When You Can and Cannot Wipe Out Taxes in Bankruptcy

by

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In Chapter 7 Liquidation Bankruptcy, the court erases your obligation to pay most or all debts. However, some debts are "non-dischargeable," which means you still have to pay them after filing for bankruptcy.

Income taxes can be discharged in a Chapter 7 bankruptcy, but only if you meet all five of the following tax code rules:

The 3-Year Rule: The tax return on which the tax debt arises must have been due at least three years before you file for bankruptcy. This usually means April 15 of the year the return was due. If an extension was filed, then it means August 15 or October 15 of that year.

You're Invited to Call or E-mail.

"If you have questions about bankruptcy, foreclosure, credit card debt, loan modifications,

tax liens or other financial problems, please send your e-mail today to

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The 2-Year Rule: You must have filed a tax return for the debt you want to discharge at least two years before filing for bankruptcy.

The 240-Day Rule: The taxes were assessed by the IRS at least 240 days before filing.

No Fraud or Willful Tax Evasion: You did not file a fraudulent tax return or willfully try to evade paying taxes.

Income Taxes Only: Taxes other than income taxes, such as payroll taxes, a 100% penalty, Trust Fund Recovery penalty, fraud penalties, or other unusual types of taxes cannot be discharged in bankruptcy.

Your Waiting Period May Be Longer

Even if you meet all five of the above rules, you must also consider other circumstances. For example, if you filed a prior bankruptcy, the 3-year, 2-year and 240-day rules are all delayed by the period in the prior bankruptcy, plus six more months. that has waiting time requirements, you must meet those requirements. If you filed an Offer in Compromise, you must extend the 240-day period by the time it is under consideration by the IRS, plus an added 30 days.

When You Cannot Discharge Federal Taxes

A Chapter 7 bankruptcy that discharges income taxes erases your personal obligation to pay the tax. But a tax lien remains on real property if it was recorded prior to your filing bankruptcy. In this case, after your bankruptcy, the IRS can seize any property you owned when your bankruptcy was filed. If you don't own any real estate or have a retirement account, then this won't likely hurt you.

Here's the good news: Tax liens survive bankruptcy only to the amount of your equity in the real estate. So if IRS recorded a tax lien of $50,000 and your equity in the property is only $10,000, then the value of the tax lien is reduced to $10,000.

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