BANKRUPTCY AND WORKOUTS

Submitted by the Committee on Bankruptcy and Workouts
George Nelson, Committee Chair;
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on Important Developments

Regulations

Prop. Treas. Reg. § 1.1001-3(f)(7)(ii)(A) provides that, in determining whether a debt instrument has been converted to equity and a taxable event triggered, the change in value of the instrument caused by the deterioration of the debtor's financial condition after the date of issuance will generally be disregarded.

Prop. Treas. Reg. §§ 1.108(i)-0 through -3 implement The American Recovery and Reinvestment Act of 2009 (ARRA), P.L. 111-5, 123 Stat. 115 at § 1231, which added new I.R.C. § 108(i) to provide for the delayed amortization of cancellation of debt income over a five-year period, starting in tax year 2014 for cancellation of debt income incurred in 2009-2010, provided the income arises from the reacquisition of an applicable debt instrument. The election under § 108(i) is made in lieu of any other § 108 exclusion.

The rules for corporations are found in Prop. Treas. Reg. § 1.108(i)-1. In particular, Prop. Treas. Reg. § 1.108(i)-1(b)(2)

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[1]Mr. Weil is the author of *Tax Liabilities and Bankruptcy*, (CCH 3rd ed 2010) (available online only). Portions of this article are adapted from that online edition. This article was last revised January 2, 2011.

lists events that trigger acceleration of the deferred gain, *e.g.*, election of S-corporation status, cessation of corporate existence, and a transaction that impairs the corporation's ability to pay the tax. The standard for impairment is "the gross value of the ... corporation's assets (gross asset value) is less than one hundred and ten percent of the sum of its liabilities and the tax on the net amount of its deferred items." Examples of impairment transactions include a below-market sale and charitable contributions. Corrective actions to restore value are allowed. Charitable contributions that match the historical average of the corporation for the past three years will not be considered an impairment transaction.

The rules for partnerships and S-corporations are found in Prop. Treas. Reg. § 1.108-2. The regulation first explains how to allocate the deferred cancellation of debt income to partners. Prop. Treas. Reg. § 1.108-2(b)(1)-(5). Thereafter, it discusses trigger events that cause immediate recognition of the deferred gain. Trigger events for a partnership include liquidation of the partnership, transfer of substantially all its assets, or a bankruptcy or receivership filing. Prop. Treas. Reg. § 1.108-2(b)(6). The gain is accelerated at the partner level if the partner dies, liquidates, or transfers all or a portion of the partnership interest. *Id.*

As to S-Corporations, the deferred cancellation of debt income is shared *pro rata*, and, it has no impact on basis. Prop. Treas. Reg. § 1.108-2(c)(1) and (2). Events that trigger immediate recognition of the deferred gain, at the corporate level, include liquidation, a transfer of substantially all assets, or a bankruptcy filing. Trigger events at the shareholder level include death or a transfer of all or a portion of an interest in the S-corporation.

Prop. Treas. Reg. § 1.108-3 provides guidance regarding the deferred original issue discount deductions under I.R.C. § 108(i)(2) because of the deferral of the cancellation of debt income.

Cases and Rulings

Dischargeability

In a series of developments overlapping 2009-2010, including *Sharp v. United States (In re Sharp)*, Adv. Proc. No. 08-01003, Docket No. 17 (Bankr. N.D. Ill. 2009) ("Creditor United States' Withdrawal Of Its Argument That Timeliness Is Part Of The Definition Of 'Return' In 11 U.S.C. § 523(a)"), CCA 201005029 (October 21, 2009), and Chief Counsel Notice 2010-016, the IRS reached the conclusion that taxes due on late-filed returns are potentially dischargeable in bankruptcy. In 2009, a series of cases held that taxes due on late-filed returns were nondischargeable, even if the return were filed more than two years prior to the bankruptcy filing. *See*, *McCoy v. Miss. Tax Comm'n (In re McCoy)*, 2009 W.L. 2835258 (Bankr. S.D. Miss. 2009), *Creekmore v. IRS (In re Creekmore)*, 401 B.R. 748 (Bankr. N.D. Miss. 2008), and *Links v. United States (In re Links)*, 2009 W.L. 2966162 (Bankr. N.D. Ohio 2009), and Bankruptcy and Workouts Developments Report 2009.

In *Sharp*, the IRS filed a brief withdrawing its argument that timeliness is part of the definition of return in 11 U.S.C. § 523(a). In CCA 201005029, the IRS reviewed the rules for discharging tax debts in Chapter 13. In so doing, it implied that taxes due on late-filed returns are dischargeable, if the returns were filed more than two years prior to the petition date. No mention was made of *McCoy*, *Creekmore*, or *Links*. In Chief Counsel Notice 2010-016 (September 2, 2010), Chief Counsel's office made it official that the IRS will not contest, under the flush language at the end of § 523(a), the dischargeability of late-filed returns.

Notice 2010-016 also provided some guidance as to returns filed after substitute-for-return (SFR) assessments. *See*, Bankruptcy and Workouts Developments Report 2006. It found that any additional tax reported by the taxpayer, over and above the SFR assessment will be dischargeable. The remaining tax is nondischargeable.

Bryen v. United States (In re Bryen), 433 B.R. 503 (E.D. Pa. 2010) illustrates that common sense is still the best guide in determining whether a tax will be dischargeable under the willful intent to evade or defeat test of 11 U.S.C. § 523(a)(1)(C). *See*, Bankruptcy and Workouts Developments Report 2007. In *Bryen*, the debtor was an accountant whose Father had been instrumental in establishing and promoting employee-leasing tax shelters. The debtor owed over $13,000,000 from his investments in the tax shelters. The debtor made no attempt to pay down that tax debt, although he had income as high as $190,000 in one year. The debtor also took vacations with his wife each year that cost, on average, $12,000 to $14,000. On the bare facts, spending $13,000 on vacations, which was .1% of the tax liability, should not be reason to deny the discharge. But, reading between the lines, it appears that the debtor did not present himself well to the court.

Sheehan v. United States (In re Sheehan), 2010-2 U.S.T.C. ¶ 50,702 (Bankr. N.D. Ohio 2010) and *Barkley v. United States (In re Barkley)*, 2010-2 U.S.T.C. ¶ 50,725 (Bankr. N.D. Ga. 2010) both cited the taxpayers withdrawal of funds from bank accounts that had been levied previously as conduct supporting nondischargeability. From a taxpayer's perspective, this is a troubling development. How is a person supposed to live. *Cf.*, *O'Callaghan v. United States (In re O'Callaghan)*, 316 B.R. 550

(Bankr. M.D. Fla. 2004) (debtor stopped using bank accounts to avoid IRS levies, so he could pay his basic expenses, worked within the system to resolve his tax problems and did not hide from the IRS, and made large payments to the IRS; held tax dischargeable).

<u>Liens</u>

In *Wadleigh v. Comm'r*, 134 T.C. No. 14 (2010), the IRS asserted successfully that its secret lien remained attached to the debtor's ERISA plan after the conclusion of the debtor's bankruptcy case. The Tax Court relied on *Patterson v. Shumate*, 504 U.S. 753 (1992) for the proposition that ERISA plans are excluded from the bankruptcy estate. If excluded, then, the IRS's secret lien remains in place and is not avoided by operation of 11 U.S.C. § 522(c)(2)(B).

But, the Supreme Court held that a debtor *may* exclude ERISA plans from the bankruptcy estate. A careful reading of *Shumate* makes clear that Justice Blackmun posed the dispositive question as permissive and not mandatory.

> We must decide in this case whether an antialienation provision contained in an ERISA-qualified pension plan constitutes a restriction on transfer enforceable under "applicable nonbankruptcy law," and whether, accordingly, a debtor may exclude his interest in such a plan from the property of the bankruptcy estate.

Id. at 755 ("may exclude" not shall exclude). The Ninth Circuit found the exclusion under *Shumate* to be permissive. *Rains v. Flinn (In re Rains)*, 428 F.3d 893, 905-906 (9th Cir. 2005) (the exclusion of ERISA plans from the bankruptcy estate under *Patterson v. Shumate*, 504 U.S. 753 (1992) is permissive). The Tax Court did not address this issue. The Tax Court seemed to indicate that *Patterson v. Shumate* was permissive, but, it did not need to reach this question. It found that the taxpayer had excluded the ERISA plan from the bankruptcy estate, based on language used in the Schedule B.

Note, objections to in-kind exemptions must be made within 30 days of the first meeting of creditors. Bankruptcy Rule 4003(b) (exemption objections must be made within 30 days after the conclusion of the 341 meeting); and *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). The Tax Court did not need to address *Taylor v. Freeland* because it found the ERISA plan was already excluded from the bankruptcy estate. Bankruptcy practitioners who are trying to avoid the IRS secret lien should keep *Taylor v. Freeland* in mind.

Judge Marvel also made clear that attorneys should be comparing the actual IRS collection actions with what is prescribed in the Internal Revenue Manual. Taxpayer representatives should follow Judge Marvel's direction and compare IRS procedures in the IRM to the actions taken by the IRS. For example, in *Wadleigh*, Judge Marvel found that there was nothing in the administrative record to explain why the IRS assumed the taxpayer would continue working and earning money after the ERISA plan came into pay status. Without this information, she was unable to determine whether the IRS abused its discretion.

In *Gross v. Comm'r*, T.C. Memo 2010-176, on the debtor's Schedule C (exemptions), the debtor stated that the listing of the ERISA plan was for notice purposes only. Thus, it was easy to argue that the ERISA plan had never been included in the bankruptcy estate.

Recommended changes to the Uniform Commercial Code by the National Conference of Commissioners on state laws will bear watching. Proposed changes to § 9-503 deal with identifying a debtor in a filed financing statement. One of the recommended changes is to use the name on the debtor's driver's license. How often is the name on the driver's license different from the name on the tax return that is used by the IRS. The rule for tax liens is that the lien must identify the taxpayer and this means a reasonable search must uncover the lien. See Bankruptcy and Workouts Developments Report 2008. If the taxpayer uses one name on the driver's license and another name on the tax return, the federal tax lien may not be subject to discovery upon reasonable inspection.

Green Pastures Christian Ministries, Inc. v. United States (In re Green Pastures Christian Ministries, Inc.), 437 B.R. 465 (Bankr. N.D. Ga. 2010) found the notice of federal tax lien

(NFTL) subject to discovery upon reasonable inspection even though the third word was misspelled. Query whether under the proposed changes this result would stand because the proposed changes require using the registered name.

In an off-handed, not-for-publication opinion, *Miles v. Comm'r*, 2010-2 U.S.T.C. ¶ 50,661 (9th Cir. 2010) seemed to answer one of the more puzzling lien questions. If (i) a lien is attached to an account at Fidelity, (ii) the taxpayer files for bankruptcy, (iii) the taxpayer discharges the underlying obligation, and, (iv) postpetition, the taxpayer moves the account to Vanguard, does the IRS have lien rights in the Vanguard account? *Miles* indicates yes, citing *United States v. Rogers*, 461 U.S. 677, 691 n.16.[2] But, *Rogers* did not address the proceeds issue; it only addressed the issue of transferring the property. In *Miles*, the Ninth Circuit upheld a levy on the debtor's ERISA account. At the time of the bankruptcy filing, the funds had been in an IRA. *Contra*, *Wood v. United States (In re Wood)*, 247 B.R. 493 (Bankr. M.D. Fla. 1999) (IRS lien attached to IRA; taxpayer withdrew all funds from IRA and deposited them in bank accounts; held, IRS levy of bank accounts violated discharge injunction).

If the IRS's claim is undersecured, *In re J.H. Inv't Servs., Inc.*, 2010-2 U.S.T.C. ¶ 50,663 (M.D. Fla. 2010) found that the

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[2] While the UCC has a proceeds rule; the Tax Code does not.

IRS must file a proof of claim for the unsecured portion. The court reasoned that due process requires notice so that the trustee and others have an opportunity to respond.

<u>Property of the estate</u>

In re Hooper, 2010 W.L. 5155828 (Bankr. D. Ariz. 2010) found that a tax refund created *postpetition* by legislation increasing the periods to which the net operating loss (NOL) could be carried back was estate property. *See*, Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA), P.L. 111-92, 123 Stat. 2984; and Bankruptcy and Workouts Developments Report 2009. *Hooper* cited *Segal v. Rochelle*, 382 U.S. 375 (1966), which held that a claim for an NOL carry back tax refund was property of the estate. Although the loss occurred postpetition, the funds generated by the NOL carry back were sufficiently rooted in the pre-bankruptcy past to merit inclusion in the bankruptcy estate. In *Hooper*, because the funds making up the refund had been paid to the IRS prepetition, the court found that the tax refund was sufficiently rooted in the pre-bankruptcy past to create property of the bankruptcy estate.

<u>Exemptions</u>

In re Chilton, 426 B.R. 612 (Bankr. E.D. Tex. 2010), *In re Klipsch*, 435 B.R. 586 (Bankr. S.D. Ind. 2010), *In re Ard*, 435 B.R. 719 (Bankr. M.D. Fla. 2010), *Doeling v. Nessa (In re Nessa)*, 426 B.R. 312 (8th Cir. B.A.P. 2010), *In re Kuchta*, 434 B.R. 837 (Bankr. S.D. Ohio 2010), *Bierbach v. Tabor (In re Tabor)*, 433 B.R. 469 (Bankr. M.D. Pa. 2010), and *In re Weilhammer*, 2010 W.L. 3431465 (Bankr. S.D. Cal. 2010) illustrate that courts remain divided on the question of whether, under the Bankruptcy Code exemption rules, inherited IRAs qualify for exemption. *See*, Bankruptcy and Workouts Developments Report 2009. *Chilton*, *Klipsch*, and *Ard* said no; *Nessa*, *Kuchta*, *Tabor*, and *Weilhammer* said yes.

The *Chilton* argument against exemption is that inherited IRAs are not funds intended for retirement purposes but, instead, are distributed to the beneficiary without regard to age or retirement status. The *Nessa* argument for exemption is that the Bankruptcy Code exemption expressly exempts IRAs under I.R.C. § 408, and, § 408 expressly includes inherited IRAs within its ambit. "For purposes of this section, the term 'individual retirement account' means a trust created or organized in the United States for the exclusive benefit of an individual or his *beneficiaries* ... " (emphasis added).

<u>Chapter 11</u>

In re South Beach Secs. Inc., 421 B.R. 456, 466 (N.D. Ill. 2009)[3] denied the confirmation of a Chapter 11 plan because it found the principal purpose of the plan was tax avoidance,

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[3]This case was not reported in the bankruptcy reporter until 2010.

thereby running afoul of 11 U.S.C. § 1129(d). The district court affirmed the bankruptcy court's finding that the sole purpose of the Chapter 11 plan was to allow the debtor to take advantage of its net operating losses. The debtor had "no business to resuscitate, no going concern to keep going." *Id.* at 462.

<u>Chapter 12</u>

In re Ficken, 430 B.R. 663 (10th Cir. B.A.P. 2010) and *United States v. Hall*, 617 F.3d 1161 (9th Cir. 2010) saw the battle continue unabated over whether the postpetition sale of farm assets can qualify for nonpriority treatment under 11 U.S.C. § 1222(a)(2)(A). *See*, Bankruptcy and Workout Developments Report 2006-2009. *Ficken* found for the taxpayer. That court stated that "Numerous courts have rejected the IRS's position, holding that 'incurred by the estate' means simply "incurred post-petition," and does not require the estate to be a separate taxable entity." *Ficken*, *supra* at 671. *Hall* found for the IRS. *Hall* reasoned that there could not be an administrative expense if there were no separate taxable estate under I.R.C. § 1398.

<u>Chapter 13</u>

In *In re The Bankruptcy Court's Use of a Standardized Form of Chapter 13 Confirmation Order that Enjoins the Internal Revenue Service to Redirect Tax Refunds to Chapter 13 Trustees*, 423 B.R. 294 (E.D. Mich. 2010), the IRS successfully prevented the bankruptcy courts of the Eastern District of Michigan from forcing it to send all refunds for Chapter 13 debtors to the Chapter 13 trustee. The Court relied on the doctrine of sovereign immunity to prevent the enforcement of the model plan provisions. The Chapter 13 trustees, who supported the model plan provisions, were unable to identify any explicit statutory provision that waived sovereign immunity.

Chapter 15.

In re Grant Forest Products, Inc., 2010 W.L. 4780805 (Bankr. D. Del. 2010) denied a motion to reconsider its previous ruling that allowed the monitor of a Canadian bankruptcy to file tax returns in the United States without risk of personal liability. The monitor needed to sign the returns as the United States subsidiaries had been dissolved, and, there was no longer any officer or director available to sign the returns.

Means Test

In re Killian, 422 B.R. 903 (Bankr. N.D. Ill. 2009)[4] used basic Tax Code principals of constructive receipt (without identifying them as such) in determining whether the debtor had income for purposes of the means test. The debtor received a "loan" upon his hiring. *Id*. at 906. His monthly repayments equaled his "transitional bonus." *Id.* at 907. Thus, the debtor never received the bonus, as it was used to repay the "loan."

[4]This case was not reported in the bankruptcy reporter until 2010.

Upon death or disability, the bonus would full pay in an amount equal to the "loan." Upon termination, the bonus would be cancelled and the "loan" would come due and payable. *Id.* The court found the debtor had income when the "advance" was received and not within the six-month-prepetition period that is part of the means test.

<u>Refunds</u>

Weinman v. Graves (In re Graves), 609 F.3d 1153 (10th Cir. 2010) seemed to land in the middle between *Weinman v. Graves (In re Graves)*, 396 B.R. 70 (10th Cir. B.A.P. 2008), discussed in the Bankruptcy and Workouts Developments Report 2008, and in *Nichols v. Birdsell*, 491 F.3d 987 (9th Cir. 2007), discussed in the Bankruptcy and Workouts Developments Report 2007. The issue is the right of the trustee to claim a prepetition tax refund from the year of filing that is applied to the following year's estimated tax payments.

Nichols held that the trustee was free to go after the taxpayer for recovery of the refund allocated to the following year's taxes. In *Graves*, the BAP held that the trustee had no power under 11 U.S.C. § 542 to go after the taxpayer for turnover, as the taxpayer did not have the funds. The BAP expressed no opinion on the estate's interest in the prepetition tax refund, nor, whether the Trustee had a claim against the IRS for return of the prepetition tax refund. *Weinman v. Graves (In re Graves)*, 396 B.R. 70, 75 (10th Cir. B.A.P. 2008).

Initially, the 10th Circuit agreed with the BAP that the trustee could not sue the taxpayer under § 542. But, the Court found that, once the subsequent year's return was filed, the trustee could successfully sue the taxpayer.

> In summary, we hold that the pre-petition portion of the refund is property of the estate. We go further, however, to hold that only the part of the refund that (1) is attributable to pre-petition earnings and (2) reverted to debtors after application of the refund to their ultimate (2007) tax liability, is subject to turnover.

Weinman v. Graves (In re Graves), 609 F.3d 1153, 1159 (10th Cir. 2010). The 10th Circuit provided no guidance on how to do this computation. Presumably, the funds are recoverable by the trustee from the taxpayer only if there is a refund in the subsequent year. Perhaps, there will be a *pro rata* allocation based on the ratio of the prepetition tax refund to the total taxes paid in the subsequent year. Taxpayers should do their best to avoid a refund in the subsequent year.

Crowson v. Zubrod (In re Crowson), 431 B.R. 484 (10th Cir. B.A.P. 2010) dealt with the allocation of the tax refund between a filing and nonfiling spouse in Wyoming.[5] The Court found that

[5]See Bankruptcy and Workouts Developments Report 2009 for a division of the refund case between filing spouses in Tennessee and a filing spouse and nonfiling spouse in New York. *In re Garbett*, 410 B.R. 280 (Bankr. E.D. Tenn. 2009); and *In re Spina*, 416 B.R. 92 (Bankr. E.D.N.Y. 2009). *In re Glenn*, 430 B.R. 56

Wyoming does not have an assumption of equal property rights between the spouses. The Court then used its own formulae to allocate the refund between the filing and nonfiling spouse.

In re Rice, 2010 W.L. 5559694 (Bankr. M.D. Fla. 2010) cited *Crowson* with approval in making its allocation of the tax refund between a filing and nonfiling spouse.

In re Meyers, 616 F.3d 626 (7th Cir. 2010) used a *pro rata* allocation based on the number of the days in the year that were prepetition to determine which portion of the refund was attributable to prepetition earnings and part of the bankruptcy estate. *See*, Bankruptcy and Workouts Developments Report 2006, 2008, and 2009. The court declined to follow *In re Donnell*, 357 B.R. 386 (Bankr. W.D. Tex. 2006), which did a precise allocation of earnings pre and postpetition. *See*, Bankruptcy and Workouts Developments Report 2006. Here, the evidence presented showed that income was earned steadily throughout the year.

In a twist on the refund-allocation rule, *Bryant v. Comm'r*, 2010-2 U.S.T.C. ¶ 50,669 (6th Cir. 2010) allowed the IRS to allocate (i) the prepetition portion of the taxpayer's overpayment in the year of filing to an otherwise discharged tax obligation and (ii) the postpetition portion of the overpayment to a nondischargeable tax from a different year.

(Bankr. N.D.N.Y. 2010) followed the 50/50 split that *Spina* applied.

Abstention

In re Swain, 437 B.R. 549 (Bankr. E.D. Mich. 2010) added a new wrinkle to the question of whether a bankruptcy court should decide a tax dispute if the underlying obligation is nondischargeable and the case is a no-asset case. *See also*, 11 U.S.C. § 505(a) (court may determine amount or legality of any tax; *Goins v. Dep't of Treasury Internal Service*, 437 B.R. 372 (Bankr. E.D. Mo. 2010) (bankruptcy court abstained from determining debtor's tax liability for nondischargeable, trust fund tax); and Bankruptcy and Workouts Developments Report 2008. It held that it did not have jurisdiction to hear the case. In Bankruptcy Code language, it found that this was not a law suit to determine dischargeability and not a core proceeding because nondischargeability was a given. *See*, 28 U.S.C. § 157(a)(2)(J). In addition, the core proceeding catch-all of 28 U.S.C. § 157(a)(2)(A)[6] (matters concerning estate administration) did not grant jurisdiction as there was no way the result in the case could "conceivably have any effect on the estate being administered."

United States v. Paolo (In re Paolo), 619 F.3d 100 (1st Cir. 2010) relied on 28 U.S.C. § 1334(d) to hold that the decision to abstain cannot be reviewed on appeal.

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[6]This code section is not cited in the opinion, but, the court does discuss matters concerning estate administration.

Right to appeal tax liability in bankruptcy court

In re Village of Oakwell Farms, Ltd., 428 B.R. 372 (Bankr. W.D. Tex. 2010) examined the time frame when a taxpayer may seek redetermination of a state tax liability. BAPCPA added 11 U.S.C. § 505(a)(2)(C), which provides that a bankruptcy court cannot determine the amount or legality of any amount arising in connection with an *ad valorem* tax on real or personal property, if the applicable period for contesting or redetermining the tax liability has expired under nonbankruptcy law. In *Oakwell Farms*, the time period for appealing a property tax assessment to the state court passed while the bankruptcy case was open, 11 U.S.C. § 108(b). Because a review of the original assessment was not requested by state court appeal before that time passed, the bankruptcy court found that § 505(a)(2)(C) prevented it from reviewing the original assessment.

Personal liability for nonpayment of bankruptcy estate tax

Jeffries v. Comm'r, T.C. Memo 2010-172 found the debtor, as the recipient of a fraudulent transfer, personally liable for the nonpayment of a bankruptcy estate tax. Jeffries also cites to the ongoing law suit against the bankruptcy trustee for the nonpayment of the same tax. *United States v. Gertz*, U.S. Dist. Ct. N.D. Ohio No. 10-1171.

In *Jeffries*, the debtor won a lawsuit against Walmart for racial discrimination. The proceeds of the lawsuit were properly paid into the debtor's bankruptcy case. Thereafter, the bankruptcy trustee distributed the proceeds to creditors and the surplus to the debtor without withholding for tax due on the damages awarded. The Tax Court found that the transfer to the debtor was a fraudulent transfer, and, the debtor was liable for the unpaid estate tax.

Frost v. Hussain (In re Hussain), 2010 W.L. 5071362 (D.N.J. 2010) affirmed the personal liability of a bankruptcy trustee for penalties and interest incurred because he failed to timely file bankruptcy estate tax returns.

<u>Procedure</u>

Scott v. United States (In re Scott), 437 B.R. 379 (9th Cir. B.A.P. 2010) gives a lesson to a *pro se* litigant on serving the United States. Pursuant to Fed. R. Bankr. P. 7004(b)(5), service must be made on the United States attorney in the district where the action is brought, the United States Attorney General in Washington, D.C., and the applicable agency. The panel found jurisdiction lacking and vacated the order of the bankruptcy court.

<u>Discharge of indebtedness income</u>

In INFO 2010-0141, the IRS found that students, with student loans from institutions that had folded, would not have discharge of indebtedness income if the students had claims against the schools for breach of contract. Those defenses would be good against the lenders on the loans, and, compromise of a claim is not a taxable discharge of indebtedness event. *See*, Rev. Rul. 84-176, 1984-2 C.B. 34.

<u>Offers in compromise</u>

In IR 2010-29, the IRS announced that “IRS employees will be permitted to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise." This means the IRS will not be as strongly bound by historical income while considering offers. The news release also implied that the IRS would push for income collateral agreements to protect its position if the taxpayer’s financial situation improves. *Id.* (“The IRS may also require that a taxpayer entering into such an offer in compromise agree to pay more if the taxpayer's financial situation improves significantly.”)

<u>Like-kind exchanges</u>

Rev. Proc. 2010-14, 2010-1 C.B. __ addresses the issue of how taxpayers report gains on like-kind exchanges when the qualified intermediary (QI) files for bankruptcy. In three separate letters to Congressmen, INFO-2009-0063, INFO-2009-0066, and INFO-2009-0106, the IRS stated its position that the bankruptcy of a QI holding funds for the completion of a § 1031 like-kind exchange, which bankruptcy prevents the QI from completing the § 1031 transaction, will result in the recognition of gain to the seller. *See*, Bankruptcy and Workouts

Developments Report 2009. The IRS has retreated from this position. Rev. Proc. 2010-14 provides that gain, if any, is not recognized until after the QI comes out of bankruptcy and payments are received. Gain is recognized under what the procedure calls the gross profit ratio method. "Under the safe harbor gross profit ratio method, the portion of any payment attributable to the relinquished property that is recognized as gain is determined by multiplying the payment by a fraction, the numerator of which is the taxpayer's gross profit and the denominator of which is the taxpayer's contract price." *Id.* at ¶ 4.03.

Table of Authorities

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Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA), P.L. 111-92, 123 Stat. 2984

Statutes, regulations, administrative rulings, etc.

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11 U.S.C. § 505(a)(2)(C)
11 U.S.C. § 522(c)(2)(B)
11 U.S.C. § 523(a)
11 U.S.C. § 523(a)(1)(C)
11 U.S.C. § 524
11 U.S.C. § 542
11 U.S.C. § 1129(d)
11 U.S.C. § 1222(a)(2)(A)
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28 U.S.C. § 157(a)(2)(J)

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I.R.C. § 1398

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Prop. Treas. Reg. § 1.108(i)-1
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Prop. Treas. Reg. § 1.108-2(b)(1)-(5)
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