Bankruptcy Court As a Tax Litigation Forum

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A. In order for a taxpayer outside of bankruptcy to be entitled to litigate a tax dispute with the IRS without first being required to pay the tax, the taxpayer must file a petition with the U.S. Tax Court within a 90 day window of opportunity after receiving a statutory notice of deficiency. IRC §§6212 and 6213 et seq. If the taxpayer does not timely file his tax court petition, he is prohibited from litigating the tax dispute in the Tax Court, and cannot litigate the matter without first paying the disputed tax, filing a claim for refund with the IRS, and upon denial of the claim for refund or the running of six months from the filing of the claim, the taxpayer may then file suit in the U.S. District Courts or the U.S. Court of Claims where a judicial review of the assessment of the tax is made. Historically, in all such litigation, the taxpayer had the burden of proof and was required to overcome a presumption of correctness that the assessment, or proposed assessment is correct. The IRS was not required to put on any evidence in order to prevail, unless the taxpayer put on enough evidence to shift the burden of proof. The IRS Restructuring & Reform Act of 1998 amended the law to provide that if the taxpayer complies with applicable regulations relating to substantiation of tax items and has maintained all records required and cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings and

interviews, then the IRS will bear the burden of proof where the taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any income, gift or estate tax. IRC §7491. Thus, the taxpayer still bears a certain degree of the burden of proof on factual issues, however, the presumption in favor of the correctness of an assessment is eliminated provided the taxpayer satisfies the conditions required.

B. Bankruptcy Code §505 provides the Bankruptcy Court with the authority to determine the correctness of tax claims. The Bankruptcy Court may rule on the merits of any tax claim involving an unpaid tax, fine, or penalty relating to a tax (or additions to a tax) of the debtor or of the estate, whether or not the tax has been previously assessed or paid, except that the Bankruptcy Court does not have jurisdiction to rule on the merits of a tax claim previously adjudicated before a court of competent jurisdiction in a contested proceeding prior to the commencement of the case under Title 11 or the amount or legality of any amount in connection with an ad valorem tax on property of the estate, if the applicable period for the contestation has expired. In the case of a tax that has been paid, the trustee must follow regular administrative procedures to obtain a refund unless the refund results from an offset or counterclaim to a claim or request for payment by the taxing authority. If the trustee files a

regular administrative request for a refund, the IRS has 120 days to determine the request, and upon its failure to do so, the bankruptcy court may rule on the merits of the refund claim. In **In re Taylor**, 132 F3d 256 (5th Cir. 1998), the 5th Circuit described the procedure for bringing a claim for determination under §505:

> . . . the normal procedure to determine the amount of a tax debt is for the debtor (or the IRS) to file a motion requesting that the bankruptcy court make a determination under 11 U.S.C. §505. *In re Horton*, 95 B.R. 436, 440 (Bankr.N.D.Tex. 1989) (determining a §6672 liability pursuant to §505; [citations omitted]. Section 505 authorizes the court to determine "the amount or legality of any tax . . . whether or not previously assessed. 11 U.S.C. §505(a)(1). This determination should be made under Rule 9014, which governs contested matters, because it does not fall within adversary proceedings as delineated by Rule 7001. *See Whelan v. United States (In re Whelan)*, 213 B.R. 310, 313 (Bankr. W.D.La 1997); *Horton*, 95 B.R. at 442 n.11; 15 COLLIER ON BANKRUPTCY *supra*, ¶TX5.04[2][b], at TX5-29. *Compare* Fed. R. Bankr.P. 9014 *with* Fed. R. Bankr.P 7001. Under Rule 9014, "relief shall be requested by

motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom the relief is sought." Fed. R. Bankr.P. 9013. The motion should state with particularity the grounds and relief desired. Fed. R. Bankr.P 9013. Alternatively, the debtor can file a proof of claim on behalf of the IRS and object to it, in order to dispute the §6672 penalty. *See* 11 U.S.C. §501(c); *United States v. Kolstad (In re Kolstad)*, 928 F.2d 171, 173 (5th Cir. 1991); 15 Collier on Bankruptcy, *supra*, ¶TX5.03[1].

C. In Bankruptcy litigation, the proponent of a proof of claim has the burden of proof by a preponderance of the evidence after the debtor has made an effective objection to the claim. Rule 3001(f) of the Rules of Bankruptcy Procedure. Prior to May of 2000, the Circuits had split on how the conflict between this rule and the general rule in non-bankruptcy court tax litigation was to be resolved.

1. The 3rd, 4th and 7th Circuits had followed the traditional rule applicable in non-bankruptcy courts, placing the burden of proof on the taxpayer. See In re Landbank Equity Corp., 973 F.2d 265 (4th Cir. 1992); Resyn Corp. v. U.S., 851 F.2d 660 (3rd Cir. 1988); and In re Stoeker, 179 F3d 546 (7th Cir. 1999).

2. The 5th, 8th, 9th and 10th Circuits had placed the burden on the IRS. See In re Placid Oil Co., 988 F2d 554 (5th Cir. 1993); In re Brown, 82 F3d 801 (8th Cir. 1996); In re MacFarlane, 83 F3d 1041 (9th Cir. 1996); In re Fullmer, 962 F2d 1463 (10th Cir. 1992).

The Supreme Court resolved the matter in 2000 when it decided Raleigh v. Illinois Department of Revenue (In re Stoeker), 530 US 15, 120 S.Ct. 1951, 147 L.Ed.2d 13 (May 17, 2000). Finding no sign that Congress meant to alter the burdens of production and persuasion on tax claims, the court held that the burden of proof with respect to a corporate officer's liability for a "responsible person" penalty where a corporation failed to pay use tax to the state was not altered from what it would have been outside of bankruptcy simply because the officer had filed for bankruptcy relief.

D. Under 11 USC 505(b)(2), the trustee may request the IRS to make a prompt determination of the estate's tax liability. The request must be made in accordance with Rev. Proc. 81-17, 1981-1 CB 688. The request leads to a discharge from liability for the estate's tax by the trustee and the debtor. The trustee makes the request by filing a written application in duplicate under penalties of perjury with the District Director for the district in which the bankruptcy case is pending. The request should be marked for the "Personal Attention of the Special Procedures Function. DO NO OPEN IN MAILROOM," and

should include an exact copy of the return filed for a completed tax period and a statement of the name and location of the office where it was filed. On a proper request, unless the return of the estate is fraudulent or contains a material misrepresentation, the estate, the trustee, the debtor and any successor to the debtor, will be discharged from any liability for the tax of the estate on either (1) the payment of the tax shown on the return if (a) the IRS does not notify the trustee within 60 days after the request for prompt determination that the return has been selected for examination, or (b) the IRS does not complete the examination and notify the trustee of any tax due within 180 days (extended as permitted by the bankruptcy court) after the request, or (2) the payment of the tax as determined by the bankruptcy court; or (3) the payment of the tax as determined by the IRS.