AMERICAN BANKRUPTCY INSTITUTE

2017 Hon. Steven W. Rhodes Consumer Bankruptcy Conference

Advising Potential Consumer Debtors About Their Tax Debts

Hon. Marci B. McIvor
U.S. Bankruptcy Court (E.D. Mich.); Detroit

Greg J. Ekdahl
Keller & Almassian, PLC; Grand Rapids, Mich.

Christopher W. Jones
Acclaim Legal Services, PLLC; Warren, Mich.

David J. Montera
David J. Montera, P.C.; Bloomfield Hills, Mich.

CONCURRENT SESSION

2017

ADVISING POTENTIAL CONSUMER DEBTORS ABOUT THEIR TAX DEBTS

Hon. Marci B. McIvor
United States Bankruptcy Judge, United States Bankruptcy Court for the Eastern District of Michigan – Southern Division-Detroit

Greg J. Ekdahl
Keller & Almassian, PLC
Grand Rapids, Mich.

David J. Montera
David J. Montera, P.C.
Bloomfield Hills, Mich.

Christopher W. Jones
Acclaim Legal Services, PLLC
Southfield, MI

ADVISING POTENTIAL CONSUMER DEBTORS ABOUT THEIR TAX DEBTS: STATUTORY AND CASE LAW CONSIDERATIONS

The key Code provisions to consider in relation to classification of tax liabilities and non-dischargeability considerations are 11 USC 523 (non-dischargeability) and 11 USC 507 (priority classification).

Much of the information in this section of the materials discusses the advent of the BAPCPA addition of the "Hanging Paragraph" found in § 523, and the effect of this language on the determination of the dischargeability of late filed tax returns. The main issue boils down to the fact that courts have not been able to agree on the definition of a "return" for bankruptcy nondischargeability purposes following the addition of the Hanging Paragraph. The results have created a circuit split that varies from the bright line "One Day Late Rule" on one side to a more nuanced, general case by case analysis on the other.

In short, despite the fact that the Code itself contemplates the eventual discharge of late filed tax returns and does not specifically deny discharge of obligations arising from them, courts around the country have been divided regarding what constitutes a tax return, when it is considered late, and what as a result is dischargeable. This section looks at the reasons for the divergence of opinion on the issue and the controlling cases.

I. BAPCPA and The Beard Test – What is a "Return" for bankruptcy purposes?

11 USC § 523(a)[1] includes three types of potentially non-priority tax debts (priority vs. non-priority requires separate analysis) that are not dischargeable. In general, the statute sets forth:

---

[1] A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(1) For a tax or a customs duty –

…

(B) with respect to which a return, or equivalent report or notice, if required-

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition;

- 11 USC § 523(a)(1)(C) – tax debts for a Debtor who fraudulently files a tax return. This is a no-brainer and is not at the heart of any real controversy.
- 11 USC § 523(a)(1)(B)(i) – tax debts for a Debtor who fails to file tax returns.
- 11 USC § 523(a)(1)(B)(ii) – tax debts for a Debtor who filed late tax returns if a bankruptcy petition is then filed within two years after the date the late tax return was filed.

These definitions are not complicated on their face, but the devil is in the details. In this case, the detail is what constitutes a "return" for bankruptcy purposes. Prior to BAPCPA, the Code did not define a "return." The IRC similarly did not define a return for these purposes. As a result, courts developed their own analysis to define what would qualify as a "return" in reference to a § 523 analysis. The development of this analysis culminated with a four part test that is often referred to as the "Beard Test."

- **The Beard Test** – *Beard v. Commissioner* 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).

In *Beard*, a taxpayer altered a line item on his tax return resulting in no tax liability. The tax court looked at what determined a filed "return" and developed a four part test. This "Beard Test" set forth that in order for a document to be a "return", it must:

1. Purport to be a return;
2. Be executed under penalty of perjury;
3. Contain data sufficient to calculate a tax liability, and;
4. Represent an honest and reasonable attempt to satisfy the requirements of tax law.

The fourth prong of the Beard Test led to varying court interpretations regarding what constituted an "honest and reasonable" attempt to satisfy tax law. In what was presumably a well intentioned effort to help clear up this issue, BAPCPA included in its additions, an additional paragraph intended to define a "return" for the purposes of § 523(a). In a twist that will surprise no one, this did not help. This addition is regularly referred to as the Section 523 "Hanging Paragraph," and due to its seemingly random placement in the section, is often cited as 11 USC § 523(a)(*).

- **The Section 523 Hanging Paragraph**[2] - The section establishes that a "return" means a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing

---

[2] 11 USC § 523(a)(*) states in full: "For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a

requirements). The Hanging Paragraph additionally specifies that returns filed under section 6020(a) of the IRC are returns (returns filed under 6020(a) are returns prepared by the IRS with information disclosed by the taxpayer and signed by the taxpayer), but that returns filed under section 6020(b) are not returns (returns filed under 6020(b) are returns made by the IRS without cooperation after taxpayer fails to file a return).[3] It is of note for consideration that 6020 does not address untimely returns that have actually been filed by the taxpayer.

II. CASE LAW

As noted, Courts have split on the interpretation of the language in the § 523 Hanging Paragraph. One approach taken by some courts is commonly referred to as the "One Day Late Rule" and is a direct result of the courts' interpretation of the language found in the Hanging Paragraph.

The "One Day Late Rule" Circuits – 1st, 5th, and 10th.

These Circuits apply the One Day Late Rule and hold that a late filed return is not a "return" (pursuant to the Hanging Paragraph) and thus associated tax liability from those late returns is absolutely and forever barred from discharge. These cases essentially reject the multi-pronged totality approach of the Beard Test, and focus on a bright line determination of dischargeability based on the timing of the return.

As mentioned, many commentators have found this result to be out of line with the Code and the intent of the Hanging Paragraph itself. For if decisions such as the "One Day Late Rule" are correct, then tax liability on late filed returns never becomes dischargeable, regardless of circumstance, and even though the language in §523(a)(1)(B)(ii) states otherwise. These arguments generally reference the fact that if interpreted in such a manner, the Hanging Paragraph reads §523(a)(1)(B)(ii) completely out of the Code as superfluous. They further argue that the Hanging Paragraph mandates that a return must satisfy requirements of applicable nonbankruptcy law, in this case tax law. Tax courts generally follow the Beard Test methodology. Under this analysis, the argument is that timeliness is not the controlling

---

return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law."

[3] One often cited note of criticism of the Hanging Paragraph's distinctions between 6020(a) and 6020(b) returns is that nearly every return filed under 6020 is filed under section (b), and as such any relief claimed as available under section (a) is somewhat illusory.

factor under applicable nonbankruptcy law, it is just one part of the analysis, and that determination based on timeliness alone is a draconian result. [4]

- **First Circuit** – *In re Fahey*, 779 F.3d 1 (1st Cir. 2015) – In *Fahey*, the issue was whether a Massachusetts state income tax return filed after the date by which Massachusetts required such returns to be filed constituted a "return" under 11 U.S.C.S. § 523(a), such that the tax debt could be discharged. The court held that debtors' tax liabilities were not discharged in bankruptcy because as a result of the Hanging Paragraph, in order for a document to qualify as a "return," it must satisfy "applicable filing requirements." Since timely filing was a requirement of Massachusetts law, the court held that a return filed after a due date is a return not filed as required as a matter of law.

  It is of note that in the dissent, the Honorable Judge Thompson made a number of persuasive arguments. Judge Thompson noted that under Massachusetts law, late filed returns are still accepted and incur only a small penalty that can be waived. Accordingly, Judge Thompson failed to agree with the majority conclusion that a late filed return could never satisfy Massachusetts law. Further, Judge Thompson raised the often cited argument that the majority reasoning rendered §523 (a)(1)(B)(ii) superfluous and that the subsection (ii) was better interpreted to create a specific exception that deals with late filers.

- **Fifth Circuit** – *In re McCoy*, 666 F.3d 924 (5th Cir. 2012) – In *McCoy*, Debtor filed an adversary proceeding against the Mississippi State Tax Commission, seeking a declaration that two years of her pre-petition state income tax debts were dischargeable. The Court found that Debtor's failure to file in the time required under Mississippi's tax law was a failure to satisfy the applicable nonbankruptcy law as referenced in the Hanging Paragraph, and as such Debtor's late-filed returns could not be considered tax returns for bankruptcy discharge purposes under the plain language of the statute. The Court determined that filing by the due date is "an applicable filing requirement," and that tax liability arising from late returns can never be discharged unless the return meets the section 6020(a) exception in IRC [which as noted almost never applies]. In this case, the Court's holding

[4] This analysis appears to be at least somewhat consistent with the IRS view of the issue. In one instance, the Office of Chief Counsel rejected the concept of the One Day Late Rule, concluding that when read as a whole, § 523(a) does not provide that every tax for which a return was filed late is nondischargeable. See Office of Chief Counsel Notice 2016-16 at 2.

shows that obligations resulting from a substitute return created by the IRS without the taxpayer's help are simply not dischargeable in the Fifth Circuit.

- **Tenth Circuit** – *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014) – In *Mallo*, the Court addressed whether an untimely Form 1040, filed after the IRS had assessed liability, was a return for purposes of § 532. The Court specifically rejected the Beard Test in its opinion, noting that it was not necessary to resolve whether a post-assessment Form 1040 could be an honest and reasonable attempt to satisfy the requirements of the tax law. The Court held that as a result of the Hanging Paragraph, a "return" had to comply with applicable filing requirements, such as the time deadline for filing tax returns. The Court found that a late-filed Form 1040 was therefore excluded from the definition of a return and the resulting liability was not dischargeable.

Circuits Rejecting the One Day Late Rule – 9th and 11th.

Despite the effect of the Hanging Paragraph and the development of the One Day Late Rule, other Circuits continue to more closely follow the analytical construct of the Beard Test. These courts have considered the effect of the Hanging Paragraph and rejected the strict interpretation based solely on the timeliness of the return.

- **Ninth Circuit** – *In re Smith*, 828 F.3d 1094 (9th Cir. 2016) – In *Smith*, the debtor failed to file timely 2001 returns. The IRS prepared a Substitute for Return ("SFR") under IRC 6020(b). In 2006, the IRS mailed a notice to the debtor asserting a deficiency in his 2001 taxes. The debtor did not challenge the deficiency and the IRS assessed the full amount. In May 2009, the debtor filed a 1040 for his 2001 tax year, noting that the return was the "original return to replace the SFR." The new return filed by the Debtor actually showed more income, which in turn increased his liability beyond that originally assessed. The IRS added the additional amount to the liability. In 2011, Debtor filed bankruptcy and sought to discharge the 2001 liability. While the initial ruling in Bankruptcy Court found for the Debtor, it was eventually reversed. The Ninth Circuit, using a four part test that follows the Beard Test (referenced in the Ninth Circuit as the Hatton Test), held that the debt was

not dischargeable because the Debtor's post assessment tax return did not comply with tax law and was therefore not an "honest and reasonable attempt" to comply. The Court found that the returns filed by the Debtor post assessment did therefore not qualify as a "return" under § 523(a)(1)(B)(i).

- **Eleventh Circuit** – *In re Justice*, 817 F.3d 738 (11th Cir. 2016) – In *Justice*, Debtor filed his Forms 1040 for four separate tax years three to six years late. The Court declined to adopt the "One Day Late Rule" and found that the liability for those years was not dischargeable under § 523(a)(1)(B)(i) because his late-filed forms did not qualify as tax returns under the Beard Test, because they did not demonstrate an honest and reasonable effort to comply with the tax law. Regarding the One Day Late Rule, the Court noted that "we can assume arguendo, although we expressly do not decide, that the one-day-late rule is incorrect." *Id* at 743.

Circuits Relying on the Beard Test –

the "Honest and Reasonable" Attempt Circuits – 4th, 6th, and 7th.

A handful of other Circuits have continued to rely on a Beard Test style analysis without a definitive Appellate case addressing the One Day Late Rule/Hanging Paragraph issue. These courts generally hold that once the tax entity assesses liability based on a substitute for return (6020(b)), it is difficult for the Debtor to discharge the debt. In essence, these courts are holding that once the 6020(b) assessment has been made, the taxpayer has failed the fourth prong of the Beard Test, in that they failed to make an "honest and reasonable" attempt to follow tax law. However, the controlling cases in these Circuits are pre-BAPCPA, and as referenced below, there have been some rulings in the Sixth Circuit at the District Court level that provide a possible road map of how the Appellate Court might address the Hanging Paragraph analysis and leaves open the possibility that discharge is achievable for even post assessment filers depending on the circumstances (see *In re Biggers*).

- **Sixth Circuit** – *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999) – In *Hindenlang*, the Debtor did not file tax returns for 1985 through 1988. The IRS prepared substitute returns for the relevant years and sent them to the Debtor who did not respond. The IRS then sent out deficiency notices and

eventually, in 1991 assessed the deficiencies. In 1993 the Debtor sent the IRS tax returns for the years in question. Then in 1996, Debtor filed a chapter 7 and sought to discharge the liability. The Court held that once a taxpayer had been assessed a deficiency, a Form 1040 submitted by the taxpayer to the IRS no longer qualified as a return under § 523(a)(1)(B) because they did not represent an honest and reasonable attempt to satisfy the requirements of the tax law. The Court held that once the tax entity showed that a Form 1040 filed after assessment could serve no purpose under the tax law, it had met its burden of proving an exception to discharge.

  - **But see** *In re Biggers*, 557 B.R. 589 (M.D.Tenn.Sept. 9, 2016) – There is no controlling appellate case in the 6th Circuit directly addressing whether the Beard Test is abandoned (in other words whether the One Day Late Rule applies). While not appellate law, this case helps understand how courts in the 6th Circuit might deal with the hanging paragraph cases in a post BAPCPA setting, particularly when certain mitigating factors are present. This case involved a Debtor who did not file returns for 2001 through 2004. The IRS made assessments and Debtor eventually filed the late returns in 2007. He filed his chapter 7 in 2009. The Debtor presented factors that played a role in his late filing. He explained that a secured lender seized his records and did not return them, that he hired an accountant to help with the returns and eventually fired that accountant because they did not do the requested work, that he moved 11 times between 1999 and 2008, and that eventually with the help of a second CPA was able to file the late returns. The bankruptcy judge found the liability nondischargeable because the returns were late. Debtor appealed and won remand at the District Court. In the opinion, the District Court found for the continuing efficacy of the Beard Test, noting that the One Day Late Rule "creates a harsh result that appears inconsistent with the statue's intent," and that the draconian result of a per se rule on this issue cannot be reconciled with the well established rule of construing exceptions to discharge in favor of the debtor. The Court also noted that "applicable nonbankruptcy law" as referenced in the Hanging Paragraph would include pre-BAPCPA law, including the Beard Test. The Judge remanded the case for the Bankruptcy Court to consider the debtor's subjective intent and actions, and that there can be compliance even after assessment.

- **Fourth Circuit** – *In re Moroney*, 352 F.3d 902 (4th Cir. 2003) – In *Moroney*, the Debtor did not file tax returns timely for 1990 and 1992. The IRS prepared substitutes for returns and assessed taxes for

both years. Debtor sought to have the liability discharged. The court held the debt was nondischargeable under § 523(a)(1)(B)(i) because his filings did not qualify as "returns." The Debtor did not explain to the bankruptcy or district courts why his eventual filings were anything other than self-serving attempts to reduce his tax liabilities. The Court held that the debtor was not able to explain why his statements, which were submitted at least four to six years after the original deadlines, should be considered honest and reasonable attempts at compliance with the tax laws.

- **Seventh Circuit –** *In re Payne*, 431 F.3d 1055 (7th Cir. 2005) – In *Payne*, the Debtor failed to file his 1986 tax returns until 1992. By this point, the IRS had already assessed the Debtor for $ 20,000 in liability. The IRS rejected Debtor's offer to compromise his tax liability, and the Debtor filed for bankruptcy in 1997. The court found the liability was nondischargeable because the late-filed return was not a "return" within the meaning of § 523(a)(1)(B)(i) and because it did not satisfy the condition that a purported return evidence an honest and reasonable endeavor to comply with the law. The fact that discharge was not prohibited under § 523(a)(1)(B)(ii) because the actual returns were filed more than two years before the bankruptcy did not mean that a discharge was warranted.

The Objective Analysis – The 8th Circuit

The Eighth Circuit has rejected the One Day Late Rule as well. This Circuit finds that as long as the returns substantively complied with applicable filing requirements, they are considered returns for bankruptcy purposes. In short, the "honest and reasonable" finding under the Beard Test should be determined from the document filed, not from the filer's lateness or reasons for it. The Eighth Circuit finds the subjective intent irrelevant.

- **Eighth Circuit** – *In re Colsen*, 446 F.3d 836 (8th Cir. 2006) – In *Colsen*, the Debtor failed to file timely tax returns and the IRS prepared substitutes, issued notices of deficiency, and assessed the liability. Debtor later filed 1040 forms for the relevant tax years and thereafter filed bankruptcy. The IRS argued that the 1040 forms that the Debtor filed were not "returns" under 11 U.S.C.S. § 523(a)(1)(B)(i), because they were filed after the IRS's assessment had taken place. However, the Court held that the liability was dischargeable because the post-assessment filings qualified as "returns." The Court held that the honesty and genuineness of the Debtor's attempt to satisfy the tax laws should have been determined from the face of the form itself, not from the delinquency or

the reasons for it. The Court found that the Debtor's subjective intent was irrelevant. In addition, the Court had no evidence to suggest that the forms appeared obviously inaccurate or fabricated.

ADVISING POTENTIAL CONSUMER DEBTORS ABOUT THEIR TAX DEBTS: PRE-FILING CONSIDERATIONS AND EFFECTIVE ISSUE ANALYSIS

Below are specific issues to identify and consider during the consultation while applying the statutory and case law framework providing earlier in the materials. The most important issues relate to identifying factors that if a Ch. 13 is filed may lead to non-dischargeability yet non-priority (thus the plan not requiring repayment and no independent way of identifying non-dischargeability other than the attorney identifying it (i.e., proof of claim will not designate non-dischargeability, no adversary need be filed)). In short, while all priority debts are non-dischargeable but not all non-dischargeable debts are priority. Your client will be counting on you to identify these non-priority and non-dischargeable taxes that will be awaiting repayment upon discharge from their Chapter 13.

The time devoted to these pre-filing considerations may depend on whether the focus of the case is the tax liabilities and/or whether or not you have flexibility in timing (e.g., pending foreclosure sale and case must be filed regardless). In the event the filing of the case is forced you should consider the client signing an acknowledgement of potential implications as to tax liabilities.

The two most important functions of in depth pre-filing analysis are to give a client realistic expectations as to the impact of the bankruptcy filing on the tax debt (especially important if the main focus of the filing is the tax debt) and whether specific timing should be considered.

An example of an actual tax transcript and a useful flow chart to evaluate tax classification and dischargeability issues can be found at http://morganking.com/SPEAKING%20/Tax%20Outline%20May%202011pdf.pdf (the tax transcript example starts on page 32 and the flow chart and explanatory materials related to flow chart start on page 26 of the PDF associated with the preceding link). Credit: Morgan D. King.

I. Don't Rely on Client! Order an "Tax Account Transcript" (not to be confused with "tax return transcript")

a. A Tax Account Transcript is the document that will help you evaluate all pertinent non dischargeability and classification issues (priority, non-priority unsecured, secured).

i. First Option - Instruct clients to obtain and bring with them (give them IRS website and phone number)

ii. Can be ordered online via IRS website (but requires password, personal information for client that client may not have).

iii. Use IRS Hotline (866) 860-4259

1. Have client sign an IRS Form 8821.
2. Have client's name, SSN and address at hand;
3. Have your fax number at hand.
4. Call the Hotline at the IRS Hotline phone number (866) 860-4259.
5. Explain you're an attorney and need Account Transcript for client. Rep will ask you for CAF number. If you've never ordered one they will put request through and mail you CAF number for future requests.
6. Rep will give you his/her fax number and wait on hold until you fax the 8821 to him/her.
7. Rep will then fax you the transcripts, typically within a few hours along with mailing copies to your office.
8. Rep may ask you for information about your client, such as name, SSN, address, place of employment.

b. Reading Account Transcript

i. See Exhibit A – Common Transcript Codes

ii. Important codes and bankruptcy implications

1. Code 150 – date the "account" officially begins. Note, this is NOT the date the return is filed but rather date account opened (for applicable year) and may be a dollar amount if account opened with an assessment (vs. return); may be a $0.00 if a "substitute for return."
2. Code 320 – Fraud Penalty (potential non dischargeability implications)
3. Code 300 – additional tax assessed (starts another 240 day period)
4. Code 480 – offer-in-compromise received (check for tolling implications)
5. Code 780 – offer accepted (11 USC 507(a)(A(ii)(I) says tolling continues while offer "in effect")
6. Code 781 – offer defaulted (tolling likely continues until this date + 30 days)

7. Code 520 – indicates litigation, bankruptcy, or request for due process hearing (must call IRS to clarify)
8. Code 521 – end of 520 event; if bankruptcy or request for due process hearing tolled 3 year or 240 day period, add 90 days. See 11 USC 507(a)(A(ii)(I) and 507(a)(8)(G)* (hanging paragraph).

II. Applicable Tax Year ("3 year rule")

One of the key primary considerations when consulting with a prospective client dealing with income tax liabilities is what tax year the liabilities are attributable to. Is the most recent due date for filing the return more than 3 years old? Time is computed from most recent date the tax return is due for the tax year (either April 15 or the date per an extension). If due date for return is not at least 3 years old the liability is entitled to priority treatment and is non-dischargeable. 11 U.S.C. Section 507(a)(8)(A)(i). Note if April 15th falls on a weekend the due date is the following Monday.

III. Whether tax return has been filed and the timeliness of tax return filing ("2 year rule" and potential non-dischargeability considerations)

Has the tax return been filed and, if so, was the tax return filed at least two years preceding the filing date of the bankruptcy? 11 U.S.C. 523(a)(1)(B).

A. Has the tax return been filed?

1. No:
    i. Non-dischargeable pursuant to 11 USC 523(a)(1)(B)(i).
    ii. Whether it is also priority (thus repayable in Ch. 13) is an independent analysis (see 3 year rule, 240 day rule of 507) that must be performed. Critical to identify this issue if liability does not other qualify as priority per 507 as the eventual IRS proof of claim will not designate as non-dischargeable or priority (i.e., proof of claim have liability as non-priority unsecured) so it is a sleeping non-dischargeable debt that will not get presumably not get paid via the plan (unless plan pays dividend to unsecured creditors).
2. Yes
    i. If filed timely, only non-dischargeability implication would arise from 11 USC 507; simply apply 3 year rule and 240 day rule pursuant to 11 USC 507.

ii. If tax return was filed less than 2 years ago the liability will be non-dischargeable pursuant to 11 USC 523(a)(1)(B)(ii).

- Whether it is also priority (thus repayable in Ch. 13) is an independent analysis (see 3 year rule, 240 day rule of 507) that must be performed. Critical to identify this issue if liability does not other qualify as priority per 507 as the eventual IRS proof of claim will not designate as non-dischargeable or priority (i.e., proof of claim have liability as non-priority unsecured) so it is a sleeping non-dischargeable debt that will not get presumably not get paid via the plan (unless plan pays dividend to unsecured creditors).

iii. If tax return was filed after IRS assessed a liability for given tax year, the portion of the liability up to the amount of the IRS assessment is non-dischargeable pursuant to 11 USC 523(a)(1)(B)(i) because it is a "for a tax. . . with respect to which a return. . . was not filed." The assessed liability must be viewed independently. If a return is late filed and after the IRS assessment and the liability is higher than the assessment, the amount per the return that is over/above the IRS assessment may independently qualify for dischargeability. Nothing can be done to undo the priority and non-dischargeability nature of the tax assessed by the IRS. Whether it is also priority (thus repayable in Ch. 13) is an independent analysis (see 3 year rule, 240 day rule of 507) that must be performed.

- Again, critical to identify this issue if liability does not other qualify as priority per 507 as the eventual IRS proof of claim will not designate as non-dischargeable or priority (i.e., proof of claim have liability as non-priority unsecured) so it is a sleeping non-dischargeable debt that will not get presumably not get paid via the plan (unless plan pays dividend to unsecured creditors)

iv. Was the tax return filed more than 2 years ago? If so

B. Was the tax return timely filed?

1. Yes – timely filed

i. Just need to evaluate the 3 year and 240 day rule. The liability will either be priority/non-dischargeable (tax due 3 or less years ago or assessed in last

240 days) or non-priority/dischargeable (tax due 3+ years ago and assessed 240+ days ago).

2. No – late filed
    i. Potential non-dischargeability implications, case law split
    ii. As long as the filing of the tax return meets the 2 year rule, the IRS currently only enforces non-dischargeability position for taxes assessed before a tax return is filed.
    iii. Implications of timeliness of filing
        - Timely filed = dischargeable if satisfying other 523 conditions.
        - Unfiled = non-dischargeable (a separate priority analysis must be performed)
        - Late filed but filed more than 2 years ago:
            a. Tax return may be deemed non-compliant per 11 USC 523(a)(*) hanging paragraph and as a result non-dischargeable (regardless of whether otherwise compliant tax return was ultimately filed). Strict position adopted by certain courts, unlikely to be practically enforced by IRS. Note: a proof of claim would classify this as a non-priority, unsecured claim and non-dischargeability implications would not be evident from proof of claim.
            b. More likely position enforced by IRS is if otherwise compliant return was filed 2 years+ pre-petition the liability will be dischargeable (see IRS Notice CC-2010-016).
    iv. Important to identify and advise as to potential non-dischargeability implications and to strategize when proposing plan if potential non-priority yet non-dischargeable implications lurk.

IV. Assessment Date
    a. If assessed within 240 days, the tax is priority pursuant to 11 USC 507(a)(8)
    b. If more of a liability is assessed after the return was filed you could have a situation where liability for certain year could be partially priority and partially non-priority

V. Nature/Basis of Liability
    a. Personal income taxes

b. 941 liabilities (withholding tax; trust fund tax; always non-dischargeable and personal liability to corporate officer)

c. Joint with spouse? (client should be advised that a non filing spouse would not benefit from any discharge and there is no co-debtor stay so collection could continue as to spouse)

d. General Corporate tax liability (would not automatically create personal liability absent fraud).

VI. Misc. Considerations:

- Failing to Consider Tolling: Impact of tolling events on discharge time periods. Only 3 year and 240 day timelines are tolled, nothing tolls 2 year rule.

1. Prior bankruptcy
    a. Hanging paragraph following 11 USC 507(a)(8)(G) provides that certain time periods are suspended for any time during which a stay of proceedings against collection was in effect in a prior bankruptcy:
    b. Tolls 3 Year Period: for time stay is in effect + 90 days
    c. Tolls 240 day period: for time stay is in effect + 90 days
2. Request for Extension to File Tax Return
    a. Delays the start of the 3 year time period to the date upon with the return is due, with the extension
3. Appeal of liability
    a. Delays assessment and thus delays 240 day period from commencing
4. Offer in Compromise (OIC)
    a. Tolls 240 day period for period of time OIC was in "in effect." This could be years if accepted OIC is structured as periodic payment or deferred periodic payment. If OIC is appealed then it is pending and thus still tolling.
    b. Merely submitting an OIC does NOT toll the 3 year period. In relation to 240 day rule, 507(a)(8)(A)(ii) specifically states period tolled + 30 days while pending or in effect. The 3 year rule laid out in 507(a)(8)(A)(i) does not mention OIC as tolling event.
    c. Appealing rejected OIC tolls both 240 and 3 year periods

d. If OIC submitted in conjunction with Collection Due Process (CDP) Hearing the OIC submission itself may not toll the 3 year period the accompanying CDP hearing tolls both (see below).

5. Request for Collection Due Process Hearing
    a. Tolls 3 year and 240 day periods + 90 days
    b. 11 USC 507(a)(8)(G) hanging paragraph, 3 year and 240 day periods tolled during any time during which governmental unit is prohibited under non bankruptcy law from collecting as a result of a request by the debtor for a hearing and appeal of any collection action.
    c. Period to file request is 30 day period following issuance of "final notice and intent to levy."
6. Installment Plan
    a. Does NOT toll
    b. Request for installment is part of collection section of IRS manual, not appeals. IRS does not treat as "appeal" so applicable language of hanging paragraph does not apply.

b. Failing to Consider extension to file tax return in calculating 3 year rule
c. Mistaking 150 code for date return was filed
d. Improper notice address for taxing authorities
e. Failing to consider in 3 year rule analysis if April 15 lands on a weekend/holiday.
f. Failing to inform client about personal liability for accrued post petition interest on non dischargeable taxes
g. Failing to identify when a non-dischargeable tax may be non-priority and instructing client to take action to make it priority (so that it can/will be paid via plan). Example, if a tax is non-dischargeable per 523 (e.g., not filed) but is not assessed you should instruct client to file the return, wait for IRS to assess, then file petition date within 240 days of assessed.

ADVISING POTENTIAL CONSUMER DEBTORS ABOUT THEIR TAX DEBTS: CH. 13 TREATMENT ISSUES AND STRATEGIES BASED ON ISSUES IDENTIFIED AT CONSULTATION

It is critical to consider the statutory and case law authority and the issues identified at the consultation in order to propose the most effective Chapter 13 Plan on your client's behalf. You should identify classification issues (priority vs. unsecured vs. secured), identify non-dischargeability issues, and propose a Chapter Plan that accomplishes the following: 1. Is feasible for your client to fund; 2. Maximizes the discharge of indebtedness; 3. Minimizes the amount of non-dischargeable debt; and 4. Adequately inform and set client expectations regarding the post-discharge landscape. Timing of filing and strategic treatment of IRS claims can make the difference between a beneficial outcome for your debtor vs. extensive post-discharge indebtedness. The most strategic consideration is to identify non-dischargeable taxes and try to time the bankruptcy and propose the Plan in a manner that gets these taxes paid.

With respect to timing considerations, the 3 year rule, 2 year rule, and 240 day rule are most important (including tolling considerations). With respect to claim treatment, examples of effective planning and treatment are:

- If funding is available based on a prospective client's disposable income, time the filing of the petition such that any taxes that may be non-dischargeable per 523 are also priority per 507 (allowing you separately classify and pay in full vs. pro rata with other unsecured creditors). The mindset is generally to avoid priority treatment as it equates to paying less back on a claim but this is counter productive if the underlying claim is non-dischargeable.
- Anticipating non-dischargeable taxes that may be subject to a tax lien when valuing the assets that secure the lien and deciding whether the claim should be crammed down. It does your client no good to cram down a lien only to have the portion of the claim rendered unsecured via the cram down be non-dischargeable and collectible from the client post-discharge.

- If non-dischargeable BUT non-priority and unsecured, consider separate classification pursuant to 1322(b)(1) but be mindful of the prohibition against unfair discrimination. However, what is "unfair" is fact specific. Note, discrimination is not barred, only unfair discrimination. See In re Engen, 561 B.R. 523 (Bankr. D. Kan. 2016) (recent case evaluating separate classification and discrimination in context of student loans)
- Account for and pay interest on priority claims (but can only do if it is a 100% plan)

I. **UNSECURED, PRIORITY CLAIMS**

a. **Priority Claims pursuant to 11 USC §507(a)(8)**

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—
(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition—
(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
(ii) assessed within 240 days before the date of the filing of the petition, exclusive of—
(I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and
(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days; or
(iii) other than a tax of any kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;
…

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.

b. Case Law Regarding Application of 11 USC §507(a)(8)

1. Priority Claims:

***Winters v. Comm'n of Internal Revenue Service,* 2013 WL 364328 (Bankr. M.D. Tn. 2013), *reversed and remanded,* 503 BR 434 (6th Cir. BAP 2013)** – Because neither Bankruptcy Court nor Tax Court had issued final determination of the amount of tax debt for year in question, issues regarding statute of limitations, prior and nondischargeability could not be resolved. Case remanded to Bankruptcy Court for further proceedings. Prior to appeal, Bankruptcy Court had held that Section 507(a)(8)(A) gives priority treatment to tax claims where the return is last due less than 3 years pre-petition, or where the taxes are assessed less than 240 days plus any time during which collection was stayed pre-petition. Income taxes must be assessed within three years of date on which return is due. Upon assessment, taxpayer has 90 days to file an appeal. If an appeal is filed, IRS is precluded from assessing until Tax Court decision becomes final. Thus, filing of tax court appeal tolls running of 240 day period until appeal is determined. Debtor filed bankruptcy before Tax Court issued ruling, which precluded Court from issuing ruling and precluded running of 240 period for assessment. Debtor's obligation for 2004 tax liability was entitled to priority under Section 507. Further Section 523 precludes discharge to taxes that have not been assessed as of the petition date but which are still assessable as of the petition date. Debtor's liability for 2004 taxes which were unassessed but still assessable as of the petition date were excepted from the discharge.

***Smith v. Internal Revenue Service,* 2016 WL 3749156 (9th Cir. 2016), *cert pending*, Case No. 16-497 (2016)** – Tax return filed 7 years after due date and three years after IRS prepared Substitute for Return was not "honest attempt to comply with the tax code". To extent debtor's return showed higher income and higher tax liability than SFR, debt was discharged, but taxes assessed pursuant to SFR were not dischargeable.

***Taylor v. IRS,* 2014 WL 1884333 (Bankr. E.D. Tn. 2014)** – Section 507(a)(8) makes priority taxes measured by income or gross receipts where the return was last due within three years preceding commencement of the case or assessed within 240 days pre-petition. Debtor filed for Chapter 7 relief in 2012. Debtor's tax liability for 2007 was priority where debtor did not file a return until 2012, less than 240 days pre-petition. Debtor signed consent form for 2007 taxes on March 9, 2011, more than 240 days pre-petition, and signed consent form for 2008 taxes in June, 2011, also more than 240 days pre-petition. However, IRS did not actually process consent agreements or "assess" taxes until September, 2011, less than 240 days pre-petition. Under Internal Revenue Code and IRS rules, taxes are assessed by recording the liability in the office of the IRS, with the date of assessment being the date on which the summary record is signed by an assessment officer. Date of assessment shown on tax account transcript is presumed date on which taxes are assessed. Delay in processing consent agreements did not alter assessment date. Assessment date is not date on which taxpayer signs consent agreement but date on which IRS accepts it. Delay by IRS, even if "unjustified" does not alter assessment date.

***In re Mazzarella,* 2013 WL 6051036 (Bankr. N.D. Ohio 2013)** – Section 507(a)(8) defines priority tax claims as those measured by income and for which a return was last due, with extensions, less than three years prior to commencement of the case. Three year period is extended for any time period during which applicable non-bankruptcy law prevents actions to collect tax. While statute tolls running of three years for any time during which a prior bankruptcy case was pending, the time is not tolled based on pre-petition tolling agreement between taxpayer and

governmental unit. Fines imposed on unpaid taxes are not compensatory in nature and are not entitled to priority status.

***In re Whitson,* 2013 WL 5965745 (Bankr. E.D. Tn. 2013)** – Section 507(a)(8) applies to any tax measured by income. IRS audit that resulted in reduction of earned income tax credit and child care credits and produced tax liability constituted a claim for unpaid income taxes. While CTC and EITC were in the nature of "public assistance" rather than true tax credits, the resulting liability was one for unpaid income taxes within Section 507(a)(8). Both credits are created by Internal Revenue Code and size of each is directly related to income. Although credits are refundable and provide assistance to low income taxpayers, both tie directly to income and overpayment of previously issued tax refund stemmed directly from the credits.

2. Straddle Taxes – Priority/Treatment Case Law

***In re Pavone,* Case No. 11-70927 (Bankr. E.D. Mi. 2012)** – Debtor cannot treat post-petition tax liability in Chapter 13 plan over objection of taxing authority. Case filed late in 2011 could not treat 2011 tax liability in plan over objection of State even if plan not confirmed until early 2012. "Straddle" tax claims are limited to those where the tax year ended prior to commencement of the case but where the return has not yet been filed.

***In re Hight*, 426 BR 258 (Bankr. W.D. Mi.) *aff'd* 434 BR 505 (W.D. Mi. 2010), *Michigan Department of Treasury v. Hight*, 670 F.3d 699 (6th Cir. 2012)** - Debtor has standing to file proof of claim on behalf of governmental unit for "straddle" tax claims. Under section 502, a tax on earnings for a taxable year ending on or before the date of the filing of the petition is a priority claim. Debtor filed for bankruptcy protection in January, 2009, prior to filing debtors 2008 State Tax Return. Debtor then filed a Proof of Claim on behalf of the State for the 2008 tax year. Section 1305 does not exclusively governed filing of post-petition claims where section 501, section 502 and section 507 established that debtor could treat the post-petition claim for a tax debt arising from the immediately preceding tax year as if it were a prepetition claim.

3. Payment of interest? 100% Dividend Plan per §1322(b)(10)

Set client's post discharge expectations with respect to accruing interest if unable to account for in plan.

This should be considered in your client interview, and in discussions leading up to development of the chapter 13 Plan, and acknowledged at the time of the signing of the Petition, Schedules and Plan.

***U.S. v. Monahan,* Case No. 12-084 (1st Cir. BAP 2013)** – Chapter 13 Plan that provided for payment of IRS priority non-dischargeable claim but did not propose to pay interest did not discharge interest portion of tax debt. Chapter 13 plan can treat only allowed claims and per Section 502 post-petition interest is not allowed claim on unsecured debt. *Espinosa* did not compel different result where plan was silent on interest, such that IRS did not have notice that plan would discharge unpaid interest at completion of case.

4. Late Filed Tax Returns – Unsecured, Non-Dischargeable

***Winters v. Comm'n of Internal Revenue Service,* 2013 WL 364328 (Bankr. M.D. Tn. 2013), *reversed and remanded,* 503 BR 434 (6th Cir. BAP 2013)** – Because neither Bankruptcy Court nor Tax Court had issued final determination of the amount of tax debt for year in question, issues regarding statute of limitations, prior and nondischargeability could not be resolved. Case remanded to Bankruptcy Court for further proceedings. Prior to appeal, Bankruptcy Court had held that Section 507(a)(8)(A) gives priority treatment to tax claims where the return is last due less than 3 years pre-petition, or where the taxes are assessed less than 240 days plus any time during which collection was stayed pre-petition. Income taxes must be assessed within three years of date on which return is due. Upon assessment, taxpayer has 90 days to file an appeal. If an appeal is filed, IRS is precluded from assessing until Tax Court decision becomes final. Thus, filing of tax court appeal tolls running of 240 day period until appeal is determined. Debtor filed bankruptcy before Tax Court issued ruling, which precluded Court from issuing ruling and precluded running of 240 period for assessment. Debtor's obligation for 2004 tax liability was entitled to priority under Section 507. Further Section 523 precludes discharge to taxes that have not been assessed as of the petition date but which are still assessable as of the petition date. Debtor's liability for 2004 taxes which were unassessed but still assessable as of the petition date were excepted from the discharge.

***In re McCarthy*, Case No. 13-30959 (Bankr. D. Ma. 2016)** – Taxes owed based on late filed tax returns filed more than three years before petition date are not dischargeable. However, penalties assessed for failure to file returns are controlled by Section 523(a)(7) which governs penalties, not Section 523(a)(1) which governs taxes. Under Section 523(a)(7), penalties are dischargeable if the event giving rise to the penalty occurred more than three years before petition date. Relevant date for tax penalties is date on which tax returns were due. Penalties where therefore discharged and state violated discharge injunction in attempting to collect those penalties.

***McBride v. City of Kettering, Ohio,* 2015 WL 4749278 (Bankr. S.D. Ohio 2015)** – Late filed return is still "return" for purposes of Section 523(1)(1). Whether late filed return is dischargeable is determined by Section 523(a)(1)(B)(ii) which provides that taxes are dischargeable if filed after the last date due but more than 2 years before case filed. Return for tax year 1998 not filed until November, 1999, was late but was filed more than 2 years pre-petition.

***Storey v. United States,* 640 F.3d 739 (6th Cir. 2011)** – Section 523(a)(1)(c) excepts from discharge taxes that the debtor willfully attempted to evade or defeat. Government must prove that debtor did not pay taxes and that debtor "knowingly and deliberately" sought to avoid payment. Mere non-payment, standing alone, is not sufficient. Debtor timely filed tax returns which acknowledged the obligations. Debtor's purchase of a residence in the same year debtor stopped paying taxes did not demonstrate a voluntary or intentional choice to purchase a home rather than pay taxes, where home was not lavish or unnecessary. Government could not

demonstrate that at the time debtor purchased the home, she was even aware that she would later have a tax liability. Debtor did not engage in excessive recreational, philanthropic or other discretionary activities such as expensive vacations or private school expenses.

***Biggers v. Internal Revenue Service,* 2016 WL 5121893 (M.D. Tn. 2016)** – Return filed after due date is not automatically excluded from discharge. Pre-BAPCPA law in the Sixth Circuit used *Beard* test and there is no indication that Congress specifically intended to overrule *Beard.* Return is a "return" even if filed after the deadline if the "return" (1) purports to be a return; (2) is executed under penalty of perjury; (3) contains sufficient data to allow calculation of tax; and (4) represents an honest and reasonable attempt to satisfy the requirements of the tax law. Whether the taxpayer meets the "honest and reasonable" test looks to all facts and circumstances, not just those presented in the form and substance of the return, and must include consideration of length of delay, reasons for the delay, and number of tax years involved. IRS conceded first three elements where debtor was unable to file returns because secured lender seized all records and refused to relinquish them; first accountant hired to file returns had to be fired for doing nothing; and debtor moved 11 times in 9 year span. Case remanded for determination as to whether returns were honest and reasonable attempt to comply with law.

5. Secured Claims – Cram Down

Note lien applies despite applicable exemption. Lien secured by all equity in real and personal property. Distinguish exempt asset vs. non-estate property (such as 401k's). Must properly account for any liability rendered non-secured per cram down. If certain amounts will be rendered non-secured but will remain priority, ensure funding accounts for such claims. If certain amounts will be non-dischargeable, does it benefit client to cram down? If funding is available it may be beneficial to ensure claim is paid as secured.

Does the IRS have to release a pre-petition tax lien associated with a secured claim that was crammed down if certain liabilities underlying the lien are non-dischargeable and were not paid based on the cram down and re-classification to unsecured?

***In re Jackson,* Case No. 09-33790 (Bankr. E.D. Mi. 2015)** – Chapter 13 Plan binds all parties including debtors. Provision of Plan dealing with claims at variance with plan provided that claim would be allowed as filed. Although Chapter 13 plan proposed to cram IRS claim and to pay any remaining balance as unsecured, IRS filed Proof of Claim with secured, priority and unsecured components and claim must be allowed and treated accordingly. IRS failure to object to proposed cram down did not alter IRS right to rely on provision that claims are treated as filed.

Department of the Treasury | Internal Revenue Service | Office of Chief Counsel

Notice

CC-2010-016

September 2, 2010

Subject: Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late-Filed Returns and Returns Filed After Assessment

Cancel Date: Effective until further notice

Purpose

This Notice provides guidance on the application of the discharge exception under section 523(a)(1)(B)(i) of the Bankruptcy Code for a debt with respect to which a return was not filed in cases in which the taxpayer filed a Form 1040 after the due date.

Background

Pursuant to section 523(a)(1)(B)(i), an individual's bankruptcy discharge does not discharge a tax debt for which a required return was not filed. The Government successfully argued in a number of circuits that a Form 1040 filed after assessment does not qualify as a return for discharge purposes under section 523(a)(1)(B)(i). For example, In re Hindenlang, 164 F.3d 1029 (6th Cir.), cert. denied, 528 U.S. 810 (1999), the Sixth Circuit held that a document must qualify as a federal tax return under tax law to be a return for bankruptcy purposes. The court applied the test in Beard v. Commissioner, 82 T.C. 766 (1984), aff'd, 793 F.2d 139 (6th Cir. 1986), which held that if a document "contains sufficient information to permit a tax to be calculated" and "purports to be a return" and "is sworn to as such, and "evinces an honest and reasonable attempt to satisfy the law," it is a return. The Hindenlang court concluded that a Form 1040 filed after assessment serves no tax purpose and therefore was not an honest and reasonable attempt to satisfy the tax laws. Other circuits largely followed Hindenlang. See In re Payne, 431 F.3d 1055 (7th Cir. 2005); In re Moroney, 352 F.3d 902 (4th Cir. 2003); In re Hatton, 220 F.3d 1057 (9th Cir. 2000). The Eighth Circuit disagreed in In re Colsen, 446 F.3d 836 (8th Cir. 2006), holding that a document that on its face evinces an honest and reasonable attempt to satisfy the tax laws qualifies as a return, whether or not it was filed after assessment.

Section 523(a) was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The following unnumbered paragraph was added to the end of section 523(a), effective for cases filed on or after October 17, 2005:

Distribute to: X All Personnel
X Electronic Reading Room

Filename: CC-2010-016 File copy in: CC:FM:PF

> For the purpose of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State of local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

(Emphasis added.) Neither Colsen nor any of the prior decisions of the courts of appeal involved a bankruptcy case filed on or after October 17, 2005. In the dissent in Payne, Judge Easterbrook remarked that, after the 2005 legislation, an untimely return cannot lead to a discharge because of the reference to "applicable filing requirements" in the unnumbered paragraph in section 523(a). 431 F.3d at 1060. In In re Creekmore, 401 B.R. 748, 751 (Bankr. N.D. Miss. 2008), a post-October 17, 2005 case, the bankruptcy court agreed with Judge Easterbrook's dissent and concluded that any late-filed return can never qualify as a return for dischargeability purposes, unless it was prepared pursuant to I.R.C. § 6020(a). The bankruptcy court in Creekmore acknowledged that its reading of the unnumbered paragraph was harsh, but stated that debtors could avoid the problem by taking advantage of the "safe-harbor" of section 6020(a) by having the Service prepare their returns. Creekmore, 401 B.R. at 752.

Discussion

1. For bankruptcy cases filed on or after October 17, 2005, can a tax debt related to a late-filed Form 1040 be discharged?

Yes. Read as a whole, section 523(a) does not provide that every tax for which a return was filed late is nondischargeable. If the parenthetical "(including applicable filing requirements)" in the unnumbered paragraph created the rule that no late-filed return could qualify as a return, the provision in the same paragraph that returns made pursuant to section 6020(b) are not returns for discharge purposes would be entirely superfluous because a section 6020(b) return is always prepared after the due date. It is a cardinal principle of statutory construction that a statute should be construed so that no clause, sentence or word is rendered superfluous. Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998) (refusing to read one provision of the Bankruptcy Code to render another superfluous).

Section 523(a)(1)(B)(ii) provides that an individual's bankruptcy discharge does not discharge a debt for which a return was filed after the last date, including any extension, the return was due, and after two years before the date of the filing of the petition in bankruptcy. The Creekmore reading would limit the application of section 523(a)(1)(B)(ii) to cases in which the Service prepares a return for the taxpayer's signature under section 6020(a) of the Internal Revenue Code. By presuming that Congress intended to limit section 523(a)(1)(B)(ii)'s long-standing discharge exception for debts with respect to which a late return was filed more than two years before bankruptcy to the minute number of cases in which the Service prepares a return for the taxpayer's signature under section 6020(a), the Creekmore reading also contradicts a special rule for interpreting the Bankruptcy Code. As the Supreme Court stated in Dewsnup v. Timm, 502 U.S. 410, 419 (1992), "This Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." Finally, the supposed "safe harbor" of section 6020(a) is illusory. Taxpayers have no right to demand that the Service prepare a return for them under that provision. We, therefore,

conclude that section 523(a) in its totality does not create the rule that every late-filed return is not a return for dischargeability purposes.

2. Whether or not a Form 1040 filed after assessment is a return under nonbankruptcy law, is the related tax debt dischargeable?

No. A debt for the portion of a tax that was assessed prior to the filing of a Form 1040 is nondischargeable under 523(a)(1)(B)(i). The debt is not dischargeable because a debt assessed prior to the filing of a Form 1040 is a debt for which is return was not "filed" within the meaning of section 523(a)(1)(B)(i).[1]

For bankruptcy discharge purposes, an income tax for any given year can be partially dischargeable and partially nondischargeable. Section 523(a)(1)(A), together with section 507(a)(8)(A), excepts debts for priority taxes from discharge. Section 507(a)(8)(A) includes three alternative rules that confer priority (and nondischargeability) on income taxes. Two of those rules clearly allow priority to apply to only a portion of the tax for a given year. Section 507(a)(8)(A)(ii) generally confers priority (and nondischargeability) to income taxes that were assessed within 240 days of the bankruptcy petition. If only a portion of a year's income tax was assessed within the 240-day period, only that portion would be excepted from discharge. Section 507(a)(8)(A)(iii) generally confers priority (and nondischargeability) to income taxes that were unassessed but assessable after the bankruptcy case was filed. If only a portion of the income tax for a given year was unassessed but assessable, only that portion would be excepted from discharge. For discharge purposes, therefore, a given income tax is divided into dischargeable and nondischargeable debts if a criterion for discharge applies only to a portion of the tax.

As with section 523(a)(1)(A), a tax liability for any given year can be divided into dischargeable and nondischargeable debts under section 523(a)(1)(B)(i). Section 523(a)(1)(B)(i) excepts from discharge any "debt" for a tax with respect to which a return was not "filed." For bankruptcy discharge purposes, a debt for an income tax recorded by an assessment should be considered independently of any part of the tax for the same tax year that may be assessed later. If at the time of assessment no return has been filed, then the debt recorded by that assessment is a debt with respect to which a return was not filed and section 523(a)(1)(B)(i) applies to except it from discharge. If the taxpayer later files a Form 1040 that reports an additional amount of tax, only the portion of the tax that was not previously assessed would be a dischargeable debt based upon that subsection. The portion of a tax that was assessed before a Form 1040 was filed would be a debt for which no return was "filed" within the meaning of section 523(a)(1)(B)(i), because at the time of assessment the debtor had not met the filing requirements for that portion of the tax and the assessed portion was not calculated based upon the tax reported on the Form 1040. The assessed portion of the tax was a debt for a tax that was legally enforceable by lien or levy before any return was filed. In the case of a debtor who files a Form 1040 after assessment reporting no more tax than was previously assessed, no portion of the tax would be a dischargeable debt.

Conclusion

A Form 1040 is not disqualified as a "return" under section 523(a) solely because it was filed late. Regardless of whether a Form 1040 filed after assessment is a "return" for tax purposes, the portion of a tax that was assessed before the Form 1040 was filed is nondischargeable under

[1] Accordingly, whether a late-filed Form 1040 is a "return" – the issue addressed in Hindenlang and other cases on section 523(a)(1)(B)(i) – is irrelevant.

section 523(a)(1)(B)(i). All bankruptcy cases involving application of the discharge exception under section 523(a)(1)(B)(i) to cases involving a Form 1040 filed after assessment should be coordinated with Branch 5, Office of the Associate Chief Counsel (Procedure and Administration). Questions about this Notice should be directed to Branch 5 at (202) 622-3620.

/s/
Deborah A. Butler
Associate Chief Counsel
(Procedure & Administration)