

Helping Clients with Income Tax Debts

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Bankruptcy can be a powerful tool for those clients facing tax debt. Taxes may be discharged through either Chapter 7 or Chapter 13 bankruptcy. Which chapter to use depends on the type of tax debt, age of the debt, and the client's overall circumstances.

In general, taxes can be discharged in Chapter 7 (liquidation) bankruptcy if it has been at least:

- Three years from due date of the return;
- Two years from actual filing of the return, but not after a Substitute for Returns (SFR) was filed by the IRS unless filed with the assistance of the taxpayer;
- 240 days from an assessment;
- Returns must not be fraudulent, and there must be no evasion.

Many clients believe they cannot qualify for Chapter 7 because their income is too high. This is often not the case. In order to qualify for Chapter 7, clients with incomes in excess of the state median must pass the so called "Means Test." The Means Test is calculated by taking the client's gross income and deducting certain expenses. Most expenses require the client to use the IRS guidelines. However, expenses such as mortgages, health care, and

priority debt (which includes non-dischargeable taxes) uses the client's actual numbers.

The other exception to passing the Means Test is the so called "non-consumer debt." If the majority of the client's debt is business related, the client does not need to complete the Means Test. Income taxes are considered non-consumer debt, and help client's circumvent the income eligibility requirement in Chapter 7.

If the client owes non-dischargeable tax debt, Chapter 13 can be a great option to have up to five years to repay the debt interest and penalty free.

There are many other benefits to Chapter 13 which may be taken into consideration. Two of the most noteworthy are: 1) curing arrearages on mortgages and cars, and 2) stripping of the second mortgage. In brief, it may be possible to reduce both the principal and interest rate on vehicles. As for homes, if the fair market value of the client's home is less than the loan value of the first mortgage, the second mortgage may be "stripped."

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