

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR DELAWARE-MARYLAND DISTRICT COUNSEL  
ATTN: WJGREGG

FROM: Alan C. Levine  
Chief, Branch 1 (General Litigation) CC:EL:GL

SUBJECT:

This responds to your request for advice dated August 10, 1998. This document is not to be cited as precedent.

Legend

Year 1 = Amount B = \$ Amount E = \$  
Year 2 = Amount C = \$ Amount F = \$  
Year 3 = Amount D = \$  
Year 4 =  
Year 5 =  
Amount A = \$

Issues:

- (1) Is the Individual who filed the bankruptcy petition a "debtor" as that term is used in bankruptcy code section 348(d)?
- (2) Does the self-employment issue have any affect upon the determination in answering 1. above?
- (3) If the debtor's taxable Year 4 liability is included as a "preconversion" liability, is that year now "closed" as to any future audit and deficiency determination because the liability was discharged.?
- (4) Can the Service claim and collect any statutory additions due on the preconversion

period or is the Service limited to only the tax amount?

(5) If the trustee does not have sufficient funds to fully pay this liability, is the balance administratively collectible?

(6) Will this area also affect post-petition liabilities in cases that were originally filed under Chapter 13?

Conclusions:

(1) The individual who filed the bankruptcy petition is a “debtor” as that term is used in Bankruptcy Code § 348(d).

(2) The self-employment aspects of this case have no effect upon the determination in 1. above.

(3) The Year 4 income tax liability is included as a “preconversion” liability, but the tax liability was not discharged in the Chapter 7 case.

(4) The Service cannot collect interest on the preconversion liability in the bankruptcy proceeding because there was no interest component to the preconversion liability, and interest does not accrue on a bankruptcy proof of claim after the petition date .

(5) Because the debtor’s preconversion liability is deemed to be a nondischargeable tax liability, to the extent that the Service is not full paid in the bankruptcy case, the Service could pursue administrative collection against the debtor outside of bankruptcy after the automatic stay terminates.

(6) The treatment of a post-petition tax claim upon the conversion of a case from Chapter 13 to Chapter 7 will depend upon whether the Service filed a proof of claim.

FACTS:

The debtor filed a Chapter 11 bankruptcy petition in Year 4. The debtor did not make an election under I.R.C. § 1398 to split Year 4 into a prepetition taxable period and a post-petition taxable period.

The Service filed a timely estimated proof of claim for Year 1, Year 2, and Year 3 in the Chapter 11 case for income tax liabilities. The estimated claim totaled Amount A. The claim was estimated because the debtor had not filed tax returns for the years in question. No assessments have been made for those years. The Service did not file a proof of claim for Year 4. Prior to April 15<sup>th</sup> in Year 5, the debtor converted his Chapter 11 case to a Chapter 7 case. Subsequently, debtor’s counsel filed a proof of claim on behalf of the Service for income tax liabilities in the amount of Amount B for Year 1, in the amount of Amount C for Year 2, in the amount of Amount D for Year 3, and in the

amount of Amount E for Year 4. The Service has not made assessments for Years 1 to 3, but an assessment was made in the amount of Amount F for Year 4.

### LAW AND ANALYSIS

(1) B.C. § 101(13) states that a “debtor means person or municipality concerning which a case under this title has been commenced.” The taxpayer is the debtor in this bankruptcy case.

(2) A debtor’s status does not depend on whether he is self-employed.

(3) I.R.C. § 1398 applies to any individual debtor case under Chapter 7 or Chapter 11 of the Bankruptcy Code. Section 1398 treats the individual debtor and the bankruptcy estate under Chapter 7 or Chapter 11 as separate taxable entities. “[T]o the extent that an individual debtor derives income from wages earned postpetition which is independent of that derived from the estate in general, the individual bears personal responsibilities in connection with the income so derived.” E.g. In re Powell, 187 BR 642, 647 (Bankr. D. Minn. 1995).

B.C. § 348(d) provides that “A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, ..., other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.” (Emphasis added.) Section 348(d) creates a general rule in which post-petition but preconversion claims are deemed to have arisen immediately before the date of the filing of the petition. The exception to this general rule is an administrative tax claim under section 503(b).

B.C. § 503(b)(i) includes in the definition of an administrative expense “any tax, incurred by the estate, except a tax of a kind specified in section 507(a)(8).”

In this case, the debtor’s post-petition but preconversion liability is his separate and distinct tax liability under section 1398. The debtor’s tax liability does not qualify as an administrative expense under section 503(b) because section 503(b) does not encompass an individual debtor’s post-petition tax liability. Instead, section 503(b) includes only the tax liability of the estate. Consequently, the debtor’s post-petition but preconversion tax liability follows the general rule and shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.

The debtor’s preconversion liability, which is deemed to have arisen immediately before the petition date, is a priority tax claim under B.C. § 507(a)(8)(A)(i), which provides priority status for the liability for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three

years before the date of the filing of the petition. 1/ Such a priority tax claim would be nondischargeable under B.C. § 523(A)(1)(A). 2/

(4) As noted above, section 348(d) provides that a post-petition but preconversion liability shall be treated as if such claim had arisen immediately before the date of the filing of the petition. In this case, debtor's tax liability was the tax in chief for Year 4. There was no interest component to the Year 4 income tax liability at the conversion date because the conversion occurred prior to April 15<sup>th</sup> of Year 5. Consequently, the tax in chief for Year 4 shall be treated as if such claim had arisen immediately before the date of the filing petition. Thus, there is no interest component in the Service's deemed prepetition claim. ( We note that an interest component for the deemed claim does not exist for the passage of time post-petition because B.C. § 502(b)(2) disallows a claim for post-petition interest.)

(5) Given the above characterization of the debtor's income tax liability for Year 4 as a nondischargeable priority tax claim under B.C. § 523(A)(1)(A), if the Service is not fully paid for the Year 4 income tax liability, plus interest and penalties to the current date, then the Service could attempt to collect the debtor's nondischargeable tax liability, plus interest and penalties, administratively after the automatic stay terminates. See Bruning v. United States, 376 US 358 (1964); In re West Texas Marketing Corp., 54 F.3d 1194 (5<sup>th</sup> Cir. 1995); In re Fulmer, 962 F.2d 1463 (10<sup>th</sup> Cir. 1992); Burns v. United States, 887 F.2d 1541 (11<sup>th</sup> Cir. 1989); In re Hanna, 872 F.2d 829 (8<sup>th</sup> Cir. 1989).

(6) Under section 1305(a), the Service is given the option of filing a proof of claim for taxes that become payable while the case is pending. However, since the language is permissive, the Service is not required to file a post-petition claim. In re Klein, 20 BR 493 (Bankr. N.D. Ill. 1982). Furthermore, a Chapter 13 debtor cannot force a post-petition creditor to file a section 1305(a) claim, nor may the debtor file such a claim on behalf of a post-petition creditor. Matter of Epstein, 200 BR 611 (Bankr. S.D. Ohio 1996); In re Hudson, 158 BR 670 (Bankr. N.D. Ohio 1993); In re Hester, 63 BR 607 (Bankr. E.D. Tenn. 1986).

If a post-petition claim is filed by the Service, then section 1305(b) indicates that the claim will be allowed or disallowed under section 502 as if it were a prepetition claim. However, we understand that some bankruptcy courts treat post-petition claims filed under section 1305(a) as administrative claims. This position is not supported by the

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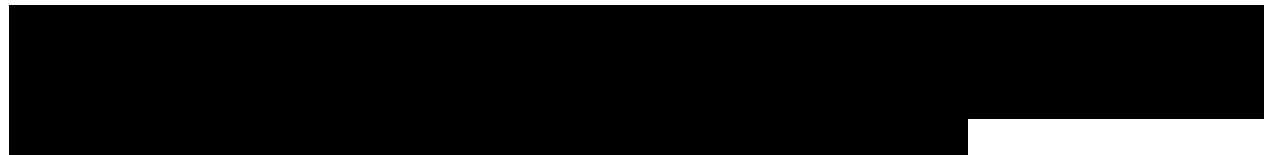
1/ Section 507(a)(8)(i) defines a priority tax claim as including an income tax for a taxable year ending on or before the last date of the filing of the petition for which a return, if required, is last due, including extension, after three years before the date of the filing of the petition.

2/ Section 523(a)(1)(A) defines a nondischargeable claim as including a tax of the kind and for the period specified in section 507(a)(8).

language of section 1305, and we note that the Justice Department is not willing to appeal any adverse order denying administrative status to post-petition taxes in Chapter 13 cases. See In re Gyulafia, 65 BR 913 (Bankr. D. Kan. 1986).

If a post-petition tax claim is filed under section 1305(a) and treated as a prepetition claim under section 1305(b), conversion of the case under section 348(d) will not change the treatment of the claim. Under section 348(d), a claim against the estate or the debtor that arises after the order for relief but before conversion, other than an administrative claim, will be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition. In other words, unless the post-petition tax claim is treated as an administrative claim under section 503(b), the claim will be treated as a prepetition claim upon conversion to Chapter 7. If the post-petition claim was allowed as an administrative claim under section 503(b), then it could be argued that it should be treated as an administrative expense in the Chapter 7 case. However, such claim would not take priority over administrative claims incurred in the Chapter 7 case. See 11 U.S.C. § 726(b).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:



If you have any further questions, please call (202) 622-3610.