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TAX DISCHARGE UNDER BAPCPA

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A CLE Presentation

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Note: BAPCPA indicated by *italics*. Where BAPCPA eliminated language from the old code, it has been indicated by a line through the words.

“DEMISE OF THE SUPERDISCHARGE”

Rule:

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

(1) for a tax or a customs duty –

(A) ...

(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.

1322(a) The plan shall –

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim.

1328(a) As *Subject to subsection (d)*, as soon as practicable after completion by the debtor of all payments under the plan [...] unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title... except any debt –

(2) of the kind specified in *section 507(a)(8)(C) or in* paragraph *(1)(B), (1)(C), (2), (3), (4), (5), (8), or (9)* of section 523(a) ~~or 523(a)(9) of this title; or;~~

What it means:

Under the old law, the discharge of taxes was treated differently depending on whether the debtor filed under Chapter 7 or Chapter 13. In Chapter 7 under the old law, the debtor must have filed all returns, non-fraudulently, and filed them at least two years prior to the bankruptcy to be discharged. But in Chapter 13, the superdischarge made only priority taxes critical and all other 523(a)(1) exceptions to discharge were ignored.

Under BAPCPA, the Chapter 13 rules now greatly resemble, but do not mirror, those in Chapter 7. Thus a Chapter 13 debtor can no longer receive a discharge of non-filed taxes or fraudulent tax returns. Curiously, the “or equivalent report or notice” appears to expand the definition of what constitutes a return for discharge purposes and the new § 1328(a)(2) permits discharge of priority taxes, except Trust Fund taxes, but excepts from discharge non-priority taxes. This creates new tax planning alternatives for Chapter 13 debtors and attorneys.

FRAUDULENT TAX FILINGS UNDER CHAPTER 13 AND CHAPTER 11

Rule:

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

(1) for a tax or a customs duty –

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

1328(a) ~~As~~ *Subject to subsection (d), as* soon as practicable after completion by the debtor of all payments under the plan [...] unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title..., except nondebt

(2) of the kind specified in *section 507(a)(8)(C) or in* paragraph *(1)(B), (1)(C), (2), (3), (4), (5), (8), or (9)* of section 523(a) ~~[or 523(a)(9)] of this title; or;~~

1141(d)(2) ~~The confirmation of a plan does not discharge an individual debtor~~ *A discharge under this chapter does not discharge a debtor who is an individual* from any debt excepted from discharge under section 523 of this title.

1141(5) *In a case in which the debtor is an individual –*

(A) unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge upon completion of all payments under the plan;

1141(d)(6) *Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt –*

(B) for a tax or customs duty with respect to which the debtor –

(i) made a fraudulent return; or

(ii) willfully attempted in any manner to evade or to defeat such tax or such customs duty.

What it means:

Under the old law, an individual debtor who filed a fraudulent return or attempted to evade a tax could not discharge those taxes in Chapter 7 or 11. However, the debtor could discharge these taxes in Chapter 13. Under BAPCPA, an individual debtor can no longer discharge fraudulent tax returns or evaded taxes at all in Chapter 13 or Chapter 11.

Under the old law, a corporate debtor under a Plan of Reorganization could discharge all preconfirmation debts, including tax fraud debts. Under BAPCPA, a corporate debtor cannot discharge taxes if the debtor has made a fraudulent return or willfully attempted to evade or defeat the tax.

DISCHARGE OF TAXES PAID BY CREDIT CARD

Rule:

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

(14) incurred to pay a tax to the United States that would be nondischargeable pursuant to paragraph (1);

(14A) incurred to pay a tax to a governmental unit, other than the United States, that would be nondischargeable under paragraph (1);

What it means:

Under the old law, 523(a)(14) protected credit card creditors when a debtor used a credit card to pay federal tax obligations. While it made it easier for debtors to pay federal taxes, it did not help credit card companies when a debtor paid other taxes, such as state or country taxes. BAPCPA changed this by adding 523(14A) to the code which extends the treatment of 523(a)(14) to all other non-dischargeable taxes paid by credit cards. However, the burden of proof is still on the creditor and the exception is virtually unavailable if the debtor takes a cash advance to pay the tax rather than paying directly by the credit card. Also note this provision has no statute of limitation while cash advances are limited to 70 days pre-petition.

DETERMINATION OF TAX LIABILITY

Rule:

505(b)(2) A trustee may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination of such tax *at the address and in the manner designated in paragraph (1)*. Unless such return is fraudulent, or contains a material misrepresentation, the *estate*, the trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax – A) upon payment of the tax shown on the return, if –

(i) such governmental unit does not notify the trustee within 60 days...of exam or

(ii) such governmental unit does not complete such exam...within 180 days...

What it means:

Under the old law, after the trustee has made his request for a prompt determination and upon payment of the tax shown on the return, if the taxing authority did not timely respond or audit the return, the trustee and debtor were discharged from any potential tax liability in excess of the tax paid. What was not clear under the old law was whether this discharge also applied to the estate. This ambiguity was clarified under BAPCPA, which provides that the estate is also discharged of any tax liability in excess of the tax paid if the governmental unit does not promptly audit the final return.

TAX RETURNS

Rule:

523(a) A discharge under section 727, 1141, 1228(a), 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*...

(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;...

[UN-NUMBERED PARAGRAPH AT THE END OF PARAGRAPH (19)] *For purposes of this subsection, the term “return” means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such terms 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.*

What it means:

Under the old law, the Courts struggled creating many case law equivalents to the requirement of the debtor filing an actual return under a strict definition of a filed return. Under BAPCPA, the case law equivalent returns have been codified by including any “equivalent report or notice.” BAPCPA thus helps to resolve the ambiguity in the old law as to what constituted a “return”, but leaves wide open the question of whether this includes all the court created exceptions or possibly even widens the door to some form of “report or notice” not filed, but only “given” to the tax authority.

FILED TAX RETURNS AS REQUIREMENT TO PLAN CONFIRMATION

Rule:

1308(a) Not later than the day before the date on which the meeting of the creditors is first scheduled to be held under section 341(a), if the debtor was required to file a tax return under applicable nonbankruptcy law, the debtor shall file with appropriate tax authorities all tax returns for all taxable periods ending during the 4-year period ending on the date of the filing of the petition.

1308(b)(1) Subject to paragraph (2), if the tax returns required by subsection (a) have not been filed by the date on which the meeting of creditors is first scheduled to be held under section 341(a), the trustee may hold open that meeting for a reasonable period of time to allow the debtor an additional period of time to file any unfiled returns, by such additional period of time shall not extend beyond –

(A) for any return that is past due as of the date of the filing of the petition, the date that is 120 days after the date of that meeting; or

(B) for any return that is not past due as of the date of the filing of the petition, the later of –

(i) the date that is 120 days after the date of that meeting; or

(ii) the date on which the return is due under the last automatic extension of time for filing that return to which the debtor is entitled, and for which request is timely made, in accordance with applicable nonbankruptcy law.

(2) After notice and a hearing, and order entered before the tolling of any applicable filing period determined under this subsection, if the debtor demonstrates by a preponderance of the evidence that the

failure to file a return as required under this subsection is attributable to circumstances beyond the control of the debtor, the court may extend the filing period established by the trustee under this subsection for –
(A) a period of not more than 30 days for returns described in paragraph (1); and
(B) a period not to extend after the applicable extended due date for a return described in paragraph (2).

1308(c) For purposes of this section, the term “return” includes a return prepared pursuant to subsection (a) or (b) of section 6020 of the Internal Revenue Code of 1986, or a similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.

1325(a) Except as provided in subsection (b), the court shall confirm a plan if –
(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308.

502(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide-, and except that in a case under chapter 13, a claim of a governmental unit for a tax with respect to a return filed under section 1308 shall be timely if the claim is filed on or before the date that is 60 days after the date on which such return was filed as required.

What it means:

The Courts, taxing authorities, and debtors have long struggled with how far back tax returns had to be filed when only the last 3 years are generally priority taxes. The IRS generally had a policy of requiring the last 6 years while the state’s policy was ad hoc. BAPCPA added an entirely new provision, 1308, which requires that a debtor must file tax returns for the four year preceding the filing of the petition by the first meeting. The rule is made less rigid by enabling the trustee to hold open the first meeting of creditors or the debtor by motion to request extra time to file the returns in certain circumstances. However, the Court is not permitted to confirm a Chapter 13 plan until the debtor has filed the tax returns as required by 1308. A major question exists as to whether this supercedes state and federal tax laws that all unfiled returns are required to be filed; or the section 523(a)(1)(B) provisions that exempts from discharge any unfiled return regardless of how old.

PRIORITY TAXES AND TOLLING

507(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 *for a taxable year ending on or before the date of the filing of the petition* –

(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 before the date of the filing of the petition, exclusive of* –

(I) 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~~ *that tax* was pending, ~~before the date of the filing of the petition;~~ 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.*

(iii) ...

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

[UN-NUMBERED PARAGRAPH AFTER PARAGRAPH 8(G)] *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.*

What is means:

BAPCPA tries to clarify the wording of 507(a)(8) without any substantive change in the law; but also codifies “tolling” of priority status due to prior appeals or prior bankruptcies, plus 90 days. This provides uniformity to the many case law tolling provisions.

POST-PETITION TAX RETURNS

Rule:

521(j)(1) Notwithstanding any other provision of this title, if the debtor fails to file a tax return that becomes due after the commencement of the case or to properly obtain an extension of the due date for filing such return, the taxing authority may request that the court enter an order converting or dismissing the case.

(2) If the debtor does not file the required return or obtain the extension referred to in paragraph (1) within 90 days after a request is filed by the taxing authority under that paragraph, the court shall convert or dismiss the case, whichever is in the best interests of creditors and the estate.

1112(b)(1) Except as provided in *paragraph (2) of this subsection*, subsection (c) of this section, *and subsection 1104(a)(3)*, on request of a party in interest ~~or the United States trustee or bankruptcy administrator~~, and after notice and a hearing, ~~the court may~~ *absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall* convert a case under this chapter to a case under chapter 7 of ~~this title~~ or ~~may~~ dismiss a case under this chapter, whichever is in the best interest *interests* of creditors and the estate, ~~for if the movant establishes~~ *cause*.

(4) *For the purposes of this subsection, the term “cause” includes –*

(l) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;

What it means:

Under the old law, a debtor could continue their reorganization plan even if they did not file and pay post-petition tax returns, i.e. were robbing Peter to pay Paul. Under BAPCPA 521(j)(1) provides that this is no longer acceptable. This is enforced under an amendment of the definitions of “cause” in Chapter 11, but note no similar addition to “cause” under Chapter 13. However, it is safe to presume that courts will equally enforce the rule under Chapter 13 as that was the primary source of the problems. If the debtor does not file post-petition tax returns, this case may be dismissed or converted upon motion of the taxing authority, the trustee, or any other party in interest.