[COMMITTEE PRINT]

TAX ASPECTS OF BANKRUPTCY: SUMMARY OF H.R. 9973

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS
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BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet has been prepared by the staff of the Joint Committee on Taxation for the use of the Ways and Means Committee for the public hearing on tax aspects of bankruptcy (H.R. 9973) scheduled for February 22, 1978.

The pamphlet provides background on proposed bankruptcy legislation, as well as a description of present law and the provisions of H.R. 9973. In addition, the pamphlet discusses various tax collection issues related to proposed bankruptcy legislation in H.R. 8200 (which was reported by the House Judiciary Committee and passed the House on February 1, 1978) and S. 2266 (currently under consideration by the Senate Judiciary Subcommittee on Improvements in Judicial Machinery).

I. BACKGROUND

H.R. 9973 provides Federal tax amendments to complement H.R. 8200, which passed the House of Representatives on February 1, 1978. H.R. 8200 would revise the Federal bankruptcy laws by codifying and enacting a new Title 11 of the United States Code.[1] In the course of considering revisions of the bankruptcy laws, the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee proposed a series of tax-related amendments to both the Internal Revenue Code and to the proposed new Title 11. The proposed amendments were designed to modernize the tax treatment of insolvency proceedings and bankruptcy cases, and to conform the tax rules to H.R. 8200. In order to reflect these tax proposals, H.R. 9973 was introduced on November 3, 1977, by Congressmen Edwards (of California), Butler, Seiberling, Drinan, Volkmer, Beilenson, and McClory of the Judiciary Committee and was referred to the Committee on Ways and Means.

H.R. 8200 is the outgrowth of the work of the Commission on the Bankruptcy Laws of the United States. The Commission was created in 1970 by Public Law 91–354. It was composed of nine members, including bankruptcy practitioners, academicians, District Court judges, two Congressmen (Edwards and Wiggins), and two Senators (Burdick and Cook). The Commission filed its report, along with bankruptcy and Federal income tax proposals, on July 30, 1973.[2]

Extensive hearings were held during 1975 and 1976 by the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee and by the Subcommittee on Improvements in Judicial Machinery of the Senate Judiciary Committee. These hearings covered the Bankruptcy Commission's proposals along with alternative proposals.

On October 31, 1977, Senators DeConcini and Wallop introduced S. 2266, which follows H.R. 8200 in several basic respects but differs from the House bill on other important provisions. The Senate bill is presently pending in the Subcommittee on Improvements in Judicial Machinery of the Senate Judiciary Committee.

Summary of H.R. 8200

The purpose of H.R. 8200 is to modernize Federal bankruptcy laws, which were originally enacted in 1898 and last overhauled in 1938. The bill is designed to make bankruptcy a more effective remedy for consumer debtors in view of the sharp rise in consumer credit since 1938. The bill also seeks to update bankruptcy law in light of the Uniform Commercial Code. It attempts to give greater protection to both

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[1] H.R. 8200 was reported by the House Committee on the Judiciary on September 8, 1977. H. Rept. 95–595, 95th Cong., 1st Sess. (1977).

[2] *Report of the Commission on the Bankruptcy Laws of the United States* (July 1973); H. Doc. No. 93–137, 93rd Cong., 1st Sess. (September 6, 1973).

debtors and creditors, to combine into a single chapter the multiple chapters now used for business reorganizations, and generally to make business reorganizations a quicker, more efficient procedure. H.R. 8200 provides rules for liquidations of a debtor's assets (proposed chapter 7 of Title 11) and for reorganizations of both individuals and corporations (proposed chapter 11 of Title 11). (In the case of an individual, reorganization broadly covers a compromise with creditors which permits the debtor to remain in business.) Rules are also provided in a new chapter 13 for so-called wage-earner plans.

A significant feature of H.R. 8200 is the creation of a new constitutional Bankruptcy Court with its own Federal judges who would be independent of the United States District Courts.

II. SUMMARY OF H.R. 9973

Title I of H.R. 9973 contains twenty sections making substantive amendments to the Internal Revenue Code. Title II contains clerical, technical and conforming amendments. Title III contains a series of special tax rules which would become part of Title 11 of the U.S. Code (Bankruptcy) rather than part of Title 26—the Internal Revenue Code. These special tax rules would deal with income tax and return filing requirements of individuals, partnerships or corporations involved in a bankruptcy proceeding.

The substantive amendments to the Internal Revenue Code contained in H.R. 9973 cover five basic subjects: cancellation of indebtedness, reorganizations of insolvent corporations, miscellaneous corporate tax amendments, recapture rules, and administrative provisions.

In general, the amendments made by the bill would apply to bankruptcy cases commenced on or after October 1, 1978.

A more detailed description of the bill follows.

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III. DETAILED DESCRIPTION OF H.R. 9973

A. Cancellation of Indebtedness

The bill revises the tax rules for discharges of debt in a bankruptcy case. In order not to create an inducement to formal bankruptcy, the bill also adopts rules for cancellation of debts generally.

Present law

Under present tax law, a taxpayer must recognize income when one or more of his debts is forgiven or in other ways canceled (sec. 61(a)(12)). A variety of important exceptions exist under present law, however. For example, a taxpayer who would otherwise have to report current income from cancellation of debt may also elect instead to reduce the basis of his assets (secs. 108 and 1017). In effect, this election defers the tax until the taxpayer disposes of the assets.

In a bankruptcy case, the general rule is the opposite of that in the tax code. The Bankruptcy Act specifically provides that no current income arises from a discharge of debt in formal bankruptcy, but the debtor must reduce the basis of his assets. The debtor's basis may not, however, be reduced below the fair market value of the assets. Any amount of canceled debt protected by this floor is not subject to tax. In addition, a corporation which transfers its assets to another corporation in bankruptcy is exempted from any basis reduction by reason of its discharged debts.

Discharge of debts in bankruptcy cases (sec. 301 of the bill)

The bill continues the present Bankruptcy Act rule that no income is realized when indebtedness is discharged in an insolvency proceeding (sec. 346(j)(1) of proposed Title 11). The bill changes present law by requiring that a discharged debt must in all cases be applied to reduce the debtor's tax attributes in the following order:

(1) expenses deducted in the taxable year in which the discharge occurs and which are attributable to a forgiven liability;

(2) net operating loss carryovers; and

(3) the basis of the debtor's assets (unless he elects instead to report part or all of the balance of the discharged debt as current income).

Reductions in loss carryovers and in the basis of assets would not have to be made under these rules if the debtor can show that a discharged liability involved an expense which gave rise to no tax benefit, that is, he did not deduct the expense or his previous deduction ultimately led to a loss carryover that expired unused. The basis of a debtor's assets would also not have to be reduced below an amount of basis equal to his remaining (i.e., undischarged) liabilities.

The bill excepts from transactions which give rise to income from cancellation of debt exchanges where a corporate debtor issues stock to one or more of its creditors for an outstanding bond or other debt. This exception would not apply to a limited partnership which issues a limited partnership interest to one or more of its creditors. Also, where a corporation previously deducted (but did not pay) an expense item, this exception would apply only to the extent that the fair market value of the stock is includible in the recipient's income.[3]

Cancellation of debts outside bankruptcy (sec. 102 of the bill)

Under present tax law, as indicated earlier, income from canceled debt is currently taxable unless the taxpayer elects to reduce the basis of his assets (secs. 108 and 1017 of the Code). H.R. 9973 retains this rule for taxpayers outside bankruptcy, but makes several modifications. A taxpayer could choose to report current income or to reduce basis as to any portion of the canceled debt he selects. Before reporting income or reducing basis, however, the taxpayer would have to reduce (1) current year deductions and (2) unused loss carryovers by the amount of total canceled debt under rules similar to those described earlier for bankruptcy cases. If any amount of canceled debt remains, the taxpayer could then choose between reporting it as current income or as reducing the basis of his assets. If an election to reduce basis is made, a solvent individual would be required to reduce the basis only of business assets or of assets for which the debt was incurred.

If the taxpayer was insolvent immediately before a cancellation of one or more of his debts, his asset basis would not have to be reduced below the same floor that applies in bankruptcy proceedings (that is, below an amount equal to his remaining liabilities). If the taxpayer was solvent before cancellation, however, the basis of his assets could be reduced to zero. An individual or corporation would be considered "insolvent" if the fair market value of all its assets was not sufficient to pay its total liabilities.

The above rules would apply to individuals, partnerships and corporations.

Partnerships (secs. 102 and 113 of the bill)

The bill applies the rules described above, both in and outside bankruptcy, to partnerships, including the reduction of basis (except that a partnership does not have loss carryovers to reduce).

Section 113 of the bill contains additional rules for taxing a partner when a partnership debt is discharged in a bankruptcy proceeding. The bill adopts special rules designed to limit the taxation of a partner where both the partner and the partnership are insolvent.

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[3] For example, assume that a corporate employer accrues and deducts (but does not actually pay) a $1,000 liability for employee salaries. In a later year the company issues stock worth $600 to the same employees as payment for their salaries. Under present law, an employee would have compensation income only for the value of the stock. Thus, the employees will have taken only $600 into their income while the employer will have obtained a $1,000 deduction. Under the bill, the employer would realize $400 in cancellation of debt income.

Similarly, if a corporate debtor had previously accrued and deducted a $1,000 liability in unpaid interest on outstanding bonds, and later issues stock to the bondholders as payment of the accrued interest, the bill would cause the company to realize $1,000 in income. Under present law, unlike the treatment of salary income, the value of stock received by the creditors for accrued interest is not currently taxable to them. *Carman* v. *Commissioner*, 13 T.C. 1029 (1949), aff'd on this issue, 189 F.2d 363 (2d Cir. 1951).

B. Corporate Reorganizations

General rules (sec. 109 of the bill)

The basic purpose of the bill in this area is to bring insolvency reorganizations into conformity with other corporate reorganizations at both the corporate and shareholder levels.

The bill combines in one Code provision (sec. 371) rules for all insolvency reorganizations involving a transfer of assets to another corporation. Railroads would also be covered under this section, so that a railroad could be acquired tax-free by a nonrailroad corporation. The bill continues the rule of present law that no gain or loss is recognized by either the debtor company, or by its security holders and shareholders, if the debtor's assets are transferred to another company under a plan of reorganization in bankruptcy, in exchange for stock or securities of the acquiring company. The bill also permits a debtor company to be acquired through various "triangular" formats now permitted for reorganizations generally. The bill also changes present law by providing for a possible reduction of a debtor company's asset basis by reason of a discharge of debts in an insolvency reorganization.

Effects on creditors and shareholders (secs. 107 and 108 of the bill)

H.R. 9973 continues present law in imposing nonrecognition of gain or loss in a bankruptcy reorganization where creditors acquire stock control of the debtor company. The bill adopts in Title 11 regorganizations, however, the rules of present law for taxing excess securities as "boot" and for taxing the boot at dividend rates if it is distributed as such to continuing shareholders of the reorganized company. On the other hand, the bill permits a so-called "triangular" reorganization under Title 11, so that the creditors may receive (without recognizing gain or loss) stock or new debt securities in a corporation which after the transaction will be the parent of the former debtor company.

For bankruptcy cases alone, the bill changes the excess security rule of present law (sec. 354(a)(2)). Under present law, outside bankruptcy, a security holder must recognize gain to the extent that he surrenders a debt security and receives a new bond or other security having a higher principal (or face) amount. In most cases, any such gain will be taxable as capital gain. For the first time, H.R. 9973 would apply an excess securities rule in bankruptcy, but in these cases the bill would compare the fair market values (rather than principal amounts) of the old and new bonds. The fact that the new security carries a larger principal amount would thus not necessarily result in a current tax to the creditor.

The bill would, however, require that a new bond received for accrued unpaid interest on an existing bond would be currently taxable to the recipient at capital gain rates (if he otherwise realized a gain on his exchange overall). New stock received for accrued interest, however, would continue, as under present law, not to be taxed at the time of the exchange.

Carryovers of the debtor company's tax attributes (secs. 110 and 111 of the bill)

Section 110 of the bill provides that net operating loss carryovers and other tax attributes available generally on a reorganization would also be available in a bankruptcy reorganization. This amendment would clarify some uncertainty under present law concerning the availability of these carryovers in an insolvency reorganization.

H.R. 9973 also incorporates the limitations on net operating loss carryovers and other carryovers in sections 382 and 383 of present law. As a result of these amendments, an acquisition of stock control of an insolvent company by its creditors will not result in loss of the company's tax attributes, but some of the attributes, such as net operating loss carryovers, would be subject to reduction or elimination by reason of the limitations in sections 382 and 383 that govern noninsolvency reorganizations generally.

Divisions of the debtor's assets.—Section 110 of the bill changes present law by authorizing the apportionment of net operating loss carryovers and other tax attributes where a debtor company's business assets are divided among two or more corporations. Present law does not permit an apportionment of this kind, except for earnings and profits (sec. 312(h)). The bill delegates authority to the Treasury to provide rules for apportioning other tax attributes where no one corporation emerges from the proceeding owning substantially all of the debtor's assets. This amendment would apply only in bankruptcy or similar receivership cases.

C. Miscellaneous Corporate Tax Amendments (secs. 103, 104, 105, 106, and 112 of the bill)

Certain railroad redemptions.—Section 103 of the bill repeals a special rule in the Code providing capital gain or loss treatment on a redemption of stock by a railroad in an insolvency proceeding (sec. 302(b)(4)).

Earnings and profits.—Section 104 of the bill amends section 312 of the Code, relating to increases and decreases in a corporation's earnings and profits account, in order to prevent the carryover of a deficit in earnings and profits to the extent the deficit reflects the investment of shareholders whose interests have been eliminated in a Title 11 proceeding.

One year liquidations.—Section 105 of the bill amends the nonrecognition provison of the Code for corporate sales of assets during a 12-month liquidation (sec. 337) to make that section apply to asset sales which are part of an insolvency liquidation. This amendment overrides the present Service position and permits nonrecognition of gain (or loss) where a company in a bankruptcy proceeding sells assets and then liquidates within the following 12 months.

Transfers to controlled corporation.—Section 106 of the bill provides that creditors of an individual or partnership may acquire control over the debtor's assets in a bankruptcy receivership through a controlled corporation without recognizing gain or loss. In such a case, under section 351 of the Code, the creditors would not recognize gain or loss;

the corporation's basis in the assets would be the same as the debtor's basis in those assets; and the creditors' basis in their stock would be the same as their basis in the claims they formerly held. This rule would be subject, however, to reductions of basis under the cancellation of indebtedness rules discussed previously.

Personal holding company rules.—Section 112 of the bill exempts a corporation in a bankruptcy case from being considered a personal holding company. This status could otherwise arise where, for example, a company in bankruptcy ceases its active operating business so that its only remaining income comes from interest, dividends or other passive income sources.

D. Investment Credit Recapture (Secs. 101, 114, 115 and 116 of the Bill)

In addition to the above amendments, H.R. 9973 amends provisions of the Internal Revenue Code dealing with the potential recapture of tax benefits on transfers of assets from a debtor to his estate and from the estate back to the debtor. The bill amends the investment credit rules of the Code (sec. 47) to prevent recapture of investment credits on such transfers.[4] The bill provides similar exemptions from recapture under the depreciation and farm loss recapture rules of the Code (secs. 1245, 1250, and 1251).

E. Administrative Amendments

"Quickie" refunds (sec. 117 of the bill)

Section 117 of H.R. 9973 would change present law by allowing the Internal Revenue Service discretion to withhold immediate payment of "quickie" refund claims (under sec. 6411 of the Code)r and to follow normal refund claim review procedures, if the taxpaye, is involved in a bankruptcy proceeding.

Refund claims in bankruptcy court (sec. 118 of the bill)

Under present law, the bankruptcy court does not have jurisdiction to order payment of tax refunds acquired by a trustee in bankruptcy from the debtor. H.R. 8200 confers expanded jurisdiction on the bankruptcy court to include tax refund claims brought by the trustee for the estate of the debtor. Section 118 of H.R. 9973 would permit a taxpayer's trustee in bankruptcy, without first filing a claim for refund with the Service, to bring a refund suit in the bankruptcy court even if the debtor had previously initiated proceedings in the Tax Court relating to an asserted tax deficiency for that year.

Tax Court jurisdiction (secs. 119–120 of the bill)

Under present law, the Service is required to assess tax liabilities against the debtor involved in a bankruptcy proceeding without following normal deficiency notice procedures (sec. 6871). As a result, the debtor cannot then petition the Tax Court to review the case before he must pay the asserted tax. Section 119 of H.R. 9973 changes present law in these situations by requiring that normal deficiency

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[4] The bill also corrects an oversight in earlier legislation relating to the Consolidated Rail Corporation (P.L. 94–253 (1976)) by exempting the transfer of assets of bankrupt railroads to ConRail from investment credit recapture.

notice procedures be followed and, if a debtor receives a deficiency notice and files a petition in the Tax Court, this case may continue despite the pending bankruptcy action. The trustee in bankruptcy would also be permitted to intervene in the Tax Court.

Section 120 of the bill deletes the provision of present law which permits the Service to dispense with usual deficiency procedures and to demand payment from a debtor after bankruptcy of a nondischargeable tax claim allowed in the proceeding.

F. Tax Liabilities Arising During Bankruptcy Proceedings

The following tax amendments would appear in the bankruptcy statute in proposed Title 11 of the U.S. Code rather than in the Internal Revenue Code.

Tax-liability and return-filing rules (sec. 301 of the bill)

Section 301 of the bill adds certain Federal (as well as State and local) income tax rules and return-filing requirements for taxpayers who file petitions in bankruptcy. These rules would apply both to businesses which liquidate as a result of the proceeding and to businesses which reorganize and continue operations.

Section 346(b) of proposed new Title 11 of the U.S. Code (Bankruptcy) provides that a separate taxable entity in the form of an estate in bankruptcy is created when an individual debtor files a petition in bankruptcy.

Section 346(c) provides that no separate taxable entity is created when a partnership or a corporation files in bankruptcy. The trustee would file all tax returns of the partnership or corporation which are required during the proceedings. This amendment would change the present Service position that a separate taxable estate arises in the case of a bankrupt partnership.

Section 346(d) provides that no separate taxable entity is created in the case of an individual debtor under a wage-earner plan. (These cases are generally of short duration and the trustee has only a limited role in administering the debtor's affairs and may not operate any business of the debtor.)

Section 346(e) treats administrative expenses of an estate as business expenses.

Section 346(f) requires the trustee to comply with any Federal, State, or local tax law requiring withholding or collection of taxes from any payment of wages, salaries, commissions, dividends, interest, or other payments.

Section 346(g) provides generally that gain or loss is not recognized on the technical transfer of a debtor's asset to his estate in bankruptcy. Similarly, the estate would not recognize gain or loss when it returns assets to the debtor at the close of the proceeding.

Section 346(h) provides that the creation of the estate of an individual as a separate taxable entity does not affect the number of taxable years for purposes of computing loss carryovers or carrybacks.

Section 346(i) permits an individual bankrupt's estate to succeed to certain pre-petition tax attributes of the debtor (such as investment credit and net operating loss carryovers). After the case is closed or dismissed, the debtor would also succeed to any tax attributes to which the estate succeeded but which were not used by the estate. This section also provides that an individual bankrupt's estate may carry back any losses of the estate and use such losses against the debtor's pre-petition income, but during the proceedings the debtor may not carry back any post-petition losses of his own to a pre-petition taxable year.

Section 346(j) deals with the tax effect of a cancellation of debts in bankruptcy, and has been discussed earlier in connection with cancellation of indebtedness generally.

Special rules for liquidations (sec. 302 of the bill)

Section 302 of the bill contains proposed rules for liquidation proceedings in bankruptcy.

Proposed section 728(a) terminates the taxable year of an individual debtor on the date on which the estate first becomes a separate taxable entity.

Section 728(b) requires the trustee of an individual or corporation to file a tax return in a liquidating proceeding only if the estate or corporation has net taxable income for the entire period during which the case is pending in the bankruptcy court. The trustee of a partnership would be required to file returns annually, however, because of the pass-through of income and losses to the partners.

Sections 728(c) and (d) provide special marshalling rules that apply if both a partner and a partnership are in liquidation proceedings.

Special rules for reorganizations (sec. 303 of the bill)

Section 303 of the bill contains proposed special tax rules for reorganization proceedings in bankruptcy.

Section 1146 of proposed Title 11 would provide that a trustee must make a return of income for the estate of an individual debtor for each taxable period during which the case is pending. Unlike liquidation proceedings, the trustee of a reorganizing individual debtor (or a corporate debtor) must file annual returns.

Section 1146(d) permits the bankruptcy court to authorize a debtor seeking a plan of reorganization to request an advance ruling from the Service on the tax effects of the plan. In the event of a controversy, the bankruptcy court may declare the Federal income tax effects of the plan at any time after the Service responds to the ruling request or after 270 days following the request. The bankruptcy court's determination could be appealed but otherwise would bind the Service.

In order to protect the Government's interest with regard to taxes becoming due during the pendency of a bankruptcy case, and to prior taxes which were not adequately determined during this period, section 1146(e) permits the Service to assess these taxes and collect them from the debtor or his successor. In these cases, the assessment must be made within one year after the bankruptcy petition was filed, but normal deficiency notice procedures must be first followed. Section 304 of the bill contains a similar assessment rule for certain individual wage-earner plans.

G. Technical and Conforming Amendments (Secs. 201–216 of the Bill)

Sections 201 through 216 of the bill provide amendments to the Internal Revenue Code of 1954 to conform the Code to the new tax rules and tax changes contained in H.R. 8200.

IV. TAX COLLECTION ISSUES

A. Priority and Discharge of Tax Claims

In general

In general, secured claims are paid before other creditors' claims are paid out of a debtor's assets in bankruptcy.

The payment of unsecured claims ordinarily occurs under a prescribed order of "priority" among the various creditors. Claims of the first priority are paid in their entirety before claims of the second priority are paid, and so on. All priority claims are paid before the claims of general (nonpriority) unsecured creditors are paid.

In some cases a claim may continue to be a liability of the debtor even after bankruptcy. The bankruptcy statute contains rules determining which creditors' claims are "dischargeable" and which are "nondischargeable."

Present law

Under present bankruptcy law, in the case of a liquidation, most Federal taxes for which the returns were due within three years before bankruptcy (or which are still open and unassessed under an extension of the statute of limitations), receive fourth priority among unsecured creditors. To the extent these taxes are not paid in the proceeding itself, they become nondischargeable liabilities of the debtor after bankruptcy. This priority treatment does not extend to other tax liabilities, even if they have already been assessed, which the Service has not collected before a bankruptcy petition is filed (unless the Service had filed a notice of lien against the taxpayer's assets and thereby become a secured creditor).[5]

The above rules also apply to State and local tax liabilities.

H.R. 8200

H.R. 8200 generally limits the present priority for pre-petition Federal tax claims, and also adds two new priorities ahead of the existing priority for tax claims. Higher priorities are given to (1) administrative expenses, (2) unsecured claims arising during bankruptcy in the ordinary course of the debtor's affairs, (3) certain wages and commissions, (4) certain employee benefit plan contributions, and (5) consumer credit (lay-away) deposits. The last two items are not contained in present law.

Generally, H.R. 8200 retains present law as to the priority for income taxes. However, the time periods for employment and excise taxes are reduced to two and one years, respectively. While present law gives nondischargeability and priority to all past due withholding taxes (including social security and wage withholding), H.R. 8200

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[5] In 1966, changes affecting the priority and dischargeability of tax claims under the Bankruptcy Act were considered by the Committee on Finance in the Senate but were not considered by the Committee on Ways and Means in the House.

limits the priority for these taxes to those for which the due date of the tax return was within two years before the case was filed in bankruptcy.

Under present law, in a bankruptcy reorganization, all tax claims must be paid in full. (This differs from the above rules for liquidations.) H.R. 8200 would require payment only of the same taxes which would receive priority in a liquidation proceeding.

S. 2266

S. 2266, referred to earlier, gives a fifth priority for Federal, State and local taxes and would apply to all taxes (except withholding taxes) which have been assessed within two years before a petition is filed in bankruptcy. S. 2266 follows present law in giving withholding (trust fund) taxes unlimited priority and nondischargeability, regardless of age.

B. Payment in Kind

H.R. 8200 also changes present law as to the payment of tax liabilities with property in kind. Under present Bankruptcy Act provisions, Federal taxes must generally be paid in full and in cash. H.R. 8200 authorizes tax claims to be paid in property in kind (other than stock or securities of the debtor itself) in reorganization cases (sec. 1129(a)(9)). S. 2266 requires payment of tax claims in such cases in cash only.

C. Exemptions

Present bankruptcy law exempts certain assets of the debtor from collection by his creditors in bankruptcy. These exemptions are those provided under the law of the State of the debtor's domicile. As an exception to the general rule, tax claims (even those which are dischargeable in bankruptcy) can be collected from these exempt assets. However, tax claims in bankruptcy cannot be collected from assets which are exempted from levy by the Internal Revenue Code (sec. 6334). (These Code amendments are generally less generous than State exemptions.)

H.R. 8200 provides new, specific bankruptcy exemptions which a debtor may elect in lieu of State exemptions. These bankruptcy exemptions would be substantially more generous than the Internal Revenue Code exemptions. H.R. 8200 also provides that dischargeable tax claims could no longer be collected from assets exempted under the bankruptcy rules, unless a notice of lien was filed.

S. 2266 retains present law on these issues.

D. Other Tax-Related Provisions

In other provisions, H.R. 8200 permits bankruptcy judges to subordinate payment of tax claims on equitable grounds until other general unsecured claims have been paid. The bill also requires that tax payments in satisfaction of a tax lien on real property are to be postponed until nontax priority claims are paid. Under present law and S. 2266, this postponement of tax liens is confined to tax liens on personal property.

H.R. 8200 contains a number of other tax rules, such as those which determine whether employment taxes, withholding taxes, tax penalties, or interest on tax liabilities incurred or paid after the bankruptcy petition is filed constitute administrative expenses (entitled to the first priority) or are claims entitled to lesser priority. Many of these rules represent changes in present law and differ from the applicable rules in S. 2266.

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