

Recent Tax Court Case Highlights Importance of Tax Counsel in Bankruptcy as Tax Court Finds the IRS Could Pursue Tax Deficiency Even After Bankruptcy Court Approved Taxpayer's Payment Plan

In *Wathen*, TC Memo 2021-100 (TCM 2021), the Tax Court has held that even though a taxpayer had his bankruptcy plan approved, this approval did not preclude the IRS from pursuing tax deficiencies (even those that had been listed in the plan) outside of bankruptcy court.

Facts. In 2021, Mr. Wathen filed for bankruptcy and the IRS filed a proof of claim with the bankruptcy court for taxes owed. Wathen's Chapter 13 plan listed the IRS's claim and the bankruptcy court, via a consent order, confirmed the plan. The consent order did not cite to 11 U.S.C. 505(a)(1) (which permits a bankruptcy court to determine tax liabilities) or otherwise indicate that it was issued pursuant to the bankruptcy court's authority to determine taxes under that section. Further, it did not include any factual recitations of Wathen's income, deductions, or credits or otherwise state his total Federal tax liability for any year.

Law. Concepts of res judicata, collateral estoppel and judicial estoppel were argued in the Tax Court. Res judicata prevents repetitious suits involving the same issues and is rooted in "considerations of economy of judicial time and public policy favoring the establishment of certainty in legal relations." *Comm. v. Sunnen*, 333 U.S. 591 (1948). Collateral estoppel prevents litigation of issues in a second cause of action if those issues were litigated in the first action. *Hambrick v. Comm.*, 118 T.C. 348 (2002). Judicial estoppel prevents parties from asserting positions contradictory to those they previously have persuaded a court to accept. *Huddleston v. Comm.*, 100 T.C. 17 (1993).

Tax Court Analysis. The Tax Court ruled against Wathen on all of these arguments. Res judicata did not apply because the redetermination of a taxpayer's total Federal tax liability for the years covered by a notice of deficiency and the resolution of the IRS's objection in a bankruptcy plan confirmation proceeding were not the same cause of action. Collateral estoppel did not apply because there was no indication that Wathen's total Federal tax liability was ever actually litigated or even at issue before the bankruptcy court. Judicial estoppel did not apply as Wathen could not identify how the IRS's position taken in its bankruptcy proof of claim is contradictory to the IRS's position regarding its determination of deficiencies in this case.

Moral of the case. Tax counsel should be consulted during Bankruptcy proceedings to be sure that the proper consideration of the taxes are given to the bankruptcy court to give it preclusive effect in the event of further tax proceedings. But this was not done in the Wathen case.