



U.S. Department of Justice

Office of the United States Trustee

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**CERTIFICATION OF RECEIPT AND UNDERSTANDING OF NOTICE -**

**INDIVIDUAL CHAPTER 11 DEBTOR IRS FILING AND REPORTING  
REQUIREMENTS UNDER SECTION 1115 OF THE BANKRUPTCY CODE**

**NOTICE**

The attached Internal Revenue Bulletin 2006-40 (Notice 2006-83) applies to the newly created section 1115 of the Bankruptcy Code, as enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Section 1115 is effective for cases filed on or after October 17, 2005.

Section 1115 provides that, for individual chapter 11 debtors, property of the estate includes property acquired after filing, but before closure, dismissal, or conversion. It also provides that property of the estate includes earnings from services performed after filing, but before closure, dismissal, or conversion.

The Internal Revenue Service (IRS) notice, which is effective immediately, establishes policies and procedures related to the fact that such property and services are subject to taxation as part of the individual chapter 11 estate.

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I hereby certify that I have read and understand the foregoing Notice - Individual Chapter 11 Debtor IRS Filing and Reporting Requirements under Section 1115 of the Bankruptcy Code..

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(Date)

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(Debtor)

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(Title)

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(Print Name of Signatory)



## Internal Revenue Bulletin: 2006-40

October 2, 2006

### Notice 2006-83

#### Individual Chapter 11 Debtors

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This notice provides guidance for individuals who file bankruptcy cases under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 1101 *et seq.*) on or after October 17, 2005. This notice also provides guidance for (1) employers of these individuals, (2) persons filing Forms W-2, 1099-INT, 1099-DIV, 1099-MISC, and other information returns (including Schedule K-1) that report payments to these individuals, and (3) Chapter 11 trustees in bankruptcy cases filed by these individuals. Upon consideration of the comments received concerning this notice, as requested in section 7, additional guidance may be published.

#### Section 1. PURPOSE

The bankruptcy estate of a Chapter 11 debtor who is an individual is a separate taxable entity under section 1398 of the Internal Revenue Code. The estate, rather than the debtor, must include in its gross income all of the debtor's income to which the estate is entitled under the Bankruptcy Code, except for amounts received or accrued by the debtor before the commencement of the case. Section 1115 of the Bankruptcy Code was enacted by section 321(a)(1) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005) and is effective for cases filed on or after October 17, 2005. As a result of the enactment of section 1115, the bankruptcy estate, rather than the debtor, must include in its gross income both (1) the debtor's gross earnings from his or her performance of services after the commencement of the case ("post-petition services") and (2) the gross income from property acquired by the debtor after the commencement of the case ("post-petition property"). I.R.C. § 1398(e)(1). The gross earnings from post-petition services include wages and other compensation earned by a debtor who is an employee and self-employment income earned by a debtor who is a self-employed individual.

#### Section 2. BACKGROUND AND GENERAL LEGAL PRINCIPLES

.01 The commencement of a bankruptcy case creates an estate, which generally includes all legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541(a)(1). Specific exclusions apply, however. See 11 U.S.C. § 541(b) (excluded property). See also 11 U.S.C. § 522 (exempt property); 11 U.S.C. § 554 (abandoned property). Exempt property and abandoned property are initially part of the bankruptcy estate, but are subsequently removed from the estate. By contrast, property excluded from the estate is never included in the estate.

.02 Confirmation of a Chapter 11 plan of reorganization generally vests all the property of the estate in the debtor, except as otherwise provided in the plan or in the court order confirming the plan. 11 U.S.C. § 1141(b). If no plan is confirmed and a bankruptcy case is dismissed, the property of the estate generally reverts in the debtor, unless the court orders otherwise. 11 U.S.C. § 349(b)(3).

.03 When a trustee is appointed pursuant to section 1104 of the Bankruptcy Code, the debtor generally must turn over to the trustee control over the assets of the bankruptcy estate. In most Chapter 11 cases, a trustee is not appointed and the debtor (referred to as the debtor in possession) remains in control of the property of the bankruptcy estate. Under section 1107(a) of the Bankruptcy Code, the debtor in possession must perform all the functions and duties of a trustee, except for the duties specified in Bankruptcy Code section 1106(a)(2), (3) and (4).

.04 Because the bankruptcy estate is a separate taxable entity, the trustee or debtor in possession must obtain an employer identification number (EIN) for the estate. I.R.C. § 6109. The trustee or debtor in possession uses the EIN on any tax returns filed for the estate.

.05 Section 1398(e)(1) of the Code provides that the gross income of the estate includes the gross income of the debtor to which the estate is entitled under the Bankruptcy Code. Section 1398(e)(2) provides that the gross income of the debtor does not include any item to the extent the item is included in the gross income of the bankruptcy estate.

.06 In general, the determination of whether or not any amount paid or incurred by the estate is allowable as a deduction or credit to the estate shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case. I.R.C. § 1398(e)(3)(A). The estate is, however, specifically

allowed a deduction for administrative expenses allowed under section 503 of the Bankruptcy Code and for any fee or charge assessed against the estate under chapter 123 of title 28 of the United States Code. I.R.C. § 1398(h)(1).

.07 The individual debtor must continue to file his or her own individual tax returns during the bankruptcy proceedings. I.R.C. § 6012(a)(1).

.08 For bankruptcy cases filed *before* October 17, 2005, the property of the estate does not generally include any post-petition property acquired by an individual Chapter 11 debtor. Nor in those cases does the property of the estate include the individual Chapter 11 debtor's earnings from post-petition services, because section 541(a)(6) of the Bankruptcy Code specifically excluded those earnings from the estate. *See, e.g., In re Fitzsimmons*, 725 F.2d 1208 (9<sup>th</sup> Cir. 1984); *In re Larson*, 147 B.R. 39 (Bankr. D.N.D. 1992). Therefore, in these cases income from post-petition property and earnings from post-petition services are not generally includible in the estate's gross income. Instead, such income and earnings are generally includible in the debtor's gross income.

.09 Section 321 of BAPCPA made several changes to Chapter 11, effective for bankruptcy cases filed by individuals *on or after* October 17, 2005. Although many of the provisions that apply to individual Chapter 11 cases now operate in a manner similar to the provisions that apply in Chapter 13 cases, section 1398 of the Internal Revenue Code has not been amended and continues to apply to individual Chapter 11 cases, but not to Chapter 13 cases. Based on section 1115 of the Bankruptcy Code, read in conjunction with section 1398(e)(1) of the Internal Revenue Code, the debtor's gross earnings from post-petition services and gross income from post-petition property are, in general, includible in the bankruptcy estate's gross income, rather than in the debtor's gross income. This rule is subject to the exceptions noted below in sections 2.10, 2.11, 2.12, and 2.13.

.10 If a chapter 11 case is converted to a Chapter 13 case, the Chapter 13 estate is not a separate taxable entity and earnings from post-conversion services and income from property of the estate realized after the conversion to Chapter 13 are taxed to the debtor. I.R.C. § 1399.

.11 If the Chapter 11 case is converted to a Chapter 7 case, section 1115 will not apply after conversion and earnings from post-conversion services will be taxed to the debtor, rather than the estate. 11 U.S.C. § 541(a)(6). In such a case, the property of the Chapter 11 estate will become property of the Chapter 7 estate. Any income on this property will be taxed to the estate even if the income is realized after the conversion to Chapter 7.

.12 If a Chapter 11 case is dismissed, the debtor is treated as if the bankruptcy case had never been filed and as if no bankruptcy estate had been created. I.R.C. § 1398(b)(1).

.13 For Chapter 11 cases filed by individuals on or after October 17, 2005, the estate's gross income includes gross income from property held by the debtor when the case commenced ("pre-petition property"), as was the case under pre-BAPCPA law. There are certain exceptions to this general rule, however. The gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, if the pre-petition property is excluded from the estate and the gross income is subject to taxation. Also, the gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, *after* the pre-petition property is removed from the estate by exemption or abandonment.

### **Section 3. FILING INCOME TAX RETURNS OF THE DEBTOR AND THE ESTATE; NOTIFICATION TO PERSONS FILING INFORMATION RETURNS (OTHER THAN FORM W-2) OF THE STATUS OF THE CHAPTER 11 BANKRUPTCY CASE**

.01 The debtor in possession or trustee, if one is appointed, must prepare and file the income tax returns of the bankruptcy estate if required under section 6012(a)(9). I.R.C. § 6012(b)(4). In preparing the income tax returns of the debtor and the bankruptcy estate, the debtor in possession (or the trustee) must follow the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice, and must attach to the returns the statement discussed in section 6.

.02 A debtor in possession may be compensated by the estate to manage or operate a trade or business that the debtor conducted before the commencement of the bankruptcy case. Such payments should be reportable by the debtor as miscellaneous income on his or her individual income tax return. I.R.C. § 61(a). Amounts paid by the estate to the debtor in possession for managing or operating the trade or business may qualify as administrative expenses of the estate. An administrative expense allowed by the bankruptcy court under section 503 of the Bankruptcy Code will generally be deductible by the estate as an administrative expense when it is paid or incurred. I.R.C. § 1398(h)(1).

.03 Within a reasonable time after the commencement of a Chapter 11 bankruptcy case, the trustee (if one is appointed) or the debtor in possession should provide notification of the bankruptcy estate's EIN to persons that are required to file information returns with respect to the bankruptcy estate's gross income, gross proceeds, or other types of reportable payments. I.R.C. § 6109(a)(2). Since these payments are property of the estate under section 1115, such persons should report the gross income, gross proceeds, or other reportable payment on an appropriate information return using the estate's name and EIN in the time and manner required under the Internal Revenue Code and regulations (*see, e.g., sections 6041 through 6049*). The trustee or debtor in possession should *not*, however, provide the EIN to the debtor's employer or other person filing Form W-2 with respect to the debtor's wages or other compensation, since section 1115 does not affect the determination of what constitutes wages for purposes of Federal income tax withholding or the Federal Insurance Contributions Act. I.R.C. §§ 3121(a) and 3401(a). As provided in section 5, an employer should continue to report all wage income and accompanying tax withholdings, whether pre-petition or post-petition, on a Form W-2 issued to the debtor under the debtor's social security number. *See sections 6721 through 6724* for applicable penalties for failure to comply with information reporting requirements, including providing taxpayer identification numbers, and provisions for penalty waivers for reasonable cause.

.04 When a Chapter 11 bankruptcy case is closed, dismissed, or converted to a case under Chapter 12 or 13 of the Bankruptcy Code, the bankruptcy estate ends as a separate taxable entity. The debtor should, within a reasonable time, provide notification of the closing, dismissal, or conversion to the persons that were previously notified of the bankruptcy case under section 3.03 to the extent notification is necessary to ensure that gross income, gross proceeds, and other types of reportable payments realized after the closing, dismissal, or conversion are reported to the proper person and with the correct taxpayer identification number. Gross income, gross proceeds, and other reportable payments realized after the closing, dismissal, or conversion to Chapter 12 or 13 should, in general, be reported to the debtor, rather than the estate.

.05 If the Chapter 11 case is converted to a Chapter 7 case, the bankruptcy estate will continue to exist as a separate taxable entity and gross income (other than post-conversion income from the debtor's services), gross proceeds, or other reportable payments should continue to be

reported to the estate if the gross income, gross proceeds, or other reportable payment represents property of the Chapter 7 estate. As section 2.11 notes, income from services performed by the debtor after conversion to Chapter 7 is not property of the Chapter 7 bankruptcy estate. Therefore, within a reasonable time after the conversion to Chapter 7, the debtor should notify payors required to report the debtor's nonemployee compensation on Form 1099-MISC that such compensation earned after the conversion to Chapter 7 should be reported using the debtor's name and taxpayer identification number, rather than the estate's name and TIN.

.06 The debtor is not required to file a new Form W-4 with an employer adjusting the debtor's withholding allowances solely because the debtor has filed a Chapter 11 case and his or her post-petition wages are includible in the gross income of the estate. This is true even though the estate may be taxed at a higher tax rate than the debtor and is entitled to only one personal exemption. A new Form W-4 may be necessary, however, under the applicable regulations when, for instance, the debtor employee is no longer entitled to claim the same number of allowances claimed on the Form W-4 previously provided to the employer, such as for certain deductions or credits that now belong to the estate. See § 31.3402(f)(2)-1 of the Employment Tax Regulations. Furthermore, even where not required, in some circumstances it may be prudent for the debtor to file a new Form W-4 to increase the amount of income tax withheld from the debtor's post-petition wages that will be allocated to the estate in accordance with section 6. Otherwise, estimated tax payments on behalf of the estate may be required in order to avoid a penalty for underpayment of estimated tax. See section 6654(a).

#### **Section 4. APPLICATION OF THE SELF-EMPLOYMENT TAX**

.01 Section 1401 of the Internal Revenue Code imposes a tax upon the self-employment income of every individual. The term "self-employment income" means the net earnings from self-employment derived by an individual. I.R.C. § 1402(b). The term "net earnings from self-employment" means, in relevant part, the gross income derived by an individual from any trade or business carried on by such individual less deductions allowed attributable to such trade or business. I.R.C. § 1402(a).

.02 Under section 1115 of the Bankruptcy Code, the earnings from a Chapter 11 debtor's post-petition services, including the debtor's self-employment income, constitute property of the estate under section 1115. As property of the estate, the income from post-petition services is includible in the income of the bankruptcy estate, rather than the income of the debtor. I.R.C. § 1398(e)(1). However, neither section 1115 of the Bankruptcy Code nor section 1398 of the Internal Revenue Code addresses the application of the self-employment tax to the earnings from the individual debtor's continuing services. Because the debtor continues to derive gross income from the performance of services as a self-employed individual after the commencement of the bankruptcy case, the debtor must continue to report on Schedule SE of the debtor's individual income tax return the self-employment income earned post-petition, which includes the attributable deductions, and must pay the resulting self-employment tax imposed by section 1401.

#### **Section 5. APPLICATION OF EMPLOYMENT TAXES AND OBLIGATION TO FILE FORM W-2**

.01 As a result of the enactment of section 1115, post-petition wages earned by a debtor are generally treated for *income tax* purposes as gross income of the estate, rather than the debtor. The reporting and withholding obligations of a debtor's employer, however, have not changed as a result of the enactment of section 1115. Section 1115 has no effect on the determination of wages under the Federal Insurance Contributions Act (FICA), including application of the contribution and benefit base (as determined under section 230 of the Social Security Act). I.R.C. § 3121(a). Similarly, the enactment of section 1115 has no effect on the determination of wages for Federal Unemployment Tax Act (FUTA) tax or Federal Income Tax Withholding purposes. See I.R.C. §§ 3306(b) and 3401(a).

.02 Since section 1115 does not affect the application of FICA tax, FUTA tax, or Federal Income Tax Withholding, with respect to the wages of a Chapter 11 debtor in a case commenced on or after October 17, 2005, an employer should continue to reflect such wages and accompanying tax withholdings on a Form W-2 issued to the debtor under the debtor's name and social security number.

#### **Section 6. ALLOCATION OF INCOME AND CREDITS ON INFORMATION RETURNS AND REQUIRED STATEMENT FOR RETURNS**

.01 When an employer issues a Form W-2 to a Chapter 11 debtor reporting all of the debtor's wages, salary, or other compensation to the debtor for a calendar year, and a portion of the wages, salary, or other compensation represents earnings from post-petition services includible in the estate's gross income under section 1398(e)(1), an allocation of the amounts reported on the Form W-2 must be made. The debtor in possession, or the trustee, if one is appointed, must allocate in a reasonable manner wages, salary, or other compensation reported in box 1 and the withheld income tax reported in box 2 of Form W-2 between the debtor and the estate. The allocations must be in accordance with all the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice. If reasonable, the debtor and trustee may use a simple percentage method for allocating income and withheld income tax between the debtor and the estate. The same method used to allocate income must be used to allocate withheld income tax. For example, if one-sixth of the wages reported on Form W-2 for the calendar year ending December 31, 2005, was earned after the commencement of the case and must therefore be included in the estate's gross income, one-sixth of the withheld income tax reported on Form W-2 must be claimed as a credit on the estate's income tax return and five-sixths of the withheld income tax must be claimed as a credit on the debtor's income tax return. See I.R.C. § 31(a).

.02 In some cases, persons filing information returns may report to the debtor gross income, gross proceeds, or other reportable payments that should have been reported to the bankruptcy estate using Forms 1099-INT, 1099-DIV, 1099-MISC, Schedule K-1 or other information returns. This may occur, for instance, if the debtor in possession fails to notify the payor of the bankruptcy in accordance with section 3.03. In these cases, the debtor in possession, or the trustee, must allocate the improperly reported income in a reasonable manner between the debtor and the estate. In general, the allocation must ensure that any income (and any income tax withheld) attributable to the post-petition period is reported on the estate's return, and any income (and income tax withheld) attributable to the pre-petition period is reported on the debtor's return. The allocations, however, must be in accordance with all the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice.

.03 The debtor must attach a statement to his or her income tax return stating that he or she filed a Chapter 11 bankruptcy case. The statement must reflect the foregoing allocations of income and withheld income tax and must describe the method used to allocate income and withheld tax between the debtor and the estate. The statement should list the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, and the bankruptcy estate's EIN. The debtor in possession or trustee must attach a similar statement to the income tax return of the estate.

.04 The following model statement may be used by debtors, debtors in possession and trustees in complying with the requirements of section 6 of this notice:

<b>Notice 2006-83 Statement</b>		
<i>Pending Bankruptcy Case</i>		
The taxpayer, , filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code on in the Bankruptcy Court for the District of . The bankruptcy court case number is . Gross income, and withheld federal income tax, reported on Form W-2, Forms 1099, K-1, Schedule K-1, and other information returns received under the taxpayer's name and social security number (or other taxpayer identification number) are allocated between the taxpayer and the bankruptcy estate (EIN-) as follows, using [describe allocation method]:		
Year	Taxpayer	Estate
1. Form W-2 from Co. Withheld income tax shown on Form W-2	\$	\$
2. Form 1099-INT from Bank Withheld income tax (if any) shown on Form 1099-INT	\$	\$
3. Form 1099-DIV from Co. Withheld income tax (if any) shown on Form 1099-DIV	\$	\$
4. Form 1099-MISC from Co. Withheld income tax (if any) shown on Form 1099-MISC	\$	\$

## Section 7. REQUEST FOR COMMENTS

.01 The IRS and the Treasury Department are aware that further guidance may be needed as a consequence of the enactment of section 1115 and request comments from the public.

.02 In particular, section 1115 does not address whether, or to what extent, the income earned by the debtor from services performed after confirmation of the Chapter 11 plan is property of the estate or property of the debtor. Nor does section 1115 address whether, or to what extent, property of the estate retains its character as such after it vests in the debtor upon plan confirmation under section 1141(b) of the Bankruptcy Code. Courts have addressed the effects of plan confirmation on the scope and extent of the Chapter 13 estate under the analogous provisions of that Chapter, but the courts have reached varying and conflicting results. See, for example, *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333, 1340 (11<sup>th</sup> Cir. 2000) (describing the estate termination approach, the preservation approach, and the transformation approach) and *Barbosa v. Soloman*, 235 F.3d 31, 36, 37 (1<sup>st</sup> Cir. 2000) (describing a fourth, hybrid, approach). Comments are requested as to the proper treatment of post-confirmation income, given the conflicting holdings under analogous provisions of Chapter 13. Comments are also requested as to whether the terms of the Chapter 11 plan and the order confirming the plan may affect the taxation of post-confirmation earnings of the debtor and post-confirmation income on property of the estate.

.03 Section 3.02 of this notice addresses the tax consequences of compensation that a debtor in possession receives from the estate for managing or operating a trade or business carried on by the debtor before the commencement of the bankruptcy case. In some cases, however, the estate might not conduct a trade or business because the debtor was the employee of a third party before the commencement of the case and continues as an employee post-petition. Comments are requested on the tax treatment to the estate and the debtor of the portion of the post-petition compensation from a third party employer that the bankruptcy court allows the debtor to retain to pay for the debtor's personal or living expenses. In particular, comments are requested regarding whether such post-petition compensation is subject to double taxation as gross income to the debtor under section 61 and earnings under section 1115(a)(2) of the Bankruptcy Code includible in the estate's gross income under section 1398(e)(1), without a corresponding deduction for the estate.

.04 Comments should be submitted on these and other relevant issues in writing on or before December 1, 2006, to the Internal Revenue Service, P.O. Box 7604, Washington, D.C. 20044, Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at Room 105, First Floor, Internal Revenue Service, 1901 S. Bell Street, Jeff Davis Highway, Arlington, Va., Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be sent electronically via the internet to the following email address: [Notice.comments@irs.counsel.treas.gov](mailto:Notice.comments@irs.counsel.treas.gov). Include the notice number (Notice 2006-83) in the subject line. All comments will be available for public inspection and copying.

## Section 8. PAPERWORK REDUCTION ACT

.01 The collection of information in the notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2033.

.02 An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

.03 The collection of information in the notice is in section 6 of this notice entitled "Allocation of Income and Credits on Information Returns and Required Statement for Returns." The collection of information is required for compliance with I.R.C. § 1398. The collection of information is required to comply with the Internal Revenue Code. The likely respondents are individuals and their chapter 11 bankruptcy estates.

.04 The estimated total annual reporting burden is 1,500 hours. The estimated annual burden per respondent is  $\frac{1}{2}$  hour. The estimated number of respondents is 3,000. The estimated frequency of responses is annually.

.05 Books or records relating to a collection of information must be retained as long as their contents may become material to the administration of the internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

### **Section 9. DRAFTING INFORMATION**

The principal author of this notice is William F. Conroy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact William F. Conroy at (202) 622-3620 (not a toll-free call).

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