

Obscure law allows discharge of taxes through bankruptcy

By EARL ZARBIN
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An airline pilot told Donald MacPherson about it a couple of years ago.

MacPherson, a Phoenix attorney specializing in tax law, checked it out and found it was true:

Under certain circumstances, federal and state income taxes can be discharged through bankruptcy.

Knowing this, he was surprised to read in an *Arizona Republic* story the following statement:

"Examples of debt that cannot be discharged under Chapter 7 (bankruptcy) are ... federal and state income taxes."

MacPherson sent a letter to *The Republic*, saying that was an error about which the writer "should feel no embarrassment."

He continued, "The truth of the matter is this: Most attorneys, when asked, will state that federal and state income taxes cannot be discharged. This would include bankruptcy attorneys. I was under the same impression until a client (an airline pilot) straightened me out."

Attorney Richard Lee of Storey & Ross, who heads the bankruptcy section of the State Bar of Arizona, agreed with MacPherson's assessment that most attorneys are unaware that income taxes can be discharged through bankruptcy.

Lee said he knows it can be done.

"I've done it," he said, "and the IRS was quite astonished to have me do it to them."

Oliver Robinson, public-affairs officer for the Phoenix district IRS office, agreed that federal taxes can be discharged through bankruptcy.

"Yes, under bankruptcy, taxes can be discharged," he said, but he cautioned there are rules that must be observed.

MacPherson was delighted to learn taxes were dischargeable. He sees the Internal Revenue Service as a bully and has published a book, *April 15th: The Most Pernicious Attack Upon English Liberty*, in which he "traces the history of the government's extraction of private information, under the guise of tax collection, from citizens under oath."

"What I like about this (the discharge of taxes in bankruptcy) is you ambush the IRS," Macpherson said. "You have to develop a strategy. It's like a chess game. You have to figure out what moves you can make."

The moves are legal rules that, if followed, can discharge the debtor from federal and state income taxes and related penalties and interest.

MacPherson said there are five general rules:

- An income-tax return must be filed.
- The return must be filed at least three years before the bankruptcy petition is filed.
- At least two years must pass before the bankruptcy petition is filed if the tax return is filed late. MacPherson said the three-year rule cannot be shortened to two years by filing a return one day late. He said the taxpayer must comply with both the three- and two-year rules.
- The taxpayer must wait 240 days from the date the taxes are assessed before filing for bankruptcy. MacPherson said the 240 days allows the IRS time to try to collect what is due.



Donald MacPherson
Sees dealing with the Internal Revenue Service as a chess game.



Kevin Rattay
Finds cases in which judges have discharged income taxes.



Patrick Sampair
"In some instances in tax cases, bankruptcy is the viable alternative."

• Fraud must not be involved. MacPherson gave this hypothetical example:

Taxpayer John Doe was involved in tax shelters for the years 1980-84. Doe filed tax returns each year no later than April 15. The tax shelters were fraudulent, but Doe was unaware of this, having relied upon the word of the promoters and the agreement of his attorney and accountant that everything

seemed in order.

In 1986, the IRS said Doe owed an additional \$100,000 for his use of "abusive tax shelters." Because Doe met the five general rules stated above, the \$100,000 was discharged through filing of a Chapter 7 bankruptcy.

MacPherson said his firm, MacPherson & McCarville, is currently involved in three tax cases in which Chapter 7 appears to be the answer to the taxpayers' problems. In Chapter 7, the assets of the debtor are converted to cash to pay off as much as possible of what is owed creditors.

Attorney Patrick Sampair, an associate of MacPherson, said income taxes could not be discharged through bankruptcy before 1966, when Congress changed the law.

"Congress could see that some taxpayers could never pay off their debts, and that's when the law was changed so they could bankruptcy out," Sampair said.

In changing the law, the U.S. House of Representatives stated:

"Frequently, (the non-dischargeability of taxes) prevents an honest but unfortunate debtor from making a fresh start unburdened by what may be an overwhelming liability for accumulated taxes."

In a 1979 case in New York, a bankruptcy judge wrote, "The legislative history indicates that the intent behind the enactment of the 1966 amendment was 'to provide relief for the financially unfortunate.'"

MacPherson said the 1966 law allowed the taxpayer who lost in court to file bankruptcy the next day. This was changed to 240 days in 1978, he said.

Kevin Rattay, another attorney working with MacPherson, said he has found at least 20 bankruptcy cases in which judges have discharged income taxes.

"We deal with a lot of people who are in tax trouble before they come to us," Rattay said. "At the end of the process, they owe more money than they can pay and they say, 'What can I do about it?'"

Sampair said, "In some instances in tax cases, bankruptcy is the viable alternative. The IRS is just another creditor."