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A SURVEY OF THE DISCHARGEABILITY OF TAXES OTHER THAN INCOME TAX

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A CLE Presentation

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I. The Applicable Code Sections.

§ 727. Discharge

11 U.S.C. § 727 is the source of the debtor's discharge as well as the exception of taxes from that discharge: "[t]he court shall grant the debtor a discharge . . . [e]xcept as provided in § 523 of [the Bankruptcy Code]."

§ 523. Exceptions to Discharge

11 U.S.C. § 523 (a) provides for an exception to discharge for an individual debtor for a tax or a customs duty—

- (A) entitled to priority under 11 U.S.C. § 507(a)(2) or 11 U.S.C. § 507(a)(8), whether or not a claim for such tax was filed or allowed;
- (B) is related to a tax return that —
 - (i) was not filed; or
 - (ii) was filed late and within 2 years of the filing of the debtor's petition;
- (C) is related to a fraudulent return filed by the debtor or a willful attempt in any manner by the debtor to evade or defeat such tax.

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

(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—

(i) for a taxable year ending on or before the date of the filing of the petition 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, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or

(iii) other than a tax of a 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;¹

(B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

¹ "Income tax" under § 507(a)(8)(A) is *without* the scope of this paper, and in fact presents a number of issues worthy of independent treatment.

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisalment or classification of such merchandise was not available to the appropriate customs officer before such date; or

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

II. THE TAXES OTHER THAN INCOME TAX—A SURVEY OF THE ISSUES

A. Property Tax (§ 507(a)(8)(B))

A property tax assessed before the bankruptcy petition was filed and last payable without penalty after one year before the date of the filing of the petition is in priority 8 and thus non-dischargeable. There is a two-step analysis to determine if a property tax is nondischargeable: first determine whether the tax in question is in fact a property tax; if it is a property tax, then determine if the one year requirement has been met. The taxing authority has the burden of proving that these requirements have been met to get the priority.²

(i). The first step is to determine whether the tax in question is a property tax. This step may seem obvious—after all, a property tax is a property tax. However, “property tax” goes undefined in the code and a number of decision have tested the bounds of what constitutes a “property tax”; for example, water or sewer rents or garbage fees owed to a city or municipality. In In re Adams,³ the district court, in reversing the bankruptcy court, held that water and sewer rents owed to the City of Philadelphia were not real property taxes. However, in In re New England Carpet Co.,⁴ the bankruptcy court held the other way, that water rents due the City of Winooski, Vermont were property taxes. On the issue of garbage fees, the bankruptcy court in In re Ayala⁵ held that garbage fees *are* property taxes, and thus entitled to priority under § 507 (a)(8)(B). Finally, special assessments to raise money for improvement districts probably are not property taxes, but rather contractual obligations.⁶

As a general rule, a charge is a property tax if it is an involuntary pecuniary burden imposed by the legislature for public purposes under the police or taxing power of the state.⁷ Unfortunately, the case law cited above does not offer much help in fleshing out whether garbage, sewer, water, or special assessment fees are property taxes.

² Daniel E. Blegen, *Would a Tax by Any Other Name Smell as Sweet? The Treatment of Special Assessment in Bankruptcy*, 104 Com.L.J. 97, 136 (1999).

³ In re Adams, 40 B.R. 545 (E.D. Pa. 1984).

⁴ In re New England Carpet Co., 26 B.R. 934 (Bankr. D. Vt. 1983).

⁵ In re Ayala, 35 B.R. 651 (Bankr. D. Utah 1983).

⁶ Blegen, *supra* note 3, at 137.

⁷ *Id* at 123.

(ii). Once the first step is completed and it is determined that the tax in question is likely a property tax, attention then must turn to the question of whether the one year requirement has been met. The one year requirement is this: a property tax is nondischargeable only if it “[has been] assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition.” 11 U.S.C. § 507 (a)(8)(B). Moreover, the “date of assessment is generally certain and is based upon the statutory method for assessment in the particular state,”⁸ and “as for the last date payable without penalty, it is also statutory and can be determined with relative ease.”⁹

B. Trust Fund Tax (§ 507(a)(8)(C))

Taxes required to be collected or withheld and for which the debtor is liable in whatever capacity are also non-dischargeable and given an eighth priority under § 507(a)(8)(c). Such taxes “required to be collected or withheld” refers to income taxes or social security taxes that employers are required to withhold from their employees and remit to the government; thus this section has applicability only for employers.

When an individual employer, officer of a corporate employer, or other “responsible person” does not collect or withhold employee income or social security taxes as required, and the employer files for bankruptcy, the amount required to be collected or withheld is given an eighth priority. Technically, a penalty *equal* to the amount of taxes required to be collected or withheld but not collected or withheld is what is due pursuant to IRC § 6672.¹⁰

While it is easy to figure out who an employer/debtor is or who a corporate officer of an employer/debtor is for purposes of collection of this tax, figuring out who a “responsible person” is requires more probing at the facts. In In Re Pond, 200 B.R. 267 (Bkrcty. S.D. Fla. 1996), a Chapter 13 debtor-husband was the “responsible person” who was held liable for payment of the § 6672(a) penalty where his wife’s bookstore failed to withhold employees’ taxes because the husband, as the book store manager, had the ability to direct payment of the taxes even though he neither owned the book store, nor was an officer of the company.

In In Re Neal, 177 B.R. 892 (N.D.Ind. 1994), debtor became personally liable for withholding taxes of an uncle’s detective agency when debtor became involved in day-to-day operations, including payroll computation. Thus §6672(a) penalty assessed to debtor personally became non-dischargeable in debtor’s bankruptcy. Moreover, debtor was responsible for amounts of delinquent tax *already* owing when debtor became responsible, in addition to current withholding delinquencies.

One additional issue under collection and withholding taxes is whether bankruptcy courts have jurisdiction to enjoin the IRS from collecting a § 6672(a) penalty. A majority of courts have held that under the Anti-Injunction Act, Bankruptcy Courts lack such jurisdiction to enjoin the IRS from collecting a § 6672(a) penalty.¹¹

⁸ Blegen, *supra* note 3, at 136 (*citing* Darrell Dunham and Alex Shimkus, Tax Claims in Bankruptcy, 67 Am. Bankr. L.J. 343 (1993)).

⁹ *Id.*

¹⁰ IRC § 6672(a) states:

[a]ny person required to collect, truthfully account for and pay over any tax imposed by this title who willfully fails to collect such tax or truthfully account for and pay over such tax, for the payment thereof, shall, in addition to other penalties provided by law, be liable to penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. §6672(2).

¹¹ The Anti-Injunction Act, 26 U.S.C. § 7421(a), states that no action may be maintained in any court to enjoin the IRS from assessing or collecting a tax.

C. Employment Tax (§ 507(a)(8)(D))

The debtor's share of an employment tax is not dischargeable from the debtor's bankruptcy to the extent that the tax is a tax on a wage, salary, or commission earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition.

Wages earned from a debtor pre-petition but paid post-petition, the wages receive a third priority and the employer's share receive an eighth priority.

D. Excise Taxes (§ 507(a)(8)(E))

An excise tax (sales tax, estate tax, gift tax, fuel tax, wagering tax, or gasoline tax) is not dischargeable if it is on a transaction occurring before the date of the filing of the petition for which a return, if requested, is last due after three years before that date; or if a return is not required, a transaction occurring during three years immediately preceding the date of the filing of the petition. One tricky issue with this tax is the determination whether an excise tax or a penalty is being assessed. "the determination between excise (priority) tax or penalty (nonpriority) is tricky. The emerging trend is for the excise taxes of subtitle D of the Tax Code to be treated as excise taxes for bankruptcy purposes." McQueen & Willaims, § 8:20 (citing In re Mansfield Tire & Rubber Co., 942 F.2d 1055 (6th Cir. Ohio 1991), cert. denied, 502 U.S. 1092 (1992).

E. Customs Duty (§507(a)(8)(F))

A customs duty arising out of the importation of merchandise entered for consumption within one year before the date of the filing of the petition, covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition, or entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisalment or classification of such merchandise was not available to the appropriate customs officer before such date, are given an eighth priority in bankruptcy.

F. Tax Penalty (§507(a)(8)(G))

A penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss has an eighth priority in bankruptcy and is thus not dischargeable. Correspondingly, a penalty which is punitive in nature is not included in this subsection, would thus be treated as a general unsecured claim, and therefore be dischargeable. See In re Hovan, Inc., 96 F.3d 1254 (9th Cir. Wash. 1996), where punitive tax penalties were not given eighth priority even though taxing agency claimed penalty compensated agency for the cost of the collection.