Consumer Workshop III

Nothing in This Life Is Certain Except Death, Taxes and Student Loan Debt

CONCURRENT SESSION

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2016

Tax Issues in Bankruptcy

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I. INTRODUCTION

This material is divided into three sections. The first section briefly addresses the nature of tax debt (consumer or non-consumer). The second section addresses discharging taxes in bankruptcy. The appendix covers the discharge information in an alternative and more detailed format. Issues relating to Federal tax liens are addressed in the third section.

II. THE NATURE OF TAX DEBT (CONSUMER OR NON-CONSUMER)

When analyzing any Chapter 7 case, there is a critical question that is often overlooked. Is the case a consumer case or a non-consumer case?[1] Non-consumer debts alter Bankruptcy in several respects. If business and other non-consumer debts are a majority of the debt (a non-consumer case), 11 U.S.C. 707(b) does not come into play and there is no requirement to complete the means test form. The threshold to recover a preference is also higher in non-consumer cases.[2] In addition, the co-debtor stay in 11 U.S.C. 1301 and the redemption rights in 11 U.S.C. 722 do not apply to non-consumer debts.

Taxes are not consumer debts.[3] The Stewart Court does not discuss the issue. However, the Court tallied various consumer and non-consumer debts and put the tax debt on the non-consumer side of the ledger. The Westberry case provides an excellent analysis of this issue. The Court laid out four basic reasons why taxes (even personal income taxes) are not consumer debts: 1) taxes are not incurred voluntarily, 2) are incurred for a public purpose (as opposed to a consumer purpose), 3) taxes arise from the earning of money whereas consumer debts are the result of consumption, and 4) consumer debt involves the extension of credit.

The critical distinction is not whether the debt is consumer debt or business debt. The critical distinction is whether the debt is consumer debt or something else. On the old voluntary petition form, the choice presented by the two boxes on the front page suggested the wrong distinction. The new voluntary petition remedies this mistake. On the new voluntary petition form, if most of the debt is neither consumer or business debt, the debtor enters the type of non-consumer debt in question 16.c.

III. DISCHARGING TAXES IN BANKRUPTCY

A. BASIC DISCHARGEABILITY RULES

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[1] 11 U.S.C. 101(8) defines "consumer debt" as "a debt incurred by an individual primarily for a personal, family or household purpose."

[2] Preferences of $600 or more can be recovered in a consumer case. In a non-consumer case, only preferences greater than $6,225 can be recovered. See 11 U.S.C. 547(c)(8) and (9).

[3] In re Westberry, 215 F.3d 589 (6th Cir. 2000), In re Harrison, 82 B.R. 557 (Bankr.D.Colo. 1987) and In re Stewart, 175 F.3d 796 (10th Cir. 1999).

Any discussion regarding the discharge of taxes in bankruptcy must start with the basic rules of dischargeability for taxes. The basic rules are:

An income tax debt cannot be discharged if:

1. The due date of the tax return is within three (3) years of the date of the petition ("3-year rule");
2. The assessment date is within 240 days of the date of the petition ("240-day rule");
3. A tax is assessable, but not assessed (in certain circumstances);
4. The tax return was filed within two (2) years of the date of the petition or not filed at all ("2-year rule"); or
5. The debt was incurred due to fraud.

These rules are for the dischargeability of income taxes. These rules are gleaned from 11 U.S.C. 523(a)(1).[4] The fourth and fifth rules are in the body of that subsection. 11 U.S.C. 523(a)(1)(A) refers the reader to 11 U.S.C. 507(a)(8) for the first three rules. The first three rules address both dischargeability and priority status. The last two rules only address dischargeability. For a more detailed description of these rules, see the Appendix.

B. TOLLING

The rules listed above are tolled for certain events.

1. BANKRUPTCY OR COLLECTION APPEAL REQUESTS

BAPCPA inserted a number of "hanging" paragraphs into the Bankruptcy Code. One of those hanging paragraphs is in 11 U.S.C. 507(a)(8).[5] The essence of this

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[4](a) 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--

(A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, or equivalent report or notice, 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; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

[5] 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

provision is that the 3-year rule and the 240-day rule are tolled for two events. The first tolling event is any request for a collection due process hearing or any other type of collection appeal that legally prevents the IRS from taking collection action. The second tolling event is the filing of a bankruptcy. Each of these tolling events tolls the 3-year rule and the 240-day rule for the duration of the event plus 90 days. These events are also events that toll the statute of limitations for collection of a Federal tax debt.[6]

2. OFFERS IN COMPROMISE

Another tolling event is the filing of an Offer in Compromise. The filing of an Offer in Compromise only tolls the 240-day assessment rule. Tolling occurs for the time of the event plus 30 days. Offers in Compromise also toll the statute of limitations for collection of a tax debt.

3. THE TWO YEAR RULE AND TOLLING

As mentioned above, the tolling provisions are in the hanging paragraph located in 11 U.S.C. 507(a)(8). The two year rule is located in 11 U.S.C. 523(a)(1)(B). Therefore, it is not possible for these tolling rules to apply to the two year rule. Prior to the passage of BAPCPA, there was a great deal of litigation regarding whether tolling applied to the discharge rules. This ended when the Supreme Court held that the principle of equitable tolling applied to the 3-year rule.[7] In Young, the Court held the discharge rules to be a form of statute of limitations. The Court then applied the statutory construction rule of equitable tolling. Equitable tolling assumes Congress did not express tolling provisions because they are implied as part of a statute of limitation. Congress has now expressly stated tolling provisions in § 507. However, is the lack of a tolling rule in § 523 by design or does the lack of any direction mean equitable tolling still applies? This question is unresolved. The answer is either that tolling does not apply to the two year rule or the rule is tolled for the time in any prior bankruptcy. At least one court has ruled that the latter is the case,[8] applying the holding in Young. The IRS position is that, by analogy, the Young ruling applies to the two year filing rule.

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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.

[6] 26 U.S.C. § 6503.

[7] In re Young, 535 U.S. 43 (2002).

[8] In re Putnam, 503 B.R. 656 (Bankr. E.D.N.C. 2014).

C. OTHER UNIQUE ISSUES REGARDING THE 2-YEAR RULE

BAPCPA inserted another hanging paragraph in § 523(a).[9] This hanging paragraph defines "return" for this subsection. The first sentence starts by making clear that non-bankruptcy law is used to define what constitutes a return. The concept seems simple. However, the tax code does not define what constitutes a tax return. We now have three Circuit Courts that have ruled that a tax return that is simply filed late is not a return for bankruptcy purposes.[10] How did we get here?

1. A LITTLE HISTORY

The question of what constitutes a tax return was litigated in the early years of the income tax. Three Supreme Court cases are commonly mentioned for the early guidance on what might constitute a tax return.[11] These cases suggested that a tax return had to be on the proper form, be signed under penalty of perjury and be a genuine endeavor to file a return. Subsequent to these decisions, a number of situations arose regarding whether certain documents constituted tax returns.

One such situation was when a taxpayer failed to file a return and the Service commenced the process of creating an assessment without the filing of a tax return by taxpayer.[12] Sometimes during this process, the taxpayer signs the final report generated by the IRS. The final report is not a Form 1040, nor is it signed under penalty of perjury. However, in 1974 the IRS issued Revenue Ruling 74-203, which indicated signing these documents would constitute the filing of a return.

In 1984, the Tax Court addressed another problem situation. Taxpayer protestors were filing 1040 documents that were clearly never intended to be tax returns. In

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[9] 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 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.

[10] In re McCoy, 666 F.3d 924 (5th Cir. 2012), In re Mallo, 774 F.3d 1313 (10th Cir. 2014), In re Fahey, 779 F.3d 1 (1st Cir. 2015).

[11] Zellerbach Paper Co. v. Helvering, 293 U.S.172, 55 S. Ct. 127, 79 L. Ed. 264 (1934), Florsheim Bros. Co. V. United States, 280 U.S. 453, 50 S. Ct. 215, 74 L. Ed. 542 (1930), and Germantown Trust Co. v. Commissioner, 309 U.S.304, 60 S. Ct. 566, 84 L. Ed. 770 (1940).

[12] This is known as a substitute for return or SFR. This process is authorized by 26 U.S.C. 6020(b). In re Bergstrom, 949 F.2d 341 (10th Cir. 1991) held that an SFR was not a tax return.

most instances, the sworn statement was crossed out. The documents normally contained little or no financial information. The taxpayer protestors were filing documents that were not intended to be tax returns for various purposes including avoiding criminal prosecution for failure to file a tax return. Using the Supreme Court cases mentioned above, the Tax Court created a four part test[13] which has become known as the Beard test to determine what constitutes a tax return. The Court ruled that such documents were not tax returns. This ruling had a number of implications: the Service could pursue criminal failure to file, such documents did not have to be processed as returns and therefore did not start the audit statute of limitations, the Service could pursue the SFR process and assert the late filing penalty because a return had not previously been filed, the accuracy related penalty could not be asserted in the SFR process (because nothing had been reported).

Another question was whether a clearly fraudulent tax return constituted a tax return. In 1984, the Supreme Court indicated the answer was yes.[14] Similarly, the Tax Court addressed the question of whether a return containing clearly frivolous positions (clearly indicating there was no honest attempt to comply with the law) constituted the filing of a return. Using the Beard test, the Tax Court found such returns were tax returns.[15] This was true despite the fact there was no reasonable attempt to comply with the law, because there was a genuine endeavor to file a tax return.

Throughout this time, the IRS used RR 74-203 to determine whether a tax return was filed, including for bankruptcy purposes.

In the 90's, the States were fighting another battle in bankruptcy courts. The issue creating the litigation revolved around State law requirements to file documents after a Federal audit. Many state tax codes require a taxpayer to file a notice, report or amended tax return within a certain period after the end of a Federal audit.[16] The States took the position that these filing requirements (applicable filing requirements that are not tax returns) should be considered returns for

[13] 1) there must be sufficient data to calculate tax liability; 2) the document must purport to be a return; 3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and 4) the taxpayer must execute the return under penalties of perjury, Beard v. Commissioner of Internal Revenue, 82 T.C. 766, 777 (T.C. 1984), aff'd, 793 F.2d 139 (6th Cir. 1986).

[14] Badaracco v. Commissioner, 464 U.S. 386, 104 S. Ct. 756, 78 L. Ed.2d 549 (1984).

[15] Steines v. Commissioner, T.C. Memo 1991-588, and Sakkis v. Commissioner, T.C. Memo 2010-256.

[16] In Colorado, this requirement is found at C.R.S. 39-22-601(6)(a).

purposes of § 523(a). There was a split, but the majority of courts agreed with the States. This result was problematic in the tax world, because it was the equivalent of ruling that there can be more than one return for any given tax year. The Supreme Court has clearly ruled that there is only one return for a given period.[17] The Supreme Court has stated that amended returns are a supplement to and part of the original return. This concept is basic and fundamental to the nature of our tax code. The Courts that ruled for the States may have been implementing good public policy, but they were not following the law as written.[18]

In the late 90's, Congress became frustrated with record bankruptcy filings during generally good economic times. BAPCPA was originally drafted in 1998. The House passed the Bankruptcy Reform Act of 1999. The Senate passed the Bankruptcy Reform Act of 2000. The bills were reconciled and sent to President Clinton, who pocket vetoed the bill. The legislative history of that effort indicates the language at issue was intended to address State issues only.[19] That history never made it into the legislative history of BAPCPA.

In the years between the initial drafting and passage of BAPCPA, another issue saw of lot of litigation. The cases had fact patterns with variations of the facts in the Mallo case. The basic issue was whether a tax return filed after the completion of the SFR process was a tax return. Six appellate courts addressed this issue between 1998 and 2005.[20] The circuits were split on the issue of how to implement the Beard test for this issue. However, BAPCPA was never redrafted to address this issue.

After the passage of BAPCPA, the IRS immediately recognizes a problem. Revenue Ruling 74-203 is not consistent with the Supreme Court cases, Beard, or BAPCPA. In response, the IRS issues Revenue Ruling 2005-59 which revokes Revenue Ruling 74-203 as of September 12, 2005.[21] Revenue Ruling 2005-59

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[17] Zellerbach at 181, 311, 269 and Badaracco at 393, 762, 557.

[18] Unless one accepts the concept put forth in In re Payne, 431 F.3d 1055 (7th Cir. 2005) that return in the bankruptcy code had a different meaning than return in the tax world.

[19] H. Rept. 106-123 - 106th Congress (1999-2000).

[20] In re Savage, 218 B.R. 126 (10th Cir. B.A.P. 1998), In re Nunez, 232 B.R. 778 (9th Cir. B.A.P. 1999), In re Moroney, 352 F.3d 902 (4th Cir. 2003), In re Hindenlang, 164 F.3d 1029 (6th Cir. 1999), In re Payne, 431 F.3d 1055 (7th Cir. 2005), and In re Colsen, 446 F.3d 836 (8th Cir. 2006)

[21] As a note, the IRS still considers documents signed pursuant to Revenue Ruling 74-203 prior to September 12, 2005 as tax returns for bankruptcy purposes.

adopts a test similar to Beard to define what constitutes a tax return. Still, Revenue Ruling 2005-59 does not specifically address the Mallo factual situation.

In September of 2010, the IRS Office of Chief Counsel issued a memo to the insolvency units around the nation.[22] The memo addressed factual situations like Mallo. The stated IRS position is that the assessment based on the original SFR is never dischargeable. However, a later filed return will create a potentially dischargeable assessment in bankruptcy if the return creates a new assessment or liability. An example (similar to the facts in Mallo) can demonstrate the position:

- the IRS creates an assessment using the SFR process on husband of $8,000
- husband and wife subsequently file a joint tax return with total tax of $10,000
- more than two years after the filing of the joint tax return, husband and wife file for bankruptcy relief
- the IRS position is that the entire tax is dischargeable for wife and the additional $2,000 assessment is dischargeable for husband.

This had been the IRS position dating back to the Savage case. The IRS put forth the 2010 memo despite the fact there is no case law to support the position and there is no credible analysis of § 523(a)(1) that supports the interpretation. The position has been consistently rejected by the courts. The analysis may be good public policy, but is not the law (whether set out by statute or case law).

2. THE INITIAL RETURN

Which brings us to today. As previously mentioned, three circuit courts have ruled that any late filed return is not a return for bankruptcy purposes.[23] The rulings are nonsensical. The rulings effectively rewrite the statute to remove the two year filing rule, destroying the concept of the statute and failing to recognize the purpose of the language used by Congress. Despite the language in the statute indicating any return in nonbankruptcy law (which is tax law) is a return for bankruptcy, the courts use a non-tax law approach. The courts arrive at this decision by finding the due date of a return is an applicable filing requirement. To a lay person this might make sense. To anyone with an understanding of tax principles, the ruling makes no sense. Filing requirements have filing deadlines. However, the filing deadline is not part of the filing requirement. Filing requirements do not end when filing deadlines pass. In the tax code, filing

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[22] IRS Office of Chief Counsel Notice CC-2010-016, dated September 2, 2010 (position reiterated in IRS Memorandum of September 28, 2011 Control Number SBSE-05-0911-078).

[23] Currently, appeals are pending in the ninth and eleventh circuits. There are differing opinions in the third circuit that may lead to an appellate court decision in that circuit.

requirements are addressed in one part of the code and the deadlines to comply with the filing requirements are set out in another part of the code.

Nevertheless, in Mallo the 10th Circuit has ruled that a tax, where the return is filed late, is not dischargeable.[24] However, that is not the end of the matter. The IRS tries to apply a uniform set of tax laws throughout the country. The IRS does not agree with the rulings of the 1st, 5th and 10th Circuits and applies the law as set out in the memo originally issued in September of 2010.[25] Therefore, at this time, the IRS will abate a dischargeable tax even when the return is filed late, as long as the other discharge rules have been met.

The Colorado Attorney General's Office has indicated that they will advise the Colorado Department of Revenue to enforce the Mallo ruling.

The bottom line is that, at this moment, the IRS is following its own reasoning, not the reasoning of Mallo on the Federal level. This is fortunate, but Mallo significantly decreases the dischargeability of taxes on the State level.

3. THE "SECOND" RETURN

BAPCPA, the legislative history of the BAPCPA predecessor, and the majority of cases prior to the passage of BAPCPA indicate there are filing requirements not normally considered tax returns which count as tax returns for bankruptcy purposes. The primary example, State law requirements to file some sort of document after the completion of a Federal audit are a second filing requirement for the same tax year. A "second" two year filing period must run before the assessment based on the "second" return can be discharged.

In theory, this can also apply to other statutory or regulatory requirements to file amended returns or other documents that would result in additional assessments. The easiest example to understand is the former 26 U.S.C. 121.[26] This section allowed homeowners to defer the capital gain on the sale of a personal residence, as long as the proceeds were reinvested into a personal residence of greater or

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[24] There are two exceptions: returns prepared under 6020(a) and stipulated decision documents. A taxpayer has no right to ask for a tax return to be prepared under 6020(a). I have practiced in this area for over 25 years and have never seen one. The last step of the SFR process is for the IRS to issue a Notice of Deficiency to the taxpayer. The taxpayer can sign a stipulated decision document after timely filing a Tax Court petition. The signed decision document is defined as a return by the hanging paragraph.

[25] The Chief Counsel memo recognizes that Colsen is still good law in the 8th Circuit and that the IRS will follow the Colsen ruling in that circuit.

[26] This section was modified to its current state in 1998.

equal value within two years. If the reinvestment did not occur, there was a requirement to amend the tax return. On the Federal level, this would have been an example of an applicable filing requirement that is not a tax return.

4. POSSIBLE LEGISLATIVE FIXES

Virtually everyone is in agreement that McCoy, Mallo and Fahey do not represent the intent of Congress. Perhaps another circuit will use an alternative approach, creating a split among the circuits on the BAPCPA language. If so, maybe the Supreme Court eventually takes up this issue. Obviously, Congress did a poor job drafting this provision. Eventually, Congress needs to improve its language.

To this end, one suggestion has been to add the phrase "except temporal requirements" to the parenthetical "including applicable filing requirements." This would be a bandage that accepts the original language was interpreted correctly. Nor does it help explain the original intent of the language.

In part, the problem here is that Congress enacted language that contains redundancies and superfluous language. There was no need to indicate a 6020(b) return was not a return. Such an assessment is not considered a return under nonbankruptcy law. The addition of "equivalent report or notice" to 523(a)(1)(B) and the parenthetical in the hanging paragraph accomplish the same purpose. This leads to two problems. One, courts use the statutory canon of construction that all language is to be given meaning if possible. Two, courts tend to assume the new language addresses the issue in front of them (which is not the case when addressing a Mallo type fact pattern). Here is my crack at a fix: I would return 523(a)(1)(B) to its prior language. I would rewrite the hanging paragraph as follows:

> For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law. In addition, the following documents will also be considered a "return:"
>
> > A. a return prepared pursuant to section 6014 or 6020(a) of the Internal Revenue Code of 1986, or similar State or local law; or
> > B. a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal; or
> > C. any amended return, report, notice or other equivalent document required to be filed by Federal, State or local statutes which creates or leads to an additional assessment.
>
> For purposes of clarity, the following documents are not a "return:"
>
> > A. documents created pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law;
> > B. Any document consenting to an assessment other than a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.

This definition assures that all traditional forms of returns are considered returns. Congress intended stipulated decision documents (and State law equivalents) to be tax returns for this subsection, but not the type of documents referred to in Revenue Ruling 74-203. This language retains that intent. Congress also intended to resolve the issue of whether State law requirements to file documents after Federal audits are "returns" in favor of the States. This language retains that intent. In addition, the language is uniform so that any statutory requirement to file a document that leads to another assessment is another return. The last two items are superfluous. This language attempts to make clear that nothing is added or subtracted by the language.

This does not address the factual issues presented in Mallo. Perhaps that issue should be addressed in tax law rather than the bankruptcy code. Courts would then have to decide whether the Hindenlang or Colsen approach was correct.

If one did want to resolve the Mallo issue in favor of the IRS position, then I would suggest adding the following language to the first (A):

> except to the extent a return filed after the completion of the 6020(b) process of the Internal Revenue Code of 1986, or a similar State or local law, duplicates the assessment made in such process;

This language attempts to achieve the position of the IRS memo on this issue.

If one wanted to resolve the Mallo issue in favor of the taxpayer position (although one could argue this is superfluous language) I would add (D):

> D. any return filed after the completion of the 6020(b) process of the Internal Revenue Code of 1986, or any similar State or local law.

This would make clear that there is no difference between a return filed prior to the SFR process and one filed after.

If you have suggestions, please let me know. I hope that Congress can address this in a technical amendment at some point.

D. PENALTIES

Generally, penalties are dischargeable if the three year rule is met.[27] Although I have not seen any case law on the issue, it should be noted that the discussion regarding tolling of the two year rule must logically apply to this issue also.

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[27] 11 U.S.C. 523(a)(7) and In re Roberts, 906 F.2d 1440 (10th Cir. 1990).

11 U.S.C. 523(a)(7) indicates the event creating the penalty must have occurred at least three years prior to filing the petition. The most common penalties are: failure to pay,[28] failure to file[29] and failure to pay estimated taxes.[30] Each of these penalties is an act of omission where the event occurs before or immediately after the tax return was due.

However, the 10th Circuit BAP has held that the frivolous filing penalty occurs when the return is filed.[31] Therefore, for the frivolous filing penalty, the three years runs from the filing of the return, not the due date. I believe the same logic would apply to the accuracy-related[32] and fraud penalties.[33] These events occur when the act occurs.

E. POST-PETITION INTEREST IN CHAPTER 13

BAPCPA added debts described in §§ 507(a)(8)(C) and 523(a)(1)(B) and (C) to the exceptions to discharge in § 1328(a). Since such debts are not dischargeable, post-petition interest continues to accrue.[34] This is the case even if the liability is being paid 100% through the plan. Pursuant to § 1322(b)(10), post-petition interest can be paid through the plan if the plan is a 100% plan. There is little case law on this issue and the application of this provision does not appear to be consistent.

IV. RESOLVING THE FEDERAL TAX LIEN

A. FEDERAL

The Notice of Federal Tax Lien survives Bankruptcy.[35] The lien cannot be avoided using 11 U.S.C. 522(f) or redeemed using 11 U.S.C. 722. The filing of tax liens is covered in 26 U.S.C. 6321 through 6325 and C.R.S. 38-25-101 through 107. For personal property, the lien must be filed with the Secretary of State. For real estate, the lien must be filed with the Clerk and Recorder for the county where the property is situated. The Federal Tax Lien is pervasive. Once

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28 26 U.S.C. 6651(a)(2)

29 26 U.S.C. 6651(a)(1)

30 26 U.S.C. 6654

31 In re Wilson, 407 B.R. 405 (10th Cir. BAP 2009).

32 26 U.S.C. 6662A

33 26 U.S.C. 6663

34 In re Monahan, 497 B.R. 642 (1st Cir. B.A.P. 2013) and In re Weiss, 113 A.F.T.R.2d (RIA) 452 (Bankr.D.Kan. 2014).

35 In re Isom, 901 F.2d 744(9th Cir. 1990).

properly filed, the lien attaches to all personal property, including after acquired property. There are a few exceptions that can be found in 26 U.S.C. 6323(b) for certain types of security interests and bonafide purchasers for value.

1. CHAPTER 7

A lien that attaches to nothing and for which there is no longer a liability is void. The IRS recognizes this. Although the IRS lien is pervasive, in cases where the assets have minimal value, the IRS routinely releases liens after abating dischargeable taxes. Generally, the IRS is only concerned with property easily converted to cash, and real estate with meaningful equity.

If the IRS is interested in pursuing its lien rights, the insolvency unit will issue a letter requesting the taxpayer turnover funds equal to the amount of the equity in assets. This letter is, in essence, an invitation to negotiate the value of the lien. There are no rules or regulations that constrain the ability of the insolvency unit to negotiate the value of the lien.

The IRS will take into account the cost of sale, administrative costs in pursuing the lien right and any other issues which may limit the IRS' ability to realize the full value of the lien.

2. CHAPTER 13

In general, a Chapter 13 plan must provide for a secured claim of the IRS in full and with interest. I use the current underpayment rate. The current underpayment rate is 3%. The claim is only secured to the extent there is equity to which the lien attaches.

One exception to the general rule that the secured claim must be provided for in full, relates to ERISA qualified pension plan benefits. Internal Revenue Service v Snyder, 343 F.3d 1171 (9th Cir. 2003) held that a plan that includes the anti-alienation ERISA rules is not property of the Bankruptcy estate and is not part of the IRS' secured claim for Chapter 13 purposes. The IRS has accepted this position. This does not remove the IRS lien. The lien survives the Bankruptcy. The question is will the IRS be open to negotiating a discount of the lien after the Bankruptcy? To date, it appears the IRS is releasing liens at the end of Chapter 13's in these situations.

B. STATE OF COLORADO

The authority of the State of Colorado to issue liens can be found in C.R.S. 39-21-114. Colorado's judgment lien is effective for six years. The lien only applies to real estate. Like the IRS, the State releases liens that clearly have no value.

If there is no real estate and the State does not release the lien, the lien is void. The problem is getting everyone to recognize this fact. A "judgment transcript can only create a lien if there is a res to which the lien can attach" In re Yates, 47 BR 460(D.Colo.1985). Once the debt has been discharged, if there is no real estate, there will never be a res to which the judgment transcript can attach. If the State (or any other creditor) is refusing to release a lien, a taxpayer can file an adversary proceeding for a declaratory order that the judgment is void. This is not a motion to void a lien pursuant to 11 U.S.C. 522(f).

APPENDIX - DISCHARGE RULES

I. Basic rules for dischargeability of income taxes (all rules must be met)

A. Three year rule

This rule relates to the original due date of the return. The date the return was actually filed is not relevant. The date of the assessment is not relevant. No tax is dischargeable unless three years have passed since the original due date of the return. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(I).

1. Therefore, between January 1st and April 15th of each year, the last four years are never dischargeable periods. After April 15th of each year, the last three years are never dischargeable periods.

2. Be wary of April 15th falling on a weekend. April 15th falling on a weekend alters the due date of a tax return to the 16th or 17th. This is complicated by the fact the IRS has recognized Patriots Day as a holiday in several northeastern states. In these states, the deadline can be extended by another day. I am unaware of any cases ruling on this issue. However, I would not want to be the test case. Normally, I do not file cases before April 19th to avoid dealing with these issues.

3. Tax returns are normally due on April 15th. In the past, a taxpayer could file an extension to August 15th and a second extension to October 15th. If these extensions were requested, the three year rule was counted from the August 15th or October 15th date. Starting with the 2005 tax year, the IRS eliminated the first extension, now all extensions are to October 15th.

4. There is no need to file an extension in Colorado. The extension is automatic. Therefore, any late filed return will have a due date of October 15th.

B. 240 day rule

This rule relates to the date the tax was actually assessed. The date the return was due is not relevant. The date the return was actually filed is not relevant. No tax is dischargeable if it was assessed within the 240 days preceding the Bankruptcy. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(ii). By statute, Colorado income taxes are deemed assessed on the date of filing.

C. Two year rule - Federal

1. This rule relates to the date the return was actually filed. The date the return was due is not relevant. The date the tax was assessed is not relevant. No tax is dischargeable if the return was filed in the two years preceding the filing of the Bankruptcy or not filed at all. See 11 U.S.C. 523(a)(1)(B). If a return is filed late, the received date is the filing date, not the postmark date. It is theoretically possible the IRS will adopt the Mallo ruling at some point in the future.

2. A return filed after the completion of the SFR process will not count as a return except to the extent the return increases the tax. In addition, the return will count as a return for any non-SFR'd spouse.

D. Two year rule - State

1. Any late filed return is not dischargeable. However, as mentioned above, in Colorado a late filing is a return filed after October 15th.

2. After a Federal audit, there is a "second" requirement to file a return. This is done by filing an amended return within 30 days of the end of the Federal audit. This later assessment is only dischargeable if the amended return is filed within 30 days of the end of the Federal audit, and two years have passed since the filing of the amended return.

E. Fraud

A tax is not dischargeable if the debt was incurred due to fraud. See 11 U.S.C. 523(a)(1)(C). However, the dischargeability of the fraud penalty is controlled by 11 U.S.C. 523(a)(7).

F. Assessable but not assessed

Any amount that could be assessed, but is not yet assessed, is not discharged. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(iii).

1. The essence of this rule is: it is foolish not to have full disclosure on any return that is going to be discharged. If the audit statute is still open, any amount that could be assessed is not discharged. On the Federal level, the statute of limitations for assessment is three years from the date of the filing of the return or the original due date, whichever is later. See 11 U.S.C. 6501. On the State level, the statute is one year longer. See C.R.S. 39-21-107(2). Taxpayers can sign extensions to the deadline. If a Notice of Deficiency has been filed, the IRS or CDR has met the deadline. Prior to filing it is important to understand whether there is potential for an additional assessment.

2. The introductory clause relating to the two year filing requirement and the no fraud rule no longer effect dischargeability. The reference to § 523 simply limits the scope of priority debt. Without this clause, all unfiled and fraudulent returns would be priority debts.

II. Tolling

A. A prior Bankruptcy tolls the three year rule and the 240 day rule for the time in Bankruptcy, plus 90 days.

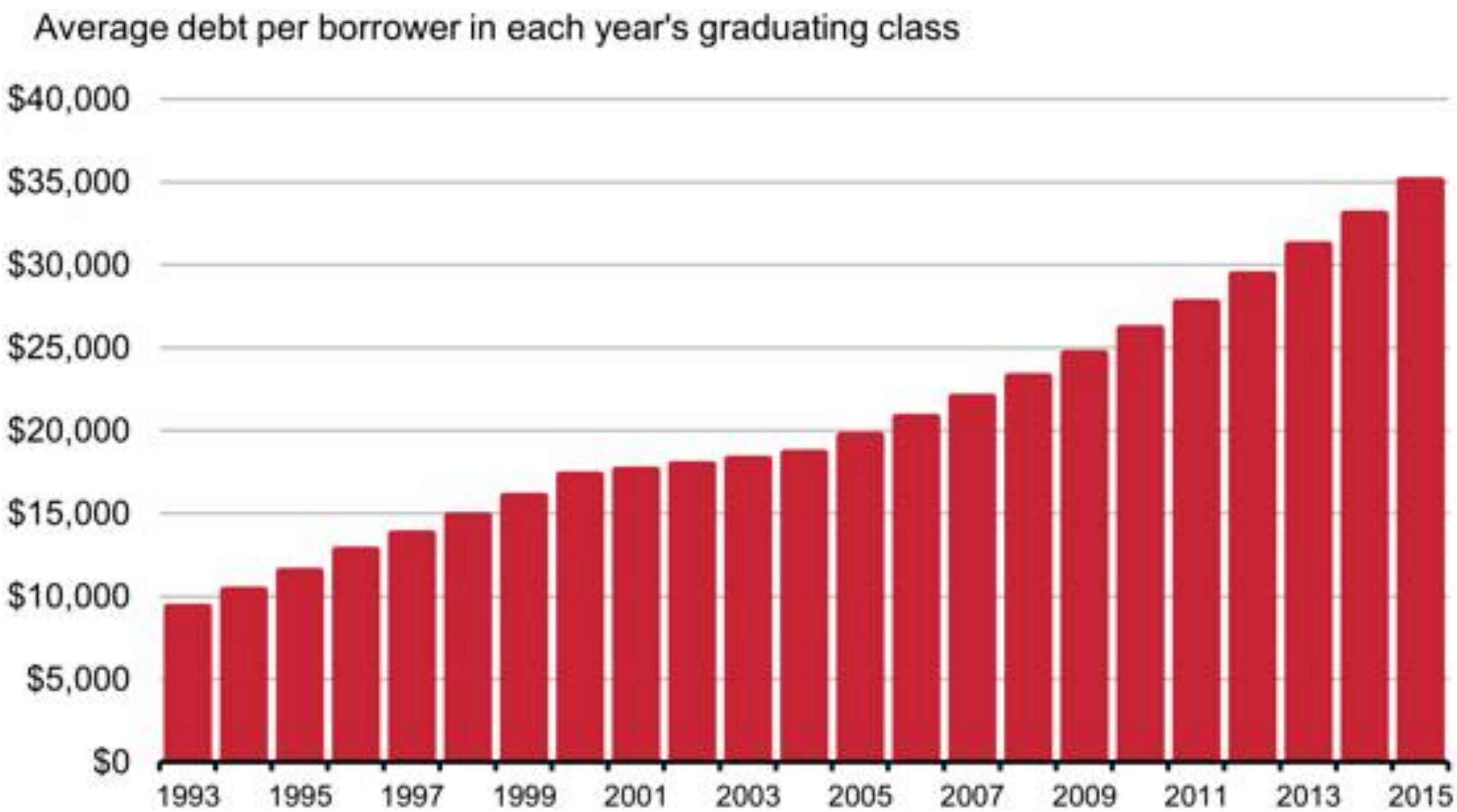
B. A collection due process request tolls the three year rule and the 240 day rule for the time in Bankruptcy, plus 90 days.

C. The 240 day rule is tolled for the time in an Offer in Compromise plus 30 days.

D. It is unclear whether tolling applies to the two year filing rule or the three year rule for penalties. If tolling does apply, the tolling would be for the time in a prior bankruptcy pursuant to Young.

Student Loan Debt

Student Loan Debt

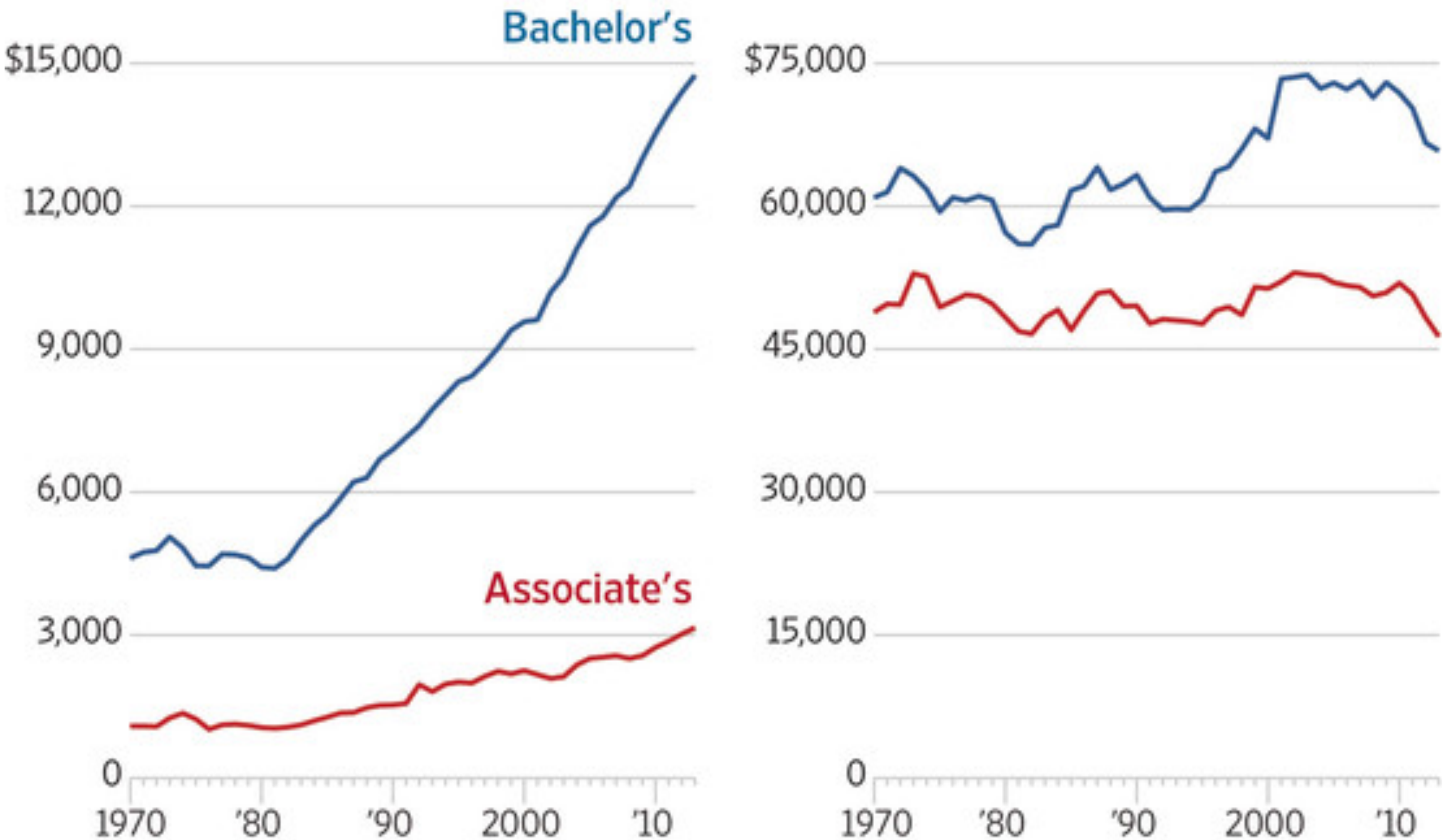


Source: Mark Kantrowitz, wsj.com May 8, 2015

The tuition cost of a four-year degree has been rising much faster than that for a two-year degree, while the wage gap of graduates hasn't changed much.

Average annual tuition cost in the U.S. by type of degree in 2013 dollars

Average wages of those with each type of degree in 2013 dollars



Source: Federal Reserve Bank of New York

The Wall Street Journal

I. GENERAL OVERVIEW OF STUDENT LOANS

- Student loan debt exceeds $1.2 Trillion; private student loans at $165 billion
- Credit Card debt at $854 billion
- Auto debt at $877 billion

- More than 70% of the graduates of the Class of 2015 graduate will have student debt with an average amount owing of $35,000
- More than 13% of borrowers will default within the first three years of repayment
- More than 40,000,000 Americans currently owe student loans

A. Higher Education Act of 1965: In 1965, Congress, in response to a perceived need for financial assistance to students in higher education, passed the Higher Education Act of 1965 (HEA). The purpose of the HEA is to "keep the college door open to all students of ability," regardless of socioeconomic background.

B. (There Were) Two Federal Student Loan Programs: The HEA governs two federally-backed student loan programs: the Federal Family Education Loan Program (FFEL Program) and the William D. Direct Loan Program (Direct Loan Program). Under the Health Care and Education Reconciliation Act of 2010, Congress eliminated new loans under the FFEL Program, effective July 1, 2010. Currently, the total debt at stake in the two federal student loan programs is over $1 trillion.

1. FFEL Program: Under the FFEL Program, eligible lenders make guaranteed loans on favorable terms to students or parents to help finance student education. The loans are guaranteed by guaranty agencies (state agencies or private non-profit corporations), which are ultimately reinsured by the United States Department of Education (ED).

2. The Direct Loan Program: Under the Direct Loan Program, ED makes loans directly from the federal treasury to student and parent borrowers.

C. Types of Federal Loans:

1. HEA: Loans under the HEA include Perkins Loans, Stafford (subsidized and unsubsidized) Loans, PLUS Loans and Consolidation Loans. Grants include Pell Grants and Supplemental Education Opportunity Grants. The terms of Stafford, PLUS and Consolidation loans in both the FFEL Program and the Direct Loan Program are similar except that the Direct Loan Program offers a Public Service Loan Forgiveness program and two income-related payment options (income based and income contingent). *See infra* at II.G., III.B.

2. Health and Human Services Loans: The United States Department of Health and Human Services (DHHS) also administered a student loan program, Health Education Access Loan program, (HEAL), for borrowers engaged in health related studies. This program is no longer active. Like FFEL Program loans, HEAL loans are also presumptively nondischargeable. Courts have construed the dischargeability standard of "unconscionability" for HEAL loans as being a "higher standard" than that of FFEL Program/Direct Loan loans, which require a showing of "undue hardship." Even though HEAL loans are administered by DHHS, HEAL loans are eligible for consolidation along with FFEL Program loans in the Direct Loan program.

D. Non-HEA Loans: Private Loans: Private loan programs have also emerged on the scene to provide educational funds to students who have exhausted their federal loan limits or are otherwise ineligible to borrow under the federal loan programs. Private loans are not eligible for administrative relief discussed below and may not be consolidated under federally-backed consolidation programs. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, however, expressly included private loans in the presumption of nondischargeability under 11 U.S.C. § 523(a)(8).

II. NONBANKRUPTCY RELIEF

There are numerous administrative remedies for student loan borrowers to consider in lieu of seeking discharge under § 523(a)(8). Unlike relief under 11 U.S.C § 523(a)(8), borrowers may be entitled to administrative relief regardless of whether they've filed bankruptcy. But these administrative options require administrative determinations and, thus, should not be the basis for claim objections or adversary proceedings in a bankruptcy context.[1]

A. Total and Permanent Disability Discharge (TPD):

1. Eligibility Criteria: Borrowers may be eligible to have their federal student loan debt discharged because of a total and permanent disability.

a. TPD application: A medical doctor or doctor of osteopathy must certify that the borrower (1) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that (i) can be expected to result in death;(ii) has lasted for a continuous period of not less than 60 months; or (iii) can be expected to last for a continuous period of not less than 60 months; or (2) has been determined by the Secretary of Veterans Affairs to be unemployable due to a service-connected disability.

b. Social security award letter: As of July 1, 2013, borrowers who receive Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) benefits may use their SSA award letter in lieu of obtaining a separate certification from a physician on the TPD discharge application. The letter must state that the borrower's next scheduled disability review will be within 5 to 7 years from the date of the most recent SSA

[1] For full detail of requirements necessary for relief, see 34 C.F.R. §§ 682.100 *et seq.*, 685.100 *et seq.* These administrative options are available for both FFEL Program and Direct Loan Program loans unless otherwise noted.

disability determination. Borrowers may also submit a Benefits Planning Query (BPQY) that can be obtained by calling 800.772.1213.

ED has designated Nelnet as its disability servicer for all TPD applications submitted after July 1, 2013. Under the new TPD process, borrowers must submit a single TPD discharge application directly to ED/Nelnet rather than to their individual loan holders. Borrowers may initiate the TPD process by going to www.disabilitydischarge.com.

If the TPD request is approved, the account is immediately discharged by ED.[2] But a three-year post-discharge monitoring period remains is in effect. During this three-year period, borrowers cannot earn more than 100% of the federal poverty guidelines for a family of two (in 2014 = $15,730) and cannot have obtained any new federal student loans. Typically, Nelnet will contact the borrower when the three-year mark is approaching to update the disability status and financial status to ensure that the borrower's discharge criteria have not changed.

2. **Veterans with service-connected disabilities:** Veterans who have a 100% service-connected disability are immediately eligible for discharge of their federal student loan debt without further certification under the TPD regulation. They need only provide their Veteran's Administration disability rating paperwork to the loan holder who will process the discharge.

B. Loan Rehabilitation: Federal regulations allow borrowers who default on repayment of their loan a one-time opportunity to bring their loans out of a default status and repair the negative credit information reported to credit bureaus. Payment amounts are set at a reasonable rate and borrowers must make nine consecutive on-time payments over a 10-month period. Completing rehabilitation restores a borrower's loans to good standing and helps to repair credit. Entering a loan rehabilitation agreement has immediate effect on a borrower's defaulted loans: it stops all collections activity and legal proceedings, prevents wage garnishment, and it may protect a borrower's federal tax refunds from IRS offsets. After successfully completing a loan rehabilitation, a borrower will be entitled to enter into deferments, forbearances, and income-sensitive repayment plans.

C. Closed School Discharge: Borrowers whose school closed before they could complete the program of study may be eligible for discharge. The borrower must show they were enrolled at the time of closure or that they withdrew from the school not more than 120 days prior to the date the school closed and that they were unable to complete the program of study through a teach-out at another school or by transferring academic credits or hours earned at the closed school to another school.

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[2] Under the Internal Revenue Code, student loan debt forgiven or discharged by TPD may constitute a taxable event. This is a nonissue in most cases because any forgiven debt is taxable only to the extent the borrower is solvent. Thus, it is unlikely that borrowers with large student loan debts will have assets that exceed the debt discharged by TPD.

D. False Certification Discharge: A borrower's student loans can be discharged if a school falsely certified the student's eligibility for a federal student loan on the basis of ability to benefit from the education, signed the borrower's name without authorization by the borrower on the loan application or promissory note, **OR** someone else obtained a federal student loan because of identity theft.

E. Death Discharge: If an individual borrower dies, or the student for whom a parent received a PLUS loan dies, the obligation of the borrower and any endorser to make any further payments on the loan is discharged."

F. Public Service Loan Forgiveness: Borrowers who make 120 qualifying payments under the IBR, ICR, or 10-year fixed payment schedule while employed in the public sector are eligible to have any balance remaining on their student loan debt forgiven. Public service includes employment with most local, state, federal, tribunal nation, or § 501(c)(3) corporations. (Direct Loan Program loans only).

III. FLEXIBLE, AFFORDABLE PAYMENT OPTIONS: INSIDE OR OUTSIDE OF BANKRUPTCY

Both the FFEL Program and the Direct Loan Program have flexible, affordable payment options for borrowers who have financial hardship. These payment options are available whether or not the borrower has filed bankruptcy. ECMC will always rely on the most affordable payment amount available to the borrower when defending undue hardship discharge cases.

A. Consolidation: Consolidation benefits a borrower by spreading the payments over a term of up to 30 years, depending on the total loan balance. After July 1, 2010, consolidations have been available only in the Direct Loan Program. Borrowers who have previously consolidated their loans in the FFEL Program may reconsolidate their loans (even if defaulted) into the Direct Loan Program.

B. Income-Driven Payments: In addition to fixed, amortized extended payment terms, there are two payments options that are based on a borrower's income and family size: the Income Based Repayment plan (IBR) (available in both the FFEL and Direct Loan Program) and the Income Contingent Repayment plan (ICR) (available only in the Direct Loan Program).

1. Income Based Repayment:

a. Eligibility for IBR: Defaulted student loans, PLUS loans, or federal consolidation loans that contain underlying PLUS loans or a mix of Stafford loans and PLUS loans are not eligible for the IBR in either the FFEL Program or the Direct Loan Program. Stand-alone Perkins loans are also not eligible for the IBR. But a borrower may include a Perkins loan in a consolidation loan that will be IBR-eligible.

Borrowers who have defaulted FFEL Program loans may re-consolidate their defaulted loans into the Direct Loan Program and elect the IBR in the Direct Loan Program. (Re-consolidating removes the default because the borrower has a new loan). Borrowers also have a one-time opportunity to rehabilitate their loan to remove the default status and be eligible for the IBR in either federal student loan program. *See supra* II.B.

b. Borrowers who have IBR-eligible loans must first demonstrate partial financial hardship (PFH). Borrowers can demonstrate PFH if the annual amount due on all eligible student loans under a 10-year repayment schedule is more than 15% of their adjusted gross income (AGI). Most borrowers whose total loan balance exceeds their annual earnings will satisfy the PFH requirement.

The IBR payment is calculated using the borrower's AGI and family size. If the borrower earns less than 150% of the poverty level for their family size, the IBR payment will be $0. The required annual loan payment under the IBR is capped at 15% of earnings above 150% of the applicable poverty level. Because the monthly IBR payment is calculated as a percentage of the borrower's income, if the borrower's income drops, the monthly payment is reduced accordingly.

The IBR payment is recalculated annually based on household income. Married borrowers who file separate tax returns have their IBR payments based on their own respective incomes but may still count each other and any dependents in the family size. Borrowers may contact their lender/servicer at any time if they experience a change in financial circumstances that could impact their required IBR payment. The IBR repayment period is 25 years. At the conclusion of the 25-year repayment period, any remaining balance is forgiven.[3] *But see infra* III.B.3 (discussing 10-year repayment term for the Public Service Loan Forgiveness Program).

2. Income Contingent Repayment: Like the IBR, the ICR is recalculated annually and the payment amount is based on 20% of the difference between a borrower's AGI and 100% of the federal poverty level for the family size. If the AGI is below 100% of the poverty level for the borrower's family size, then the ICR payment is $0. The ICR is the only income-driven payment option available to PLUS loan borrowers or to borrowers who have defaulted loans in the Direct Loan Program. The ICR is always based on household income regardless of tax filing status. After 25 years, any balance that is remaining is forgiven by the Secretary of Education. *See* Note 3.

3. Public Service Loan Forgiveness: Borrowers who make 120 qualifying payments under the IBR, ICR, or 10-year fixed payment schedule while employed in the public sector are eligible to have any balance remaining on their student loan debt forgiven. Public

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[3] Under the Internal Revenue Code, student loan debt forgiven at the end of the IBR (and ICR, discussed *infra*) term may constitute a taxable event. This is a nonissue in most cases because any forgiven debt is taxable only to the extent the borrower is solvent. Thus, it is unlikely that borrowers with large student loan debts will have assets that exceed the debt forgiven 25 years into the future.

service includes employment with most local, state, federal, tribunal nation, or § 501(c)(3) corporations. There is specific language in this regulation that exempts any forgiven debt from constituting a taxable event. (Direct Loan Program loans only).

D. Suspension of Payments: In addition to the different types of repayment plans, borrowers may seek deferment or forbearance. Deferment or forbearance may be granted for specific bases stated in federal regulations, which include, but are not limited to, poor health, economic hardship, federal student loan payments that are equal to or greater than 20% of monthly gross income, or other reasons acceptable to ED.

During a deferment period, no interest accrues on subsidized loans, but interest continues to accrue on unsubsidized loans. The borrower may pay the accruing interest on any unsubsidized loans or have it added to the principal when the deferment expires. Forbearance postpones or reduces the monthly repayment for a limited, specific period, during which interest on subsidized and unsubsidized loans continues to accrue. If the interest is not paid during the forbearance, it is added to the principal balance when the forbearance period ends.

IV. ADMINISTRATIVE REMEDIES v. § 523(a)(8): IS THERE COMMON GROUND?

11 U.S.C. § 523(a)(8)
Student loans are not dischargeable unless excepting them from discharge would impose an undue hardship on the debtor and dependents.

- Adversary proceeding required under F.R.B.P. 7001(6)

Undue hardship undefined term in 523 context

- Phrase lifted from draft bill proposed by Commission on the Bankruptcy Laws of the United States. Report of the Comm'n on the Bankr. Laws of the United States, H.R. Dock. No. 930137 Pt. II § 4-506 (1973).

Bruner Standard:
Most circuits use three prong standard developed in Second Circuit via Bruner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987).

1) The debtor cannot maintain based on current income and expenses, a "minimal" standard of living for herself and dependents if forced to repay the loans;
2) That additional circumstances exist indicating that this state of affairs is likely to persist for significant portion of the repayment period of the student loans;
3) That the Debtor has made good faith efforts to repay the loans.

Eighth Circuit: Long v. Educ. Credit Mgmt. Corp., 322 F.3d 549 (8th Cir. 2003): totality of circumstances should include consideration of:

1) Past, present and reasonably reliable future financial resources;
2) A calculation of the debtor's and dependent's reasonable necessary living expenses;
3) Any other relevant facts and circumstances surrounding the each particular bankruptcy case.

First Circuit: Murphy v. U.S. Dept. of Educ.; Educ. Credit Mgmt. Corp. As of date of the written material submission, decision has not been rendered.

Tenth Circuit: Bruner plus totality of circumstances?
Application of Bruner does not mean ruling out consideration of all facts and circumstances – Judges shall have discretion to weigh all the relevant considerations when determining if student loan repayment will be undue hardship. Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1309 (10th Cir. 2004).

Likelihood of Success of Determination of Dischargeability
An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard, Jason Iuliano, 86 American Bankruptcy Law Journal 495 (2012).

Searched adversary proceedings on pacer filed in 2007

Used 10 largest education loan holders as party (holding 71.2% of all student loans)

Analyzed 207 cases filed (extrapolating that this was 1/10 of 1% of cases with student loans)

Those who filed relatively successful:
- 51 cases received full discharge
- 30 cases received partial discharge
- 25 cases obtained administrative

Three variables statistically significant in cases obtaining relief:
- Medical hardship
- Employment status
- Income year before filing

Why are more not seeking relief:
1) Administrative relief as discussed above
2) Long held belief that discharge in bankruptcy impossible – self-fulfilling prophecy
    a. Prevents individuals with student loans from filing adversary proceeding
    b. Prevents individuals with majority debt from student loans from filing bankruptcy
    c. Keeps individuals in perpetual chapter 13 bankruptcy to retain automatic stay and some or no repayment while making minimal payments to bankruptcy trustee while interest continues to accrue on student loans.

1. Failure to consider or pursue IBR/ICR favors nondischargeability:[4]

[4] The following circuit-level cases have held that the IBR and ICR are an important consideration in the undue hardship analysis: *Educ. Credit Mgmt. Corp. v. Jesperson (In re Jesperson)*, 571 F.3d 775, 783 (8th Cir. 2009); *Educ. Credit Mgmt. Corp. v. Mason (In re*

a. Fifth Circuit:

***Educ. Credit Mgmt. Corp. v. Young*, 376 B.R. 795 (E.D. Tex. 2007)**. Debtor, an attorney, who owed nearly $235,000 was unable to establish good faith efforts because among other things he had failed to investigate the Ford consolidation plan, but instead researched bankruptcy discharge.

***Jones v. Bank One Tex.,* 376 B.R. 130 (W.D. Tex. 2007)**. Although debtor has no legal obligation to apply to the ICR, the debtor's effort to pursue options to make her debt less onerous is an important indicator of good faith. "Debtor's reason that she does not have disposable income to make payments under the ICR lacks merit because at this time she would owe zero dollars ($0)."

b. Sixth Circuit:

***In re Gibson*, 428 B.R. 385 (Bankr. W.D. Mich. 2010).** Debtor failed the third prong because she refused the consolidation options, particularly the ICR "explaining that she regarded the repayment trigger levels as 'arbitrary'" The court found that "In other words, she believes that her obligation to begin repaying the loans would commence, under the programs, before her income would support a middle class lifestyle *and* repayment." The court held that these repayment plans are a product of regulation, not negotiation. The debtor also found a 25-year repayment period contrary to a "fresh start." The court rejected this stating, this "ignores the fact that student loans are excepted from the Chapter 13 discharge." Finally, the court rejected the debtor's concerns regarding the possible tax implications of the ICR's forgiveness of debt.

c. Seventh Circuit:

***Educ. Credit Mgmt. Corp. v. Vargas,* 2010 WL 5395142 (C.D. Ill. 2010).** The district court reversed the lower court's discharge, finding that the debtor failed the good faith prong because he "did not explore, much less take advantage of, one of the alternative repayment plans available to him even when able to do so." The District Court further stated "[e]ven if no payment was required under the plan and the amount due would have essentially remained unchanged, signing up for one of the repayment

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Mason), 464 F.3d 878, 885 (9th Cir. 2006); *Educ. Credit Mgmt Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 396-397 (4th Cir. 2005); *Tirch v. Pa. Higher Educ. Assistance Agency (In re Tirch)*, 409 F.3d 677, 682 (6th Cir. 2005); *Alderete v. Educ. Credit Mgmt Corp. (In re Alderete)*, 412 F.3d 1200, 1206 (10th Cir. 2005).

alternatives would have demonstrated a continued acknowledgement of the debt and some intent to repay.

d. Eighth Circuit:

***In re Sederlund*, 440 B.R. 168 (B.A.P. 8th Cir. 2010).** The debtor's payment under either the ICR or IBR, at her current income level, would be zero. She refused to apply because of her believed tax consequences. The Court, citing *Jesperson*, rejected this, stating "while there is some question as to whether borrowers whose student loans are forgiven are subject to tax liability, the Eighth Circuit…appeared to reject the argument that such potential tax liability is a basis for a finding of undue hardship under §523(a)(8)."

***Educ. Credit Mgmt. Corp. v. Jesperson (In re Jesperson)*, 571 F.3d 775, 783 (8th Cir. 2009).** The Eighth Circuit found, "[w]hen a debtor is eligible for the ICR, the court in determining undue hardship should be less concerned that future income may decline. The ICR formula adjusts for such declines, without regard to the unpaid student loan balance, which in most cases will avoid undue hardship." The court further held that "a student loan should not be discharged when the debtor has 'the ability to earn sufficient income to make student loan payments under the various special opportunities made available through the Student Loan Program.'"*Jesperson*, 571 F.3d at 781.

e. Ninth Circuit:

***Educ. Credit Mgmt. Corp. v. Beattie*, 490 B.R. 581 (W.D. Wash. 2012).** The District Court reversed the bankruptcy court's ruling granting the debtor a partial discharge of her student loan debt. In so doing, the District Court evaluated the existence of undue hardship by applying the IBR payment amount, not the original, higher contract payment amount. The court stated that "Congress's creation of the flexible income-based repayment options . . . reflects an intent that debtors not be automatically or easily excused from their student loan obligations."

***In re Dimoyannis*, 2010 WL 1780098 (Bankr. N.D. Cal. Apr. 29, 2010)**. The debtor failed the first prong of the undue hardship test because of the availability of the IBR plan, under which debtor would be required to make payments of $0 to $47, amounts that were less than debtor's monthly surplus. Although the court held that the second and third prongs of the *Brunner* test were moot as a result of debtor's failure to satisfy the first prong, it went on to state that the debtor's "failure to renegotiate his debt through the Department of Education's IBR program would weigh against a finding that he has made a good faith effort to repay the debt."

f. **Tenth Circuit:**

***Buckland v. Educ. Credit Mgmt. Corp. (In re Buckland)*, 424 B.R. 883 (Bankr. D. Kan. 2010).** The debtor's refusal to consider the ICR or IBR supports a finding he did not make a good faith effort. The debtor's stated reasons for not entering the ICR – he would be 72 years old and the potential tax consequences – were rejected by the court.

***Robinson v. Educ. Credit Mgmt. Corp. (In re Robinson)*,390 B.R.727 (Bankr. W.D. Okla. 2008)**. A 52-year-old debtor had accumulated $120,000 in student loans earning a B.A, M.A., and an Ed.D. The court found that she had not made good faith efforts because she failed to minimize her expenses, failed to make any payments on her student loan since earning her doctoral degree, 81% of her total unsecured debt was student loan debt, and she failed to take advantage of the ICR. The court rejected the debtor's two excuses for refusing participation in the ICR: (1) she would be too old and still making payments; and (2) there was a potential for tax consequences. The court held that "while it is true that the ICR's 25-year term would result in the plaintiff's being obligated to make student loan payments until she is nearing the age of eighty, this result is simply a function of the plaintiff's age at the time she obtained her degrees and executed the Consolidation Note and her exercise of forbearances prior to filing her bankruptcy case." Second, "[w]hile the possible tax implications of the ICR are not to be ignored, they are of much lesser importance than the plaintiff's showing of good faith in repayment of her student loans."

g. **Eleventh Circuit:**

***Groves v. Citibank*, 398 B.R. 673 (Bankr. W.D. Mo. 2008).** The bankruptcy court, utilizing the loan-by-loan analysis of partial discharge, determined that Sallie Mae's private loans imposed a greater hardship because they were not eligible for the ICR. Only a portion of the ECMC loans were discharged because they were eligible for the ICR. "[I]t is the availability of the income contingent option that makes a portion of the ECMC loans nondischargeable because that option allows the Debtor the ability to find employment with an annual salary in line with what she is capable of earning."

2. **ICR/IBR Criticized:**

a. **First Circuit:**

***Educ. Credit Mgmt. Corp. v. Bronsdon*, 435 B.R. 791 (B.A.P. 1st Cir. 2010).** In a case involving a 64-year-old debtor, the BAP, which affirmed the bankruptcy court's discharge, stating, "a debtor's eligibility to participate in the ICR may be considered by the court when applying the totality of the circumstances test, but it is not determinative" and found that the bankruptcy court's analysis of the ICR was sufficient this time.

b. Second Circuit:

***In re Bene*, 474 B.R. 56 (Bankr. W.D.N.Y. 2012).** The bankruptcy court discharged a 64-year-old debtor's student loan. In doing so, it offered a lengthy critique of the current applicability of *Brunner* in light of the development of the Ford Program, as well as the evolution of the Bankruptcy Code's provisions for discharge.

c. Third Circuit:

***In re Crawley*, 460 B.R. 421 (Bankr. E.D. Pa. 2011).** Fact that Chapter 7 debtor had elected not to participate in income contingent repayment plan (ICR), pursuant to which debtor's payment obligation would have been $0.00 per month, was irrelevant to whether debtor satisfied "minimal standard of living," prong of *Brunner.* "To hold otherwise would make eligibility in the ICR outcome determinative in undue hardship determinations under § 523(a)(8) and would result in the delegation to an administrative agency, the Department of Education, the authority to determine the dischargeability of certain student loans." As to the role of the ICR in the good faith analysis, the court stated "consideration of the significance, if any, of the debtor's failure to participate in the ICR must be tailored based on the individualized circumstances of the debtor who is before the court."

d. Fourth Circuit:

***In re Todd*, 473 B.R. 676 (Bankr. D. Md. 2012).** Mere fact that debtor declined the "meaningless gesture" of participating in ICR, under which her payment obligation would be $0.00, did not prevent her from satisfying "good faith" test. The court was very critical of the ICR and noted "[t]o hold that good faith will only be found if [debtor] agrees to a repayment program that will not require her to make any payments—$0.0 "monthly payments" for twenty-five years—would be the height of Kafka-esque logic."

e. Sixth Circuit:

***Marshall v. The Student Loan Corp. (In re Marshall)*, 430 B.R. 809 (Bankr. S.D. Ohio 2010).** Debtor's decision to not enroll in the IBR was reasonable. The court stated "There is more to student loan debt than merely the monthly payment to be made." First, the court held, even if the debtor was not required to make monthly payments, the "debt is still hanging over her head, it will affect her credit and cause a 'psychological and emotion toll.'" Second, there would be tax consequences at the end of the 25 years and these could be "devastating."

f. Seventh Circuit:

***Larson v. United States of Am.*, 426 B.R. 782 (Bankr. N.D. Ill. 2010)** The bankruptcy court spent time addressing why the ICR is only marginally relevant in undue hardship proceedings, explaining that (1) Congress could have easily drafted it into the legislation if it had desired for it to restrict the judge's discretion in 523(a)(8) actions; (2) the standards, while related are not the same because the ICR solely looks at income and the published poverty level, whereas the *Brunner* test compares the debtor's income to actual expenses (such as extensive medical expenses) that are not routinely considered in ICR calculations; (3) the ICR does not take into account the "emotional" and "social" toll caused by the debt remaining hanging over their heads and affecting their credit; and (4) the tax implications.

g. Eighth Circuit:

***Wallace v. Educ. Credit Mgmt. Corp. (In re Wallace)*, 2007 WL 4210450 (Bankr. E.D. Mo. Nov. 27, 2007).** In this totality analysis, the argument that Debtor's failure to take part in the ICR precludes an undue hardship was rejected by the court for three reasons. First, the undue hardship analysis focuses on the debtor's reasonable and necessary expenses and the ICR ties payments to income in excess of federal poverty standards. "[B]ecause it is unlikely that a person could pay her reasonably necessary living expenses if her income is at the federal poverty level…the ICR is of limited probative value." Second, the Debtor was 58 years old and would be 83 when the payments would cease. Last, there was "a very real possibility of a significant tax liability" at age 83.

h. Ninth Circuit:

***In re Roth,* 490 B.R. 908 (B.A.P. 9th Cir. 2013).** The bankruptcy court denied debtor's student loan discharge, concluding that she failed to show she made a good faith effort under prong three. The BAP reversed, holding that debtor's refusal to enroll in the IBR should not be weighed against her where the evidence showed that she currently would not be required to make a payment under the IBR and that "it is more probable than not she would never be required to make a payment," especially given her age, poor health, and limited income or prospects." The BAP also noted the "[p]otentially disastrous tax consequences" awaiting the debtor at the conclusion of the 25-year IBR period and observed that the "IBR was set up to allow borrowers to pay an affordable amount toward retirement of their student loan debt. However, when absolutely no

> payment is forecast, the law should not impose negative consequences for failing to sign up for the program. This is consistent with the general maxim that the law does not require a party to engage in futile acts."

V. The Demise of *Brunner*: Brave New World?

After nearly three decades of construing the statutory undue hardship legal standard and creating an epic body of case law, a few courts have begun questioning *Brunner*'s viability. Contributing to this growing dissent is the fact that Congress repealed the "time in repayment" provision of § 523(a)(8), leaving undue hardship as the only means of discharging student loan debt in bankruptcy and has increased the availability of administrative options, including flexible, income driven repayment plans.

Some courts view administrative options as improperly usurping their judicial authority. *See* Terrence L. Michael & Janie M. Phelps,"*Judges?!- - We Don't Need No Stinking Judges!!!": The* Discharge *of Student Loans in Bankruptcy Cases and the Income Contingent Repayment Plan,* 38 Tex. Tech L. Rev. 73 (Fall 2005); *see also In re Todd*, 473 B.R. 676 (Bankr. Md. 2012) (noting that § 523(a)(8)"allows debtors to discharge their student loans upon a showing that repaying them would be an 'undue hardship.' There is no indication that Congress intended to supplant this unambiguous directive with the Ford Program and its existence should not be treated as an implicit repeal of § 523(a)(8)").

The bankruptcy court in the Western District of New York, recently indicted *Brunner* with these observations:

- The "bargain" has changed. In 1987, student loans were dischargeable under a "time in repayment" provision as well as undue hardship. Students whose loans pre-date the changes in the Bankruptcy Code cannot be said to have agreed to this bargain.
- The *Brunner* decision used words like "poverty" and "minimal standard of living," words which have a different meaning today.
- The term "repayment period" as used in *Brunner* envisioned a maximum repayment term of 10 years—not the 25 years contemplated under income-driven repayment terms.
- Repayment options under William D. Ford Direct Loan Program were not available when the *Brunner* case was decided.
- "Satisfaction" of the debt after 25-years of successful payments under the ICR/IBR is not the same as "repayment" of the debt.
- "But if Congress ever were to require this writer to instruct a student loan debtor that he or she must carry the burden of proving that he or she has a 'certainty of hopelessness,' this writer would retire."
- The case of Marie Brunner did not require the court to apply all three prongs of what is now referred to as the "*Brunner* test" because Marie Brunner failed the first prong. "[F]ormulation of a three-prong test applicable to *every* student loan debtor who has ever sought relief in the bankruptcy courts of the Second Circuit since *Brunner* was not *required* under the facts of Ms. Brunner's case."

- Marie Brunner was pro se—and the holding is now binding upon every student loan borrower who ever sought bankruptcy relief in the 2nd Circuit since 1987. "It is time for a student loan debtor's counsel to present these matters to the Circuit Court."

In re Bene, 474 B.R. 56 (Bankr. W.D.N.Y. 2012); *see also In re Roth*, 490 B.R. 908 (B.A.P. 9th Cir. 2013) (Pappas, J., concurring) (comparing *Brunner*'s harshness to lesson learned from "America's experience in the recent 'mortgage crisis'" and urging the 9th Circuit to re-visit its adherence to the *Brunner* test, specifically the "good faith" prong.); *In re Cummings,* 2007 WL 3445912 (Bankr. N.D.Cal.2007) ("This court has long been spitting into the wind by noting that the [*Brunner*] test is a terrible example of judge-made law which gives no real guidance to a court in determining what undue hardship is. . . . "The worst part of the *Brunner* test is the requirement that a debtor has to have made a good faith effort to pay the loans. Congress said nothing about such a requirement in the Bankruptcy Code, and Congress knows how to draft a good faith requirement when it wants one. An effort to repay has absolutely nothing to do with hardship.").

VI. PRACTICE TIPS

A. Who's Got My Loans? The single most important inquiry in the student loan industry is "who's got my loan?" ED maintains an information repository called National Student Loan Data Systems (NSLDS). NSLDS is a database that contains information, including chain of custody, interest rate, loan type, loan status, etc., regarding every federal student loan a person has borrowed. Lenders, servicers, and guarantors have access to borrower NSLDS reports if they hold the loan. Borrowers may access their own NSLDS reports by going to www.nslds.ed.gov. They must first obtain a PIN at www.pin.ed.gov.

B. Industry resources:

- National Student Loan Data System (www.nslds.ed.gov)
- ED PIN website: (www.pin.ed.gov)
- Federal Student Aid (government website): (http://studentaid.ed.gov)
- Finaid (consumer financial aid website): (www.finaid.org)
- Department of Education (www.ed.gov)
- Department of Education Ombudsman Office (www.ombudsman.ed.gov)
- William D. Ford Direct Loan Program (www.loanconsolidation.ed.gov)
- National Counsel of Higher Education Resources (www.ncher.us)
- Educational Credit Management Corporation (www.ecmc.org)
- FFEL Forms: (http://www.ecmc.org/topic/mainForms.html)
- Direct Loan (Ford program) Forms: (https://www.dl.ed.gov/borrower

VII. CONTACT INFORMATION

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