

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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subject: Dischargeable Taxes, Penalties, and Interest under Post-BAPCPA Chapter 13 Provisions

[This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.](#)

ISSUES

1. For Chapter 13 bankruptcy cases filed on or after October 17, 2005, in which the taxpayer properly completes the plan and receives a discharge, which tax claims are nondischargeable?
2. Is interest on nondischargeable tax claims also nondischargeable?
3. Are postpetition penalties relating to nondischargeable tax claims dischargeable?

CONCLUSIONS

1. For bankruptcy cases filed on or after October 17, 2005, debts for withheld taxes, taxes for which a return was not filed, taxes for which a return was late-filed within two years of the bankruptcy case, taxes for which the debtor filed a fraudulent return, and

taxes that the debtor attempted to evade or defeat, are not subject to the Chapter 13 discharge.

2. If the tax debt is dischargeable in Chapter 13, then the associated prepetition and postpetition interest is dischargeable. If the underlying tax liability is not dischargeable, then the associated prepetition and postpetition interest liability is also not dischargeable.
3. All nonpecuniary tax penalties and the interest that accrues thereon are dischargeable.

## DISCUSSION

Significant changes were made to the Bankruptcy Code by the Bankruptcy Abuse and Consumer Protection Act of 2005 (BAPCPA). Most of the changes were effective for bankruptcy cases filed on or after October 17, 2005. You requested advice because you will soon be required to decide whether a variety of federal tax debts are no longer collectible because the taxpayer successfully completed a Chapter 13 plan in a post-BAPCPA case and received a discharge. This memorandum identifies those tax claims that are not dischargeable under the regular Chapter 13 discharge in B.C. § 1328(a), as amended by BAPCPA. The effect of the discharge on interest and penalty claims is discussed thereafter. A note of caution, however, is required. The Ninth Circuit has held that a plan that was confirmed without objection to a provision purporting to discharge an otherwise nondischargeable claim was binding on the parties. The terms of the plan made a nondischargeable debt dischargeable. *In re Pardee*, 193 F.3d 1083 (9<sup>th</sup> Cir. 1999).

## LAW AND ANALYSIS

### **A. Taxes Nondischargeable Under B.C. § 1328(a) as Amended by BAPCPA.**

Prior to BAPCPA, a Chapter 13 debtor who completed his plan payments was entitled to what has been referred to as a “super discharge” of all taxes provided for by the plan or disallowed under section 502, including taxes stemming from fraudulent or unfiled returns. 11 U.S.C. § 1328(a). BAPCPA substantially narrowed the scope of the Chapter 13 discharge by excepting from the discharge a number of tax debts. B.C. § 1328(a) lists the debts excepted from the general discharge. In relevant part, § 1328(a) provides:

“[A]s soon as practicable after completion by the debtor of all payments under the plan ... , the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt . . . of a kind specified in section 507(a)(8)(C) or in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a) ... .

Of the provisions referenced by section 1328(a), four are most likely to apply to tax debts at issue in a Chapter 13 proceeding; they are sections 507(a)(8)(C), 523(a)(1)(B), 523(a)(1)(C), and 523(a)(3). Each of these exceptions to the discharge under 1328(a) is discussed below.

#### **1. B.C. § 507(a)(8)(C)**

Subsection (C) of subparagraph 507(a)(8) refers to a tax required to be collected or withheld and for which the debtor is liable in whatever capacity. This exception encompasses the portion of employment taxes withheld from employees wages, and the Trust Fund Recovery Penalty under I.R.C. § 6672. While a claim for section 507(a)(8)(C) liabilities is entitled to priority status, and must be paid in full under the terms of a Chapter 13 plan, the exception to discharge allows the Service to collect such liabilities even if it was not able to identify the liability in time to file a claim, which was a problem before BAPCPA because the Service often could not identify the debtor as a responsible officer under section 6672 in time to file a claim. See IRM 5.9.10.5.3(6) *Note* and 5.9.17.15.1(1).

#### **2. B.C. § 523(a)(1)(B)**

This subsection excepts from the discharge any debt --

(1) for a tax ...

(B) with respect to which a return . . . , if required --

- (i) was not filed or given; or
- (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition.

Stated more simply, taxes for which no return was filed, and taxes for which a return was late-filed within two years before the petition date, are nondischargeable. See IRM 5.9.17.15.1.

#### **4. B.C. § 523(a)(1)(C)**

This subsection makes nondischargeable any debt “for a tax with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.” See IRM 5.9.2.9.1(2)f and 5.17.8.22(6).

#### **5. B.C. § 523(a)(3)(A)**

This subsection makes nondischargeable debts that are neither listed nor scheduled under B.C. § 521(1) [re-designated by BAPCPA as subsection 521(a)(1)] with the name of the creditor to whom the debt is owed in time to permit a proof of claim to be timely filed, unless the creditor had notice or actual knowledge of the case in time to file a timely proof of claim. This exception applies where the debtor fails to list the Service on its schedule of liabilities or otherwise notify the Service of the bankruptcy case. However, if the Service learns of the bankruptcy proceeding in time to file a timely claim, this exception will not apply. Note that even in pre-BAPCPA cases, courts have held that a Chapter 13 debtor does not receive a discharge of a debt if the creditor did not have notice of the bankruptcy case in time to file a timely claim. See *Ellet v. Stanislaus*, 506 F.3d 774 (9<sup>th</sup> Cir. 2007) (refusing to discharge a tax debt where the taxing authority was not given adequate notice of the debtor's Chapter 13 proceeding in time to file a timely claim). See also *United States v. Hairopoulos*, 118 F.3d 1240 (8<sup>th</sup> Cir. 1997) (fundamental fairness requires that the tax debt was not provided for by the plan and could not be discharged where the Service did not file a claim due to inadequate notice).

## **B. The Status of Prepetition and Postpetition Interest**

Prepetition interest (interest through the date the bankruptcy petition was filed) is nondischargeable if the underlying tax is nondischargeable. *In re Larson*, 862 F.2d 112, 119 (7<sup>th</sup> Cir.1988). Postpetition interest is generally not paid through a Chapter 13 plan and cannot be collected after the bankruptcy case if the debt is discharged. There are three important exceptions in Chapter 13 cases (the first two are not new to the Service in Chapter 13 cases). First, if a creditor's claim is over-secured – the value of the collateral exceeds the amount of the prepetition claim - then the creditor's claim includes postpetition interest until the value of the claim exceeds the value of the collateral. 11 U.S.C. § 506(b). Second, even an under-secured secured claim may be entitled to postconfirmation interest on its claim. See 11 U.S.C. § 1325(a)(5). Third, if the debt is nondischargeable, the postpetition interest is not discharged and can be collected from the debtor after the bankruptcy case. See *Bruning v. United States*, 376 U.S. 358 (1964). Since BAPCPA created a number of tax debts that are now nondischargeable, debtors will owe postpetition interest on the nondischargeable tax obligations. Congress recognized this when drafting BAPCPA and also added B.C. § 1322(b)(10), which allows a Chapter 13 plan to provide for the payment of postpetition interest on nondischargeable claims, except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims.

## **C. The Status of Prepetition and Postpetition Penalties**

BAPCPA did not alter the dischargeability of penalties; prepetition penalties are still nonpriority claims that are subject to discharge. To the extent prepetition tax penalties (and their associated prepetition interest) are not paid pursuant to the Chapter 13 plan,

they are dischargeable under B.C. § 1328(a)(2) because that subsection does not include subsection 523(a)(7) among its list of nondischargeable provisions. Also note that under I.R.C. § 6658, penalties under section 6651, 6654, and 6655 for failure to make timely payments of tax incurred by the debtor before the bankruptcy case do not accrue during the bankruptcy case.

Please call (202) 622-3620 if you have any further questions.