the CARES Act also modified the business interest deduction limitations, the qualified improvement property depreciable life and the noncorporate excess business loss deduction.

11. **Tax year of the estate**

Inasmuch as the estate is a new tax entity created in individual chapter 7 and chapter 11 cases pursuant to I.R.C. § 1398, the trustee or debtor-in-possession is permitted to select the estate’s tax year with its first return (Treas. Reg. §1.441-1T(b)(2)). Since it is an estate, not a trust, it can select a year other than a calendar year.

A fiscal year can be established by filing a tax return on or before the 15th date of the fourth month following the selected year end. (I.R.C. §§ 441(e) and 6072(a)).

A fiscal year cannot be adopted by filing a request for extension of time to file the return. Temp. Reg §1.441-1T(b)(2). In a chapter 11, this election must be signed by the debtor and not the tax preparer; the election statement could accompany an extension request.

For federal tax purposes, the estate of an individual debtor is allowed to “change its annual accounting period one time without the approval of the Secretary” (I.R.C. § 1398(j)(1)). Presumably the purpose of this provision is to allow an estate to close its tax year just before the termination of the case in order to take advantage of the provisions of 11 U.S.C. § 505(b). This provision may, however, be utilized as a tax planning tool in many other ways.

For purposes of determining the number of years to which a loss can be carried back or carried over, section 346(h) of the U.S. Bankruptcy Code provides that the two short periods of the debtor created by filing the petition count as only one year for state and local purposes (For cases filed prior to October 17, 2005). Federal law contains no similar provision.

**TAX PLANNING:** The trustee or debtor-in-possession should select the year-end for the estate that will allow the income to be spread over the largest number of taxable years or that places the income in the years that will be most beneficial to the estate.

12. **Tax year of the debtor**
The general rule outlined in I.R.C. § 1398(d)(1) provides that the taxable year of the debtor continues as if no petition had been filed. However, I.R.C. § 1398(d)(2)(A) provides that the debtor can make an irrevocable election to treat the year in which the case commences as two short tax years with the first year ending on the day before the petition is filed and the second year beginning on the petition date and ending on the last day of the taxpayer’s regular tax year (usually December 31). This election is not available for “no-asset” cases I.R.C. § 1398(d)(2)(D).

If the taxpayer makes this election, his or her taxable year is divided into two ‘short’ taxable years. For example, if a calendar-year taxpayer filed a petition on July 15, the first “short” year from July 15 through December 31. The tax liability computed for the first short year is collectible from the bankruptcy estate. The tax is considered a liability before bankruptcy and thus payable by the estate. In the event the estate does not possess enough assets to pay the tax, the remaining liability, as is true with any priority tax, is not discharged, but is collectible from the individual after the case terminates (11 U.S.C. § 523(a)(1)). If the individual has positive taxable income up to the date the petition is filed and has net operating losses, the individual could file the short tax return, and then offset the income earned during the short year against the net operating loss. Then, the balance of the net operating loss after this adjustment would be carried over to the estate as of the date the bankruptcy petition is filed.

The election must be made by filing a return for the short taxable year ending the day before the commencement of the case (the “first short taxable year”) on or before the fifteenth day of the fourth full month following the end of the month in which the petition was filed. The spouse of such a taxpayer makes the election by making a joint return with the taxpayer for that first short taxable year within the time prescribed in the preceding sentence. (IRS Announcement 81-96) To facilitate processing, Temporary Treasury Regulations §7a.2(d) directs the taxpayer to write “SECTION 1398 ELECTION” at the top of the return. A taxpayer may also make the election by attaching a statement of election to an application for extension of time to filing a return that satisfies the requirement under I.R.C. §6081 for the first short taxable year. The application for extension must be submitted under §6081 on or before the due date of the return for the first short taxable year. The statement must state that the taxpayer elects, under I.R.C. §1398(d)(2), to close his or her taxable year as of the day before commencement of the case. If the taxpayer’s spouse elects to close his or her taxable year, the spouse must join in the application for extension and in the statement of election. If a joint return is not filed for the first short taxable year, the election the spouse made with the application is void. Temp. Reg. §20.9100 14T(d).

Joining or failing to join in a debtor’s election will not bar a spouse who, later in the same year, is involved in her own bankruptcy proceeding from electing a short tax year. Separate bankruptcies may result in one or both of the spouses having multiple short tax years in the same calendar year. However, a debtor whose spouse has
failed to join in an election would not be eligible to join in the spouse’s subsequent same-year election because the spouses would have different tax years at the time of the second election and could not file a joint return for the critical period—the year ending with the spouse’s bankruptcy commencement date.

If the debtor makes the election and, as a result of filing the short period return, ends up with a refund, it would appear that the refund would be property of the estate. The debtor cannot be forced to make the election, but once the election is made, then it would seem that he would lose all rights to the tax refund.

The debtor must file a return for each of the two short tax years resulting from the election.

Pursuant to I.R.C. § 1398(d)(2)(F), the taxable income for each short tax year shall be placed on an annual basis. The debtor must annualize income and make the other adjustments that are required under section 443 of the Internal Revenue Code.

Bankruptcy Code § 728(a) and § 1146(a) include rules for state and local tax purposes. Pursuant to these rules, the taxable year of an individual debtor automatically terminates on the date the petition is filed in chapters 7, 11 and 12 cases for state or local tax purposes, regardless of whether or not the debtor has made an election under I.R.C. §1398(d)(2)(a) for federal income tax purposes (For cases filed prior to October 17, 2005).

TAX PLANNING: In most cases it would be presumed that the debtor would make the short tax year election if income was earned as of the date the petition was filed and would not make the election if there was a loss for this time period.

TAX PLANNING: In making a decision as to whether a short-period tax return should be filed, the debtor will need to consider the fact that the basis of assets is transferred to the estate as of the first day of the taxable year in which the petition was filed. Thus, if the short-period tax return is not filed, the individual, it appears, would not have any depreciation deduction for the assets that were transferred to the estate. To obtain the depreciation deduction, the individual would have to elect to file a short-period tax return.

TAX PLANNING: Another factor to consider when deciding whether or not to elect to file a short-period tax return is the forum under which any dispute regarding the tax liability will be resolved. If an election to file a short-period tax return is made, any litigation associated with the taxes due on that return would be handled by the bankruptcy court. However, if the debtor did not elect to file a short-period tax return, any dispute concerning that return would be resolved by the Tax Court.
TAX PLANNING: A tax refund due a bankruptcy individual for a period prior to the filing of a bankruptcy is a right that passes to the trustee upon the filing of bankruptcy. The trustee can file a claim on Form 843 to obtain the refund.

TAX PLANNING FOR TRUSTEES: The income tax returns of the debtor for the tax year in which the bankruptcy case commenced and preceding years are open upon written request to inspection by or disclosure to the trustee of the bankruptcy estate. Such disclosure is necessary so that the trustee may properly determine attribute carryovers to the estate and also to carry back any net operating loss deductions to preceding years of the debtor. I.R.C. § 6013(e)(s).

TAX PLANNING FOR TRUSTEES: The Trustee succeeds to the net operating loss as of the beginning of the year. However, if a short-year return is filed and losses are incurred in the short year, the Trustee can take advantage of those losses because he will succeed to the net operating loss as of the end date of the short filing period.

13. Estate’s Deductions, Credits and Employment Taxes

The trustee or debtor in possession must withhold and file employment tax returns for any wages paid during the administration of the case, including wage-claims paid. The trustee or debtor in possession must also file any required Forms W-2 or Forms 1099 for the estate. Failure to deposit withheld amounts with the tax agencies involved may result in the person responsible for such withholding being held personally liable for payment of the taxes. The question as to whether a W-2 is required versus a Form 1099 is based on “What was the debtor doing prior to the petition for the wages for which the wage claim was made?”

I.R.C. §1398(e)(3) provides that an amount would be allowed as a deduction or credit if the debtor had paid or incurred the amount in connection with the debtor’s trade or business conducted prior to commencement of the proceedings and if the debtor would have been entitled to these deductions or credits.

A question arises as to how to handle disbursements made by the estate to the individual debtor.

a. Section 1398(d)(3)(B) provides:

Rule for making determinations with respect to deductions, credits, and employment taxes. Except as otherwise provided in this section, the determination or whether or not any amount paid or incurred by the estate

(1) is allowable as a deduction or credit under this chapter, or

(2) is wages for purposes of subtitle C,
shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case.

b. In a private ruling (8728056) the Service looked at the issue as to whether or not withdrawals by a debtor-in-possession are wages. In this situation the farmer and his wife filed a chapter 11 petition. The farmer had been engaged to manage the farm for the bankruptcy estate as a debtor-in-possession as provided for in the Bankruptcy Code. As such, the bankruptcy estate treated the farmer as an employee of the estate and characterized amounts withdrawn from the estate for personal expenses as the payment of manager’s salary. The farmer asked, if, for federal employment tax purposes, a debtor-in-possession should be treated as an employee of the bankruptcy estate. The Service concluded that “accordingly, for purposes of determining whether the amounts withdrawn by you constitute wages for federal employment tax purposes, section 1398(e)(3)(b) of the Code requires such amounts to be treated as though they had been paid by you and as though you were still engaged in the business of operating your farm. Thus, we conclude that these amounts are not considered as wages paid you as an employee of the bankruptcy estate.”

c. It might be assumed from this private letter that the Service is stating that the amounts paid are not wages but distributions that are taxable to the individual and deductible by the estate, requiring Form 1099 to be filed. A careful review of the test would, however, also suggest that since the payments cannot be considered wages for employment tax purposes, they could not be considered a deduction because the same modification (amount...paid...as if the debtor was still engaged in the trades and businesses...) That applies to the wages also applies to the deduction.

d. Legislative history suggests that the purpose of the modification was not to consider the issues of how wages paid to the owner are handled, but to deal with the problem of how to deduct expenses and handle wages if the trustee does not operate the debtor’s trade or business, as shown in the following (Senate Report No. 96-1035, 96th Cong. 2d Sess. 30 (1980)):

Under present law, it is not clear whether certain expenses or debts paid by the trustee are deductible if the trustee does not actually operate the debtor’s trade or business (and if such expenses are not incurred in a new trade or business of the estate). To alleviate this problem, the bill provides that an amount paid or incurred by the bankruptcy estate, is deductible or creditable by the estate to the same extent as that item would be deductible or creditable by the debtor had the debtor remained in the same trades, businesses, or activities after the case commenced as before and had the debtor paid or
incurred such amount. The same test is applied to determine whether amounts paid by the estate constitute wages for purposes of federal employment taxes (new Code section 1398(e)(4)).

e. In many cases it would be to the advantage to the debtor to claim that amounts paid are not income (wages or Form 1099 income item) but distributions of the assets of the estate. Often the individual has no deductions since all of his or her property was transferred to the estate and the individual will have to pay taxes on the income received from the estate. At the same time, the estate has the net operating losses of the individual that were acquired when the petition was filed, and does not need the wage deduction. This private letter ruling might indicate that the amounts paid to the individual by the estate are withdrawals or distributions are not income. However, it is suggested here that the Service has misapplied this section of the Code and that it will not be extended to apply to deductions as well.

f. The number of cases that must deal with tax reporting of chapter 11 estate income- and potential deductions for amounts paid or retained by the debtor is increased by the Section 1115 changes as discussed in Section 4.

14. **Attribute Carryover to Debtor Upon Termination of Estate**

c. Recovery exclusions related to bad debts, prior taxes, and delinquency amounts under I.R.C.§ 111.
d. Credit carryovers and all other items which, but for commencement of the case, would be required to be taken into account with respect to any credit.
e. Capital loss carryovers under I.R.C. § 1212.
f. The estate’s basis in a holding period for and the character in the estate’s hand of any asset acquired other than by sale or exchange from the estate.
g. Other tax attributes to the extend provided by treasury regulations.

a. Treasury Regulation §1.1398-1 provides that the individual debtor succeeds to the unused passive activity losses and creditors under section 469 of the estate on termination of the estate.

b. Treasury Regulation §1.1398-2 provides that the individual debtor succeeds to the unused losses from at-risk activities under section 465 of the estate on termination of the estate.

15. **Abandonment in Bankruptcy**

A transfer (other than by sale or exchange) of an asset from the debtor to the estate shall not be treated as a disposition for purposes of any provision of the Internal
Revenue Code. The estate steps into the shoes of the debtor regarding adjusted tax basis, holding period, character and all other attributes associated with transferred assets (I.R.C. § 1398(f)(1)).

The treatment of abandonment of assets, i.e. the transfer of assets from the estate to the debtor before termination of the case, however, may not be as clearly defined. Tax liability from disposition of assets through sale, foreclosure or other transfer may be devastating to the bankruptcy estate. Through 11 U.S.C. § 554, the trustee has the right, after notice and a hearing, to abandon any property of the estate that is burdensome or of inconsequential value and benefit to the estate. One reason a bankruptcy trustee may abandon an asset back to the debtor is to avoid tax liability associated with the disposition of that asset.

In order to fulfill a trustee’s fiduciary duty to the estate, the trustee must responsibly understand and act when potential negative tax ramifications from the foreclosure or other disposition of estate assets exist. In an effort to avoid the realization of taxable gain in the estate, it is a common practice for a trustee to seek an order from the court for an abandonment of an asset for which relief from the automatic stay has previously been granted.

Unfortunately, or perhaps fortunately, there does not seem to be a clear answer to the question as to whether a trustee must formally obtain an abandonment order from the court to successfully transfer the asset back to the debtor and, thereby, avoid the income tax liability resulting from the foreclosure of the asset in question.

**Case Law Regarding the Issue - Relief of Stay Constitutes Abandonment**

In *In re Feilmeier*, 92 TNT 11-22 (Bankr. D. Neb. 1992) prior to the confirmation of the Feilmeier’s chapter 11 plan, relief from the automatic stay was granted pursuant to stipulation. Property was sold and all the proceeds were applied to a bank debt. Tax was due from the sale of the property; however, it was not paid. The IRS filed a notice of tax lien against the Feilmeier’s property. The Feilmeiers filed a motion to compel the IRS to release the lien, arguing that the estate had the obligation to pay the tax and that the obligation did not follow to them post-confirmation.

The court denied the motion, stating, in part, “When relief from the automatic stay was granted by stipulation of the debtors with the creditor bank, the estate no longer had an interest in the property... It was not sold by the debtors-in-possession, because the debtors-in-possession were no longer in possession of that particular personal property after relief from the stay was granted. The granting of relief from the stay, *at least for tax purposes*, is similar to an abandonment by a trustee.” (Emphasis added).
In re Griggs, 82 B.R. 532 (Bankr. D. Neb. 1988), held that if the stay has been lifted on certain property, that property is no longer property of the estate and thus, there is no longer any power of abandonment with respect to that property.

Likewise, In re Incor, Inc., 113 B.R. 212 (D. Md. 1990), held that when First National Bank of Maryland asked for, and was granted leave to proceed against United States Wall Corporation, the estate lost all interest in the property. The lifting of the stay was equivalent to an abandonment of the property. InCor had lost all interest in the property. Therefore, the bankruptcy court could not take jurisdiction over the property under the theory that it is a part of the estate.

Case Law - Relief from Stay Alone does not Constitute Abandonment

In general, it appears that the cases ruling that the granting of an order for relief from the automatic stay, in and of itself, is not sufficient to transfer the asset in question out of the estate appear to more thorough and well thought out that do the cases ruling to the contrary.

In In re B.S. Livingston & Co., 186 B.R. 841 (Bankr. D.N.J. 1996), the court performed extensive analysis of the issue regarding whether the lifting of the automatic stay was sufficient to constitute abandonment of an asset by a bankruptcy estate. The court specifically set out to address the core issues of “whether the lifting of the automatic stay ... stripped the bankruptcy court of the subject matter jurisdiction of the adversary complaint.”

The following are brief summaries of rulings from various cases cited by the B.S. Livingston court in reaching its conclusion:

Maislin Industries, U.S. Inc., v. A.J. Hollander, 69 B.R. 77 (E.D. Mich. 1986), a party must benefit from a lifting of the automatic stay and obtain the property under applicable non-bankruptcy law before the estate may be said to have been divested of all interest in the property. Absent such events the potential that a secured claim may fail justifies the exercise of subject matter jurisdiction pursuant to “related to jurisdiction.”

If the two provisions were analogous, Section 554 [which governs abandonment] would be superfluous in any case in which relief from the stay was granted. This result would conflict with the principle that the Court should read and apply the plain language of the Bankruptcy Code. Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992).

The court in In re N.J. Cordry, 149 Bankr. 970, 973 (D. Kan 1993), likewise held that the mere lifting of the stay does not extinguish the bankruptcy court’s subject matter jurisdiction when it stated, “relief from the stay simply removes the bankruptcy restraints on a claimant’s rights to pursue contractual and non-bankruptcy
remedies as to the matter in question.” In re Ridgemont Apartment Assoc., 105 B.R. 738, 741 (Bankr. N.D. Ohio 1989). This alone does not divest the bankruptcy court of jurisdiction over the property Id.; In re Oakes, 129 B.R. 477, 479 (Bankr. N.D. Ohio 1991); In re Fricker, 113 B.R. 856, 864 (Bankr. E.D. Pa 990). Indeed, jurisdiction is considered to be continuing unless some action is taken which would necessitate the relinquishment of jurisdiction. Oakes at 479.

See also, In re Oakes, 129 B.R. at 479 (“While relief from the stay permits a creditor to exercise its rights and remedies under applicable non-bankruptcy law, it does not mandate that such rights and remedies be exercises immediately.” This reasoning appears to be similar to that of the bankruptcy court here when it noted that 11 U.S.C. § 362(d) merely permits a creditor to pursue its remedies under state law after the stay has been lifted. In other words, the mere lifting of the stay in and of itself does not bestow any rights in the subject property. It is only until some post-lifting action is taken that the property’s ownership status will change (and, presumably, removed from the estate).

The court went on to explain that the grant of relief from the automatic stay typically diminishes the estate’s interest in the property but does not necessarily extinguish jurisdiction over the property. Fricker, 113 B.R. at 864.

“The effect of abandonment by a trustee ... is to divest the trustee of control over the property because once abandoned, property is no longer a part of the bankruptcy estate.” [Citations omitted].

Relief from the automatic stay entitles the creditor to realize its security interest or other interest in the property but all proceeds in the excess of the creditor’s interest must be returned to the trustee. Killebrew v. Brewer (In re Killebrew), 888 F. 2d 1516, 1520 (5th Cir. 1989).

Abandonment is irrevocable, and to treat an abandonment as identical to relief from the automatic stay is inconsistent with the principle that property once abandoned may not be recovered by the bankruptcy estate. Id.; accord Jones v. Star Bank (In re Angel), 142 B.R. 194, 198 (Bankr. S.D. Ohio 1992) (“Relief from the stay did not effectuate an abandonment. In a bankruptcy context, only abandonment constitutes a waiver of a trustee’s interest.”)

16. Tax Liability of the Estate

1. Administrative expenses are paid out of the property of the estate. Section 522 of the Bankruptcy Code provides that administrative expenses are not to be paid out of exempt property. Thus, the debtor should not be personally liable for any tax that is classified as an administrative expense. Any tax liability that is created by the estate on the disposition of property or on the transfer of property in settlement of the debt is an administrative expense of the estate under bankruptcy Code §503(b)(1)(B)(i). The tax obligation is not a debt of the debtor, but of the estate.
2. The estate has the responsibility for paying any tax that becomes due after the petition is filed that would be classified as an administrative expense. This tax liability is an obligation of the estate and not that of the individual. For example, in In re Kochell 804 F.2d 84 (7th Cir. 1986), the Seventh Circuit held that when the debtor filed the petition the estate succeeded to the individual retirement benefits (IRA). Any penalty tax under I.R.C. § 408(f)(a) due to the early withdrawal of funds from the IRA by the trustee is a liability of the estate. The court further ruled that “Kochell personally was out of the picture.”

3. The tax liability is not a tax attribute that reverts to the debtor upon the termination of the estate. While the debt is not technically discharged, it appears that it will not become a liability of the individual debtor. Thus, in cases where all of the debtor’s property is secured with a low basis, such as farm property, and the property is transferred in settlement of the debt, the individual debtor may avoid having to pay the tax on the transfer by filing a chapter 7 or chapter 11 petition before the transfer takes place. The tax obligation is that of the estate, but the estate has not assets with which to pay the tax. If a bankruptcy petition is not filed or if the property is transferred prior to the filing of the petition, the tax liability is a debt of the individual that cannot be discharged.

4. Often in situations where it is desirable to transfer the tax liability to the estate it is better to file a chapter 11 petition and adopt a chapter 11 plan of liquidation. If the judge, as is done in some chapter 7 cases, allows the trustee to abandon the unsecured property to the debtor, it appears the tax liability would be that of the individual and not the estate. Section 554 of the Bankruptcy Code gives the trustee the right after notice and a hearing to abandon any property of the estate that is burdensome or that is of inconsequential value and benefit to the estate.

   a. Section 1398(f) provides that transfers to the estate by the individual and transfers by the estate to the individual in the case of a termination of the estate are not treated as a disposition. This section does not address transfers made prior to termination.

   b. In In re McGowan, 95 B.R. 104 (Bankr. N.D. Iowa 1988), the bankruptcy court held that abandonment of property by the estate to the individual prior to termination is not a disposition. See In re Olson, 121 B.R. 346 (N.D. Iowa 1990), aff’d, 930 F.2d 6 (8th Cir. 1991)


   d. In In re Larry F. and Mary A. Layman, Civil No. 6-89-235; LEXIS, 88 TNT 240-17 (D.C. Minn. 1989), the district court would not allow the estate to abandon the property where the estate had already received $22,000 in the form of rental income before the request for abandonment.
e. In the case of *In re Bentley*, 916 F.2d 431 (8th Cir. 1990), the Eighth Circuit held that if the property is sold and then the proceeds are subsequently abandoned the estate is responsible for the tax on the gain on the sale of the property. See also *In re Perlman*, 188 B.R. 704 (Bankr. S.D. Fla. 1995)

f. In *In re Terjen*, 154 B.R. 456 (E. D. Va. 1993), the district court held that the individual and not the bankruptcy estate was liable for taxes where the trustee abandoned property after creditors were afforded relief for the bankruptcy stay, but before a foreclosure sale was held.

g. In *In re POPP*, 166 B.R. 697 (Bankr. D. Neb. 1993), the bankruptcy court held that the trustee may only abandon property to the debtor because the debtor has a possessory interest in the assets that is superior to all third parties.

h. In *In re Nevin*, 135 B.R. 652 (Bankr. D. Hawaii, 1991) the bankruptcy court ordered, on motion from the IRS, the trustee to abandon to debtors their respective interests in the limited partnerships.

i. Abandonment or property relates back to the inception of the case and revests title in the debtor as though the trustee never owned it. *Mason v. Commissioner*, 646 F.2d 1309 (9th Cir. 1980)

17. **Section 505(a) Prompt Refund of Tax**

Pursuant to 11 U.S.C. § 505(a) the bankruptcy court may determine any right to a refund of any tax, any fine or penalty relating to a tax, or any addition to tax 121 days after the trustee properly request such refund from the governmental unit from which such refund is claimed. However, the trustee cannot make a request for prompt refund if such tax was already contested. The procedures to be followed are outlined in Rev. Proc. 2010-27 as modified by Announcement 2011-77.

“The forms or returns described in this section must be mailed to Centralized Insolvency Operation, P.O. Box 7346, Philadelphia, PA 19101-7346 (updated for change 12/19/11). The return must be marked “Request for Prompt Refund” and be accompanied by a written statement explaining that the request is being submitted pursuant to Section 505(a) of the Bankruptcy Code.” The service will complete the examination and notify the trustee of the decision within 120 days from the date of the filing of the claim.

Pursuant to 11 U.S.C. § 505(a):

“(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.”

“(2) The court may not so determine—
(A) the amount or legality of a tax, fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title;

(B) any right of the estate to a tax refund, before the earlier of—

(i) 120 days after the trustee properly requests such refund from the governmental unit from which such refund is claimed; or

(ii) a determination by such governmental unit of such request; or

(C) the amount or legality of any amount arising in connection with an ad valorem tax on real or personal property of the estate, if the applicable period for contesting or redetermining that amount under applicable non-bankruptcy law has expired.”

18. **Section 505(b) Prompt Determination of Unpaid Tax**

Pursuant to 11 U.S.C. § 505(b), a trustee may request a determination of any unpaid tax liability of the estate incurred during the administration of the case. To receive the determination the trustee should submit a tax return for the tax, along with a request for the determination. The procedures to be followed are outlined in Rev. Proc. 2006-24, which reads in part as follows:

“To request a prompt determination of any unpaid tax liability of the estate, the trustee must file a signed written request, in duplicate, with the Centralized Insolvency Operation, P.O. Box 7346, Philadelphia, PA 19101-7346 marked, “Request for Prompt Determination”). To be effective, the request must be filed with an exact copy of the return (or returns) for a completed taxable period filed by the trustee with the Service and must contain the following information:

1. a statement indicating that it is a request for prompt determination of tax liability and specifying the return type and tax period for each return for which the request is being filed;
2. the name and location of the office where the return was filed;
3. the name of the debtor;
4. the debtor's Social Security number, taxpayer identification number (TIN) and/or entity identification number (EIN);
5. the type of bankruptcy estate;
6. the bankruptcy case number; and
7. the court where the bankruptcy is pending.

Once a request package is received by the Centralized Insolvency Operation, the request will be assigned to a Field Insolvency office.

It is imperative that the copy of the return(s) submitted with the request be an exact copy of a valid return. A request will be considered incomplete and returned to the trustee if it is filed with a copy of a document that does not qualify as a valid return.”

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In most cases the IRS will no longer advise the trustee as to the acceptance of the tax return.

The IRS has recently sent advisory notices that a 505(b) request for an individual debtor’s estate MUST include the social security number of the debtor per item 4 above. *Always redact social security numbers when providing copies of such documents to outside parties.*

Pursuant to 11 U.S.C. §505(b):

“Unless the return is fraudulent, or contains a material misrepresentation, the Trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax-

(1) upon payment of the tax shown on such return, if -

   (A) such governmental unit does not notify the Trustee, within 60 days after such request, that such return has been selected for examination; or

   (B) such governmental unit does not complete such an examination and notify the Trustee of any tax due, within 180 days after such request or within such additional time as the court, for cause, permits;

(2) upon payment of the tax determined by the court, after notice and a hearing, after completion by such governmental unit of such examination; or

(3) upon payment of the tax determined by such governmental unit to be due.”

19. Application of 11 U.S.C. § 505(b) to Pass-Through Entities

The National Office the Internal Revenue Service has issued a policy statement that all requests for determination of tax liability pursuant to 11 U.S.C. § 505(b) for pass-through entities (i.e. partnerships and S-corporations) are not to be honored. As a result of the policy statement, the Special Procedures Function of the IRS has consistently refused to accept 505(b) requests relating to pass-through entities. Until very recently, the IRS would simply return the 505(b) request, along with the attached copies of the tax returns, indicating that the request had neither been accepted nor considered. Now the IRS is indicating that 505(b) requests for pass-through entity tax returns that do not report a tax liability are disregarded. However, it appears beneficial to make the request regardless of how the IRS replies:

The trustee of First Securities Group of California, Inc., an S-Corporation, submitted a §505(b) request to the IRS for the 1996 tax year. Pursuant to the policy statement, the IRS rejected the Trustee’s request, stating that 11 U.S.C. §505(b) only applied to returns for which there is a tax liability, and generally, partnerships and S corporations show no tax liability. The Trustee petitioned the bankruptcy court to enforce the provisions of 11 U.S.C. § 505(b). In the petition the Trustee noted that IRS policy statements do not have the force
and effect of law and are not binding on the bankruptcy court. See *In re Technical Knockout Graphics, Inc.* 68 B.R. 463 466 (9th Cir. BAP 1986).

The bankruptcy court held that the estate has no unpaid tax liability for 1996 and that the S Corporation and the Trustee are discharged from any liability for unpaid federal income taxes for 1996. The court also held that “as a result of the Trustee’s February 1997 filing of a request for prompt determination pursuant to 11 U.S.C. §505(b) of the final tax return ("Return") filed by the First Securities Estate for calendar year ending December 31, 1996, and the IRS’s failure to notify the Trustee that the Return was subject to audit within 60 days of the prompt determination request, as well as its failure to complete an examination within 180 days of the Trustee’s request, the Internal Revenue Service shall be precluded from hereafter auditing the Return.” See, *In re First Securities Group of California, Inc.*., SIPA No. LA 92-01156 KM (Bankr. C.D. Cal. Oct. 7, 1997).

20. **Deferred Compensation Issues**

In a pre-BAPCPA decision, *Patterson v. Shumate (91-913)*, 504 U.S. 753 (1992), the Supreme Court ruled that a tax qualified vested ERISA plan interest existing on the petition date is excluded from the bankruptcy estate, however, some deferred compensation assets will still impact the bankruptcy estate.

Certain employer stock option plans are not ERISA plans and vested interests in compensatory stock options are often included in W-2 compensation upon exercise. The debtor may have partial or fully vested interests at the petition date. Further, BAPCPA amended the bankruptcy code by adding Section 1115 to include as property of the estate (1) post-petition acquired property and (2) earnings from services performed by the debtor after the commencement- but acquired before dismissal or conversion.

Thus, it would appear that certain property that vests during the chapter 11 period may become property of the estate. Further, income from the exercise of options during the chapter 11 period is arguably post-petition earnings or petition date assets taxable to the estate. Care must be given in determining debtor and estate reporting of this income.

21. **Cancellation of Indebtedness (COD)**

If non-recourse debt is involved, there is no COD. The Supreme Court held in *Tufts*, 461 U.S. 300 (1983), that nonrecourse debt should be included in the amount realized on sale and it does not matter if the debtor is insolvent or in bankruptcy. Recourse debt forgiveness can result in COD income.

Safe Harbors from recognizing COD Income:

1. Bankruptcy
2. Insolvency
3. Qualified farm indebtedness
4. Qualified real property business indebtedness
5. Qualified principal residence indebtedness

Extra Safe Harbors:

1. COD Income does not include an amount that if paid would be tax deductible
2. Reduction of a purchase money obligation held by the seller of property is not COD income.
3. COD Income does not include discharges on account of death or disability in the case of student loans (Tax Cuts and Jobs Act)

The creditors are issuing 1099s in COD situations. As you report the income, be sure you agree with the fair market value that is reported on the 1099.

Form 982: The exclusion of COD income is only good to the extent of insolvency on the day prior to the foreclosure.

Reduce the tax attributes as of the first day of the following year … I.R.C. § 108(b)(5)(B)

NOTE: this means that any NOL can be carried back prior to the reduction of that tax attribute!!

Debt forgiveness can arise from asset dispositions including foreclosures and can also arise from settlements involving various causes of action and other events. Consideration should be given to the timing of COD income events, for instance a sale of an asset in the year following a COD income event may give rise to a substantially higher tax than if that sale had occurred in the prior year due to the loss of tax attributes such as NOLs.

22. Income Tax Refunds and Overpayments Applied to Subsequent Tax Years

An asset of an individual debtor’s estate includes tax overpayments for pre-petition years to the extent it is an asset on the petition date. An overpayment existing on the petition date for the petition year is also an asset of the estate. However, a debtor may elect to apply an overpayment to the subsequent year on Form 1040. If that election is made after the petition date and if such taxes are applied to pay post-petition taxes or otherwise prevent a Trustee’s collection of a refund, that election could be an unauthorized post-petition transfer to the IRS. Similarly, if a pre-petition election is made to apply an overpayment to the petition year, such transfer could represent a fraudulent conveyance.


Bankruptcy estate property—prepetition transfers—application of prepetition refund to post petition taxes. The Ninth Circuit affirmed decisions that taxpayers’ interest in prepetition overpayments which they elected to apply to future year liabilities constituted bankruptcy estate asset subject to turnover to trustee. Taxpayers’ argument that funds
couldn't be bankruptcy estate property, because of election's irrevocable nature and its effect of changing overpayments to estimated tax payments, was erroneous under 11 U.S.C. § 541 and case law, which established that estate property was to be interpreted broadly and encompassed even those prepetition interests incapable of immediate liquidation.

If the Trustee cannot recover such funds from the taxing authorities and the debtor uses the overpayments to pay post-petition taxes, recovery may be difficult or impossible.

23. **Post-petition K-1 and Other Penalties Not Based on a Tax**

The 9th Circuit BAP issued a decision in July 2013 addressing the priority of penalties arising from the late filing of an S Corporation return- a penalty based on the number of K-1s contained in the return (Richard M. Kipperman v Internal Revenue Service, (BAP N. SC-12-1496-JuBaPa). The case was remanded to address the priority issue noting penalties don’t preserve the estate. Kipperman argued there should be no priority based on 503(b)(1)(C) and it does appear the court took some comfort in the specific code provisions therein over the general provisions of 503(b)(1)(A). The detailed analysis begins at page 16 and concludes close call apparently looking to the need to maintain the integrity of the tax system- and thus the penalty might just be a ‘necessary cost’ but tips the scales in Trustee’s favor. **At page 2, the decision states the penalty is NOT ‘priority as an actual and necessary cost per 503(b)(1)(A). That is great news for Trustees.**

At page 28 a discussion of § 503(b)(1)(B)&(C) begins and those are the provisions to be reviewed on REMAND- a penalty relating to a tax. The Court notes IRS asserted that the penalty related to a tax of a kind specified in § 503(b)(1)(B) but that is WRONG, there is NO TAX. The IRS only later asserted its 503(b)(1)(A) as actual /necessary cost of preserving the estate argument- probably because it knew there was no tax on which to base its penalty.

The case is also remanded to determine what these allowed claims are if not Administrative. If they are determined to be General Unsecured and not subordinated, this issue could still be problematic for Trustees in some cases.

It seems that the accountant’s delay in preparing returns really steamed the Court and led them in a direction to find the penalties may be appropriate because of a lack of diligence, and as noted a failure by the Trustee to get the returns timely filed. They also note the **‘simple procedure’ for obtaining waiver of filing tax returns** in a no asset case but that is not as simple as suggested and may not be appropriate in a case that could have assets. It is also not clear that such waiver would provide penalty relief when assets are ultimately realized.

The base argument is that § 503(b)(1)(C) specifically provides administrative priority for penalties relating to a tax and if Congress intended for these K-1 penalties, that are NOT related to a tax, they would not have put the ‘relating to a tax’ language in this provision. That is, the Kipperman decision appears to render the ‘relating to a tax’ language as superfluous. In fact, it would appear to render § 503(b)(1)(C) as superfluous since any fines
or penalties can come in under § 503(b)(1)(A) under this case’s approach. It appears that is what this court concluded—if the penalty is priority it must fall under § 503(b)(1)(C).

It is unclear why the court thinks this penalty could possibly fall within § 503(b)(1)(C)—it may have been misled by the IRS contention that the penalty related to a tax. If the IRS does somehow prevail, it may be necessary to file the request for relief from filing in some probable no assets—and that can later be used as a basis for reasonable cause relief. In cases that are clearly and unequivocally no asset cases, it should still not matter as the penalty asserted will still get ZERO distribution and there is no basis for asserting personal liability for such penalties.

24. Tax Cuts and Jobs Act’s effect on the estate

The Tax Cuts and Jobs Act was the most significant change in tax legislation in the past 30 years. Unfortunately, many of these changes will likely create additional tax for distressed debtors. This material seeks to only provide information the authors believe is most likely to have the greatest effect on individual debtors.

1. For years beginning after December 31, 2017 and before January 1, 2026 the act adds Section 461(l) Limitation on Excess Business Losses of Noncorporate taxpayers. Excess business losses are defined as aggregate business losses that exceed $250,000 ($500,000 for married filing joint). The cap is adjusted for inflation annually and the disallowed losses are treated as a net operating loss carryover to the following taxable year under I.R.C. § 172. Section 461(l) is applied at the partner or shareholder level. The limitation is applied after the application of I.R.C. § 469 (passive losses). The previously existing limitation on excess farm losses under I.R.C. § 469 (passive losses). The previously existing limitation on excess farm losses under I.R.C. § 461(j) is suspended thru 2025.

2. The act permanently amended I.R.S. § 172(a) to limit the deduction for Net Operating Losses (NOLs) to 80% of taxable income. Under old law a taxpayer could carry back NOLs two years and forward 20 years. Under the new law there is no carryback while the carryforward is indefinite. The old law still applies to NOLs arising before 2018. There are exceptions that allow for carrybacks for farming businesses and property and casualty insurance companies.

TAX PLANNING: The act did not amend section 1398(h) provision allowing for administrative expense carryovers. An accountant may need to separately track pre and post 2018 NOLs and administrative expense carryovers. The administrative expense carryover is considered after the computation under § 172(b)(2) with respect to net operating loss.

3. For years beginning after December 31, 2017 and before January 1, 2026 the act provides a new code section 199A more commonly known as the pass-thru deduction. Section 199A provides a 20% deduction for “qualified business income,” which includes most trade or business income that is passed thru to the individual’s
tax return. “Qualified business income” includes income from S-corporations, partnerships, sole proprietorships and likely most rental and royalty activities. A full analysis of section 199A is beyond the scope of this material.

Generally, the deduction is limited to the lesser of 20% of “qualified business income” or taxable income. Most taxpayers with trade or business income and taxable income less than $157,500 ($315,000 for married filing joint) will qualify for the deduction. The deduction is fully phased out for certain taxpayers with taxable income that exceeds $207,500 ($415,000 for married filing joint).

Taxpayers with a “specified service business” and taxable income above the thresholds mentioned above will not qualify for the deduction. “Specified service businesses” are defined as businesses in the fields of law, accounting, health, athletics, performing arts, actuarial services, consulting, financial services, brokerage, and a business the principal asset of which is the reputation or skill of one or more of its owners or employees.

Taxpayers who do not have a “specified service business” with income above the taxable income thresholds will qualify for a deduction equal to the lesser of i) 20% of qualified business income or ii) the greater of 50% of the W-2 wages with respect to the qualified trade or business or the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the business’s aggregate acquisition cost of certain depreciable “qualified property.”

4. For years beginning after December 31, 2017 and before January 1, 2026 the act limits the aggregate of state and local income tax (or sales tax in lieu of income tax) and property taxes to $10,000.

[TCJA amended §164 and specifically says it does not limit business or §212 deductions. Arguably, Section 212 is describing the administrative expenses incurred and deductible under §1398. There may be a good argument that SALT incurred by a BK estate are not limited because §212 and/or trade business allows full deduction.]

Excerpt from TCJA:
[SEC. 11042. Limitation on deduction for state and local, etc. taxes.

(a) In general.—Subsection (b) of section 164 is amended by adding at the end the following new paragraph:

“(6) LIMITATION ON INDIVIDUAL DEDUCTIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026—}
“(A) foreign real property taxes shall not be taken into account under subsection (a)(1), and

“(B) the aggregate amount of taxes taken into account under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) of this subsection for any taxable year shall not exceed $10,000 ($5,000 in the case of a married individual filing a separate return).

The preceding sentence shall not apply to any foreign taxes described in subsection (a)(3) or to any taxes described in paragraph (1) and (2) of subsection (a) which are paid or accrued in carrying on a trade or business or an activity described in section 212. For purposes of subparagraph (B), an amount paid in a taxable year beginning before January 1, 2018, with respect to a state or local income tax imposed for a taxable year beginning after December 31, 2017, shall be treated as paid on the last day of the taxable year for which such tax is so imposed.”.

(b) Effective date.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.]

5. For years beginning after December 31, 2017 and before January 1, 2026 the deduction for interest on home equity indebtedness is eliminated and the deduction for mortgage interest is limited to indebtedness of up to $375,000 ($750,000 for married filing joint).

6. For years beginning after December 31, 2017 and before January 1, 2026 the casualty and theft loss deduction is limited to only those taxpayers who incur losses from federally-declared disasters.

7. For years beginning after December 31, 2017 and before January 1, 2026 the act eliminates miscellaneous itemized deductions.

8. For years beginning after December 31, 2017 and before January 1, 2026 the act amends Section 1221(a)(3), to exclude from the definition of capital assets a patent, invention, model or design (whether or not patented), a secret formula or process, a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property held by - A) a taxpayer who’s personal efforts created such property or B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced for or C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from the sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in A or B.

**TAX PLANNING:** Individual taxpayers with cost basis above mentioned self-created assets may now be able to deduct those assets on disposition as an ordinary loss.
9. The act permanently repeals the deduction for alimony payments made while making alimony payments received non-taxable.

10. The act permanently amends Section 108(f) by adding paragraph (5) Discharges on account of death or disability. In general, in the case of an individual, gross income does not include any amount which would be includible in gross income by reason of the discharge of a student loan on account of the death or total and permanent disability of the student.

25. **New tax transcripts procedures**

   The IRS is adopting safeguards for dissemination of tax transcripts in an effort to combat identity theft as follows:

   The IRS began redacting all or some personally identifiable information for tax transcripts such as Social Security numbers, employer identification numbers, telephone numbers, last name, business name and address.

   Form 4506-T, Request for Transcript of Tax Return, and Form 4506-T-EZ, short-form request, were revised in May 2019.

   The IRS will no longer mail transcripts to third parties. Transcripts will be delivered by postal mail to the taxpayer’s address of record within five to ten business days.

   Taxpayers can access their transcript immediately by going to the IRS’s Get Transcript online service.

   The IRS has provided a method for tax practitioners to obtain unredacted wage and income tax transcripts immediately upon request, electronically, by registering for IRS e-Services. The practitioner must have the following to obtain transcripts through e-Services:
   a. Centralized Authorization File (CAF) number in good standing
   b. An e-Services account and access to the Secure Object Repository (SOR) or e-Services secure mailbox.

   The practitioner must call the Practitioner Priority Services Line at 866-860-4259 to authenticate their identity and setup access for e-Services.

26. **IRS revises EIN application process disallowing use of EINs to obtain additional EINs (IR-2019-58)**

   The IRS revised the application process for obtaining an employer identification number (EIN) starting May 13, 2019. Only individuals with social security numbers (SSNs) or individual taxpayer identification numbers (ITINs) may request an EIN as a responsible party on the application.
The IRS is revising the EIN application process by disallowing the use of an EIN as a responsible party’s TIN. The change will prohibit entities from using their own EINs to obtain additional EINs.

There is no change for tax professionals who may act as third-party designees for entities and complete the paper or online applications on behalf of clients.

C. Income tax reporting in bankruptcy for a sole member LLC

Outside of bankruptcy for income tax reporting purposes a single member LLC is usually disregarded and accounted for on the sole member’s income tax return -typically on a schedule C or E for individuals – and not on a Form 1065 as are LLCs with multiple members.

However, the Trustee of an LLC may lack adequate documentation to determine the tax status of potentially disregarded LLC. In some situations, in which it is not clear if the Trustee is required to file an income tax return for the LLC, a Trustee’s safest course of action in a case that was reported on the sole member’s tax return before bankruptcy, may be to file a Form 1065 and issue the member or the member’s bankruptcy estate the K-1 along with a request for prompt determination under 11 USC §505(b). If the sole member is also in bankruptcy, coordinating the tax reporting with that estate’s fiduciary is advisable. However, if the single member clearly acknowledges its responsibility to include the disregarded entity activity, the Trustee’s exposure should be greatly reduced or eliminated.

Some states require special LLC reporting that closely tracks Form 1065 reporting and any state taxes or annual fees may give rise to administrative claims- inclusive of late filing penalties and interest.


In December 2012, the IRS issued Prop Reg § 1.1411. Is the IRS wrong as to the proposed §1411 regs for I.R.C. § 1398 bankruptcy estates?

While the IRS never wrote a proposed regulation on applicability of Alternative Minimum Tax (“AMT”) to Section 1398 Estates, as to § 1411, they say:

\(d(1)\) Bankruptcy estates. A bankruptcy estate (“Estate”) in which the debtor is an individual is treated as a married taxpayer filing a separate return for purposes of section 1411. See §§1.1411-2(a)(2)(iii) and 1.1411-2(d)(1)(ii).

This proposed application seems to apply §1398(c)(1) but ignores §1398(c)(2).

§1398(c)(2) provides a limitation on the rates to be used to compute an estate’s tax- that provision says the tax shall be determined (I would add ONLY) under subsection (d) of section 1:
(1) Computation and payment of tax.
Except as otherwise provided in this section, the taxable income of the estate shall be computed in the same manner as for an individual. The tax shall be computed on such taxable income and shall be paid by the trustee.

(2) Tax rates.
The tax on the taxable income of the estate shall be determined under subsection (d) of section 1.

Per I.R.C. § 1398, an Estate (only) pays tax under I.R.C. § 1 because that is what I.R.C. § 1398 dictates, and thus, taxes under other sections such as AMT § 55 and NIIT § 1411 are not applicable.

The non-applicability of I.R.C. § 55 AMT and I.R.C. § 1411 NIIT derives from the same application of I.R.C. § 1398(c)(2).

I.R.C. § 1398 states that the tax on the taxable income of the estate shall be determined under subsection (d) of Section 1. Subsection d imposes the regular tax rates for MFS status. For decades, many tax preparers have relied on this provision to avoid AMT tax that would otherwise arise under I.R.C. § 55, and have so disclosed in the filed returns, if this approach is taken as to I.R.C. § 1411, that disclosure should now be expanded.

Contrary to this approach, in 2013, RIA analysis of this proposed regulation concludes: Application of the net investment income tax to bankruptcy estates and foreign estates. Estates are subject to a 3.8% net investment income tax on their undistributed net investment income.

§ 1398 Rules relating to individuals' title 11 cases

(a) Cases to which section applies.
Except as provided in subsection (b), this section shall apply to any case under chapter 7 (relating to liquidations) or chapter 11 (relating to reorganizations) of title 11 of the United States Code in which the debtor is an individual.

(b) Exceptions where case is dismissed, etc.

(1) Section does not apply where case is dismissed.
This section shall not apply if the case under chapter 7 or 11 of title 11 of the United States Code is dismissed.

(2) Section does not apply at partnership level.
For purposes of subsection (a), a partnership shall not be treated as an individual, but the interest in a partnership of a debtor who is an individual shall be taken into account under this section in the same manner as any other interest of the debtor.

(c) Computation and payment of tax; basic standard deduction.
(1) **Computation and payment of tax.**
Except as otherwise provided in this section, the taxable income of the estate shall be computed in the same manner as for an individual. The tax shall be computed on such taxable income and shall be paid by the trustee.

(2) **Tax rates.**
The tax on the taxable income of the estate shall be determined under subsection (d) of section 1.

§ 55 *Alternative minimum tax imposed*

(a) **General rule.**
There is hereby imposed (in addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of—

(1) the tentative minimum tax for the taxable year, over

(2) the regular tax for the taxable year.

(b) **Tentative minimum tax.**
For purposes of this part—

(1) **Amount of tentative tax.**

(A) Noncorporate taxpayers.

(i) In general. In the case of a taxpayer other than a corporation, the tentative minimum tax for the taxable year is the sum of—

(I) 26 percent of so much of the taxable excess as does not exceed $175,000, plus—

(ii) Taxable excess. For purposes of this subsection, the term “taxable excess” means so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

(iii) Married individual filing separate return. In the case of a married individual filing a separate return, clause (i) shall be applied by substituting 50 percent of the dollar amount otherwise applicable under subclause (I) and subclause (II) thereof. For purposes of the preceding sentence, marital status shall be determined under section 7703.

§ 1411 **NIIT:**

(a) **In general.**
Except as provided in subsection (e) —
(1) Application to individuals.
In the case of an individual, there is hereby imposed (in addition to any other tax imposed by this subtitle) for each taxable year a tax equal to 3.8 percent of the lesser of—

(A) net investment income for such taxable year, or

(B) the excess (if any) of—

(i) the modified adjusted gross income for such taxable year, over

(ii) the threshold amount.

(2) Application to estates and trusts.
In the case of an estate or trust, there is hereby imposed (in addition to any other tax imposed by this subtitle) for each taxable year a tax of 3.8 percent of the lesser of— (A) the undistributed net investment income for such taxable year, or (B) the excess (if any) of—

(i) the adjusted gross income (as defined in section 67(e)) for such taxable year, over (ii) the dollar amount at which the highest tax bracket in section 1(e) begins for such taxable year.
E. COVID-19 and Bankruptcy

On February 19, 2020, the Small Business Reorganization Act (SBRA) became effective, adding a new subchapter 5 to the United States Bankruptcy Code. The SBRA was enacted to reduce the cost and expense for small businesses to reorganize under Chapter 11. To qualify as a debtor under Subchapter 5, the debts of a company must not exceed $2,725,625 (secured and unsecured debts). Section 1113 of the CARES Act increases the debt limit to $7.5 million for one year through March 27, 2021. Thereafter, the debt limit will once again be reduced to $2,725,625.

The CARES Act (Act) excludes any coronavirus-related payments received under federal law from the Bankruptcy Code's definition of "current monthly income." The Act’s amendments apply to means testing or disposable income calculations in individual cases under chapters 7 and 13. The Act permits Chapter 13 debtors to modify their confirmed plans if they are experiencing a material financial hardship due to the COVID-19 pandemic, including extending payments for up to 7 years after the initial plan payment was due. These changes are temporary and, if not extended, will expire on March 27, 2021.

Coronavirus Aid, Relief, and Economic Security Act (CARES Act, H.R. 748)

On March 27, 2020, President Trump signed into law the CARES Act, commonly referred to as a stimulus package.

Here is an abbreviated list of CARES Act tax provisions:

- Tax credit rebates of up to $1,200 per individual and $500 per child that are phased out for taxpayers with AGI over $75,000 ($150,000 MJF and $112,500 HOH) and will be “rapidly advanced;”
- Deferral of 50% of an employers’ payroll tax deposits for 2020 (with 50% of deferred amount due by December 31, 2021, and 50% due by December 31, 2022);
- A refundable employer retention credit equal to 50% of qualified wages against quarterly employment taxes, to offset up to $10,000 of wages paid per employee in 2020;
- The reinstatement of NOL carrybacks for the 2018–2020 taxable years, and repeal of the 80% taxable income limitation for the 2018–2020 taxable years;
- A TCJA technical correction that classifies qualified improvement property as 15-year recovery period, allowing the bonus depreciation deduction to be claimed for such property retroactive as if it was included in the TCJA at the time of enactment;
- Penalty-free withdrawals of tax retirement funds of up to $100,000 (income recognized over a three-year period);
- A temporary waiver of RMD requirements in 2020;
- Increased individual and corporate charitable contribution deductions for 2020;
- The deferral of excess business loss limitations until 2021;
- Deferral of an employer’s 2020 minimum contributions to its single-employer defined benefit pension plan until January 1, 2021;
- An increase in the business interest deduction limitations from 30% to 50% of adjusted taxable income for the 2019 and 2020 taxable year;
• An exclusion from income for employer-payments made on employee student loans paid before January 1, 2021;
• The acceleration of the corporate credit for prior-year minimum tax liability, allowing 100% of the credit to be claimed in 2019 (2018 at the election of the taxpayer); and
• A COD exclusion of small business Payroll Protection loans forgiven under the Act.

The CARES Act provides for Payroll Protection loans of up to $10 million to COVID-19 impacted businesses. PPP loans:
• Are guaranteed 100% by the Small Business Administration (no personal guarantees or collateral required);
• Must be taken out between February 15, 2020, and June 30, 2020;
• May be forgiven for amounts used to cover basic operating expenses such as payroll costs, rent and mortgage, and utilities for up to 8 weeks from the loan origination date (excluded from COD income); and
• Have a maximum maturity rate of 2 years and 1% interest if not forgiven. Repayment has a six-month deferral.
• Stay tuned for changes to PPP loan rules from Congress.

The CARES Act expanded the Economic Injury Disaster Loan (EIDL) for small business owners to apply and qualify for a loan advance up to $10,000 that will not have to be repaid.

**IRS Operations During COVID-19 Updated May 19, 2020**

The Internal Revenue Service reminds taxpayers and tax professionals to use electronic options to support social distancing and speed the processing of tax returns, refunds and payments. To protect the public and employees, and in compliance with orders of local health authorities around the country, certain IRS services such as live assistance on telephones, processing paper tax returns and responding to correspondence are extremely limited or suspended until further notice. All Taxpayer Assistance Centers remain temporarily closed as are many volunteer tax preparation sites until further notice. However, as of May 17, the IRS has delivered Economic Impact Payments to 140 million individuals and millions more are on the way every week. Although the tax filing deadline has been extended to July 15, 2020, from April 15, the IRS continues to process electronic tax returns, issue direct deposit refunds and accept electronic payments.

**IRS operational status and alternatives**

**Paper Tax Returns:** All taxpayers should file electronically through their tax preparer, tax software provider or IRS Free File if possible. The IRS is not currently able to process individual paper tax returns. If you already have filed via paper but it has not yet been processed, do not file a second tax return or write to the IRS to inquire about the status of your return or your Economic Impact Payment. Paper returns will be processed once processing centers are able to reopen. This year, more than 90% of taxpayers have filed electronically.

**Ordering Forms:** The IRS’s National Distribution Center is closed until further notice. We are not able to take any orders for forms or publications to be mailed during this time. Most forms and publications are available for download electronically at [IRS.gov/forms](https://www.irs.gov/forms).
Web Options: IRS.gov remains the best source for questions about tax law, checks on refund status, tax payments and Economic Impact Payments. All IRS updates on the Economic Impact Payments and other Covid-19 related issues continue to be posted immediately on IRS.gov/coronavirus. Taxpayers can check the status of their Economic Impact Payment at Get My Payment, their refund status at Where’s My Refund? or obtain a tax transcript at Get Transcript Online. Tax transcripts are only available online at this time.

Taxpayers also can make tax payments through Direct Pay. Tax Year 2019 individual income taxes are due July 15. The Interactive Tax Assistant can help answer tax law questions. There currently are no email options that will generate answers to questions posed by taxpayers. Publication 5136, IRS Services Guide (PDF), is a good source of information.

Taxpayers who previously have been issued an Identity Protection PIN but lost it, must use the Get an IP PIN tool to retrieve their numbers. Taxpayers who have an IP PIN need to provide it when they file their return or if they are using the Non-Filer tool to enter their Economic Impact Payment information.

Telephonic Options: Automated phone lines which handle most taxpayer calls - also remain available. Some tax compliance lines also remain available and some IRS phone lines supported by customer service representatives for both taxpayers and tax professionals including the EIP phone line for those who received an EIP letter (Notice 1444) are open with limited staffing at this time, however callers should expect long waits. To check on regular tax refund status via automated phone, call 800-829-1954. (This line has no information on Economic Impact Payments.)

Practitioner Priority Service (PPS): The Practitioner Priority Service line is open with limited service due to continued staffing limitations. The IRS is unable to process Centralized Authorization File (CAF) requests at this time.

IRS.gov remains the first option for answers to questions. Practitioners with e-Services accounts and with client authorization can access the Transcript Delivery System to obtain prior-year transcripts. Taxpayers should use Where’s My Refund? and Get Transcript Online, both common requests. However, the Get Transcript by Mail option should not be used since the offices that print and mail the transcripts are closed.

Taxpayer correspondence: While the IRS is receiving and storing mail, our mail processing functions have been scaled back to comply with social distancing recommendations. This includes the IRS’s ability to correspond with taxpayers about a variety of issues including requests for information needed to process a tax return. Currently, we have reduced responses to paper correspondence. Our primary concern is serving taxpayers as indicated in the People First Initiative, which includes numerous actions to alleviate taxpayer burden during this time.

Taxpayers who mail correspondence to the IRS during this period should expect to wait longer than usual for a response. Once normal operations resume it will take the IRS time to work through any correspondence backlog. Correspondence sent to IRS offices may be returned to the taxpayer if that office is closed and no one is available to accept them.

U.S. Residency Certification: The Philadelphia Accounts Management Campus is currently closed. Processing of the US Residency Certification Program is temporarily suspended. Normal operations will resume as soon as possible.

Taxpayer Protection Program: If you received correspondence (Letters 5071C, 5447C or 5747C) from the IRS asking if you filed a suspicious tax return, you may use the online Identity Verification Service to validate your identity. If you received a Letter 4883C, follow its instructions. Please note: phone assistance is limited and wait times are lengthy.
Kimberly J. Lam, CIRA
Bachecki, Crom & Co., LLP
South San Francisco, CA
Partner

Kimberly J. Lam is a Partner of Bachecki, Crom & Co., LLP, a public accounting firm in San Francisco Bay Area, specializing in bankruptcy tax, forensic accounting and fraud investigations. She provides consulting on bankruptcy and insolvency matters, including income tax and cash flow analysis pertaining to liquidation of bankruptcy estate assets, tax elections, and attribute utilization, financial advisory, avoidable transfers, solvency, claim analysis, and assistance in complying with Bankruptcy Court and tax filing requirements.

Kimberly has more than 20 years of experience in public accounting. Kimberly also specializes in tax consulting and compliance services for high net worth individuals and their related entities including trusts, partnerships and corporations. She has extensive experience working with professional service companies, law firms and real estate businesses. She enjoys working with closely held family businesses, high growth companies and companies in multi-states and worldwide operations. Kimberly works closely with her clients and their advisors and attorneys to develop and implement strategic plans that minimize income and estate taxes. Kimberly is dedicated to providing a comprehensive, thoughtful and personalized approach to her client’s tax and financial needs.
Robert L. Nistendirk
Woomer, Nistendirk & Associates PLLC
Charleston, WV

Robert Nistendirk is a member of Woomer, Nistendirk & Associates PLLC, Certified Public Accountants, in Charleston, West Virginia. He specializes in providing accounting, tax and advisory services.

Robert has been employed in hundreds of bankruptcy cases since 1988. His bankruptcy experience includes accounting, taxation, reorganization, liquidation, forensics, solvency, preferences, fraudulent conveyances, succession planning, feasibility and valuation.

Certain responsibilities include:

- Chapter 7 accountant
- Chapter 11 accountant
- Examiner
- Creditor trust trustee
- Post-confirmation plan manager
- Forensic analysis
- Insolvency and preference analysis
- Liquidating trust trustee
- Qualified settlement fund trustee
- Feasibility expert
- Chapter 11 trustee
- Subchapter V trustee

Robert’s industry exposure includes advertising, agriculture, attorneys, construction, manufacturing, mining, physicians, public relations, real estate, restaurants, transportation and warehousing, wholesale and retail trade.

He is a regular speaker at Association of Insolvency and Restructuring Advisors annual conferences. Bob boasts he has been attending AIRA conferences since before it was AIRA (29 years in 2020!).

About AIRA
AIRA is a nonprofit professional association serving the bankruptcy, restructuring and turnaround practice area. AIRA’s membership consists of accountants, financial advisors, investment bankers, attorneys, workout consultants, trustees, and others in the field of business turnaround, restructuring and bankruptcy. AIRA

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Contact Us
221 W. Stewart Avenue, Suite 207
Medford, OR 97501
Ph: (541) 858-1665
Fx: (541) 858-9187
aira@aira.org
Ron Maroko, CIRA
U.S. Department of Justice
Los Angeles, CA

Trial Attorney

Ron Maroko has been a Trial Attorney with the Department of Justice, Office of the United States Trustee since 1989, handling bankruptcy matters in chapters 7, 11, and 13. He is currently working in the Los Angeles Division of the office, but has also worked in the Santa Ana and Woodland Hills Divisions. Between 2003-2006, he served as a Special Assistant United States Attorney in the fiscal litigation unit. Ron received his law degree from UC Davis in 1986. He has a Bachelor of Arts in Business-Economics from UCLA and Masters in Business Taxation from U.S.C. In addition to his law license, Ron has been a CPA since 1989. Ron is a Certified Insolvency and Restructuring Advisor (CIRA), receiving the Association of Insolvency and Restructuring Advisors (AIRA), silver medal in 2002. He also been designated Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants (AICPA).

Ron is a past chair of the Federal Bar Association National Bankruptcy Section and serves on the board of directors for the 9th Judicial Circuit Historical Society. He previously served as Managing Editor for the California Bankruptcy Journal and on the State Bar of California Committee on Professional Responsibility and Conduct.

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Contact Us
221 W. Stewart Avenue, Suite 207
Medford, OR 97501
Ph: (541) 858-1665
Fx: (541) 858-9187
aira@aira.org

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