

Tax Talk: Filing Income Tax Returns
by Chad C. Coombs*

One of the first and most basic tax issues a receiver must address when taking on a new case is whether the receiver must file income tax returns and, if so, what kind of returns. And critically, a receiver who must file federal income tax returns must pay any tax liability reported on those returns and may be held personally liable for failing to pay any federal tax claims to the extent the receiver had funds available.ⁱⁱ

For receiverships involving business entities, a receiver need not be appointed as receiver for the entity itself to be required to file income tax returns for that entity. The Internal Revenue Code (IRC) requires a receiver of assets of a corporation to file the income tax returns for the corporation if the receiver takes possession of all or substantially all of the property or business of the corporation,ⁱⁱⁱ and the Internal Revenue Service essentially takes the same position for a receiver in possession of all or substantially all of a partnership's assets.^{iv} Therefore, the receiver in such cases may need to conduct due diligence on the entity's assets or business to determine whether the receiver has a filing requirement.

Where a receiver is appointed over the financial affairs of an individual, the test is slightly different. The IRC requires a receiver for an individual to file the returns of the individual unless the receiver is in possession of only a part of the individual's assets.^v

Separately, 28 U.S.C. Section 960 provides that a federal court appointed receiver who operates a business is required to file all applicable federal, state and local returns and pay all applicable taxes. This applies even if the business will be liquidated.

A receiver is required to prepare income tax returns in the same manner and form as the entity or owner of the property would have had to file the returns. However, if the receivership is a qualified settlement fund (QSF) for income tax purposes,^{vi} the assets of the receivership are deemed transferred to the QSF. The QSF is a new and separate tax entity for which the receiver files tax returns, and the receiver may have to file returns for both the QSF and the entity or owner of the property in receivership.

When filing income tax returns, a receiver cannot simply rely on what was done previously. For example, a receiver of an entity which has filed S corporation returns could discover that the entity is not a valid S corporation.^{vii} Or a receiver of real property in which the owners are tenants-in-common and have treated themselves as such for income tax purposes could find that the IRS may require that partnership returns be filed.^{viii} The receiver may need to break some bad news to the parties in interest and take appropriate action.

Another problem receivers sometimes face is a lack of adequate books or records, especially in cases involving fraud, and a receiver may have to reconstruct the books and conduct substantial forensic accounting. No matter the state of the records, it is critical that receivers disclose on the income tax returns that the receiver does not have personal knowledge of the records of the business or individual and therefore cannot provide assurance as to their accuracy.

Additional and inescapable issues arise when prior year income tax returns have not been filed. In these situations, bankruptcy cases provide some guidance. For corporate debtors, courts

have held that a bankruptcy trustee's obligation to file the corporate debtor's income tax returns include returns due prior to the bankruptcy filing,^{ix} and it is reasonable to conclude that receivers have a similar responsibility.

For partnerships, however, the IRS has taken the position that a bankruptcy trustee is not obligated to file the prior year returns (and, in filing current year returns, may rely on the current year information to the extent possible).^x In fact, one court held that a Chapter 7 trustee for a debtor partnership only has a duty to file returns for the period during the trustee's appointment and therefore denied any fees related to investigation of a debtor's prepetition activities.^{xi}

Nevertheless, in most instances a receiver will need to prepare prior year returns if only to be capable of filing meaningful current year returns. Given the uncertainty in this area, the receiver would be wise to seek instruction from the appointing court regarding the receiver's tax filing obligations.

Another issue receivers sometimes face is whether to amend prior year returns. The IRC does not address the amendment of returns, but the tax regulations provide guidance on when a taxpayer should (but not must) amend a return.^{xii} Amending a return can raise a host of issues to be addressed on a case-by-case basis. In some cases, a receiver may wish to amend a prior year return to claim a refund (if timely).

In all, given the importance of tax return filing requirements, a receiver should seek guidance from a tax professional early in the case so the receiver may ascertain the proper filing requirements and obtain the necessary information to file any required returns without unnecessary delay.

- i I.R.C. Section 6151(a). See also 28 U.S.C. Section 960.
- ii See Coombs, Tax Closure, Receivership News, Issue 76 at p. 22 (Winter 2022).
- iii I.R.C. Section 6012(b)(3). See also Treas. Reg. Section 1.6012-3(b)(4).
- iv See IRS Gen. Counsel Mem. 36811 (1976) and IRS Gen. Counsel Memo 38781 (1981).
- v I.R.C. Section 6012(b)(2). See also Treas. Reg. Section 1.6012-3(b)(5).
- vi See Coombs, Qualified Settlement Funds, Receivership News, Issue 75 at p. 30 (Summer 2022).
- vii See I.R.C. Section 1361.
- viii See IRS Rev. Proc. 2002-22 regarding advance rulings.
- ix I.R.C. Section 6012(b)(3); *In re Hudson Oil, Inc.*, 91 B.R. 932, 946 (Bankr. D. Kan. 1988); *In re JD Tool, Inc.* 2013 Bankr. Lexis 184 (Bankr. W.D. Mo. 2013).
- x Private Letter Ruling 8535015.
- xi *In re Riverside-Linden investment Co.*, 85 B.R. 107, 114 (Bankr. S.D. Ca. 1988), *aff'd* 99 B.R. 439, 445-46 (9th Cir. BAP 1989), *aff'd* 925 F.2d 320, 324-25 (9th Cir. 1991).
- xii See Treas. Reg. Sections 1.451-1(a) and 1.461-1(a)(3).

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