Are Client's Tax Returns Timely Enough for Discharge

by Robert Meyer

An increasing number of published cases deliver a BAPCPA[1]-created issue to the bankruptcy journals: Can a personal tax return filed under proper extension be discharged under 11 U.S.C. Â§523(a) — most importantly when the tardy tax return's filing is deemed timely under the Internal Revenue Code?

Most taxpayers know that 1040 individual tax returns are due April 15 of most any year.[2] And, most taxpayers know that extensions for filing taxes are freely made as an entitlement occurs by merely filing an IRS-regulated form.[3] It is the latter event that could become problematic if the taxpayer later becomes a bankruptcy debtor.

The simple rule of thumb for a bankruptcy discharge of a tax debt is a chronological test: If the bankruptcy petition is filed more than three years after tax assessments, the tax should be discharged.[4] The tax assessment date is measured by the date the IRS receives the taxpayer's return. Before BAPCPA, the tax would be discharged even for those who filed tax returns under "an extension." For example, an extended return filed August 8, 1985, would be a dischargeable tax debt should the bankruptcy petition be filed after August 9, 1988. This rule has subsequently been altered by BAPCPA.

The rule of thumb changed when statutory revisions to 11 U.S.C. Â§523(a) created the definition of "return" in a floating paragraph located after 11 U.S.C. Â§523(a)(19), which courts describe as 523(a)(*). That section reads:
"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)[5] of the Internal Revenue Code of 1986, or similar [s]tate 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)[6] of the Internal Revenue Code of 1986, or a similar [s]tate or local law."

By one code referencing another, and many practitioners being knowledgeable about one and not the other, this clause becomes problematic on many levels. But, walking back and forth between the codes brings clarity and delivers insight to the inequitable result that may occur.

Under 26 U.S.C. Â§6020(a), the IRS secretary may file a return, even untimely, for a taxpayer under the condition that the taxpayer consents to disclose all information necessary for the preparation. Alternatively, 26 U.S.C. Â§6020(b) addresses a taxpayer's failure to file, after which the IRS secretary files a return for the taxpayer. The latter returns, even under prior law, would not deliver a dischargeable debt. The former's fortuitous event would deliver discharge *even if filed late*.

Another dichotomy is that Â§523(a)(1) uses the pre-BAPCPA language, while the 532(a)(*), or the floating paragraph, creates new interpretation and potential modification of Â§523(a)(1). From this has come cases delivering three interpretations.

Strict Prohibition
Three circuits demand no discharge from any return filed after April 15.[7] Dire consequences may occur. Hypothetically these rulings conclude that a return filed one minute late will make the debt nondischargeable. This applies even to those that have valid extensions. Alternatively, a fortunate taxpayer whose return is prepared by the IRS and filed in accordance with the floating paragraph would be allowed to discharge the tax debt. In the 10th Circuit, such strict interpretations disallowed tax

discharge.[8] Understanding this inequity, certiorari was requested of the 10th Circuit's decision in *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014). The request was denied. Thus, debtors in the First, Fifth, and 10th circuits cannot seek discharge of a tax return filed under extension.

Beard Test

Instead of using a chronologically inadjustable timeline, the majority created a test to determine if a return filed after the April deadline would be dischargeable.[9] These bankruptcy courts rely on the Tax Court's opinion in *Beard v. Comm'r of Internal Revenue*, 82 T.C. 766 (1984), which defines the term "return." The *Beard* test governs in the Fourth, Sixth, Seventh, Eighth, Ninth, and 11th circuits.[10]

The *Beard* test looks to the following: The document 1) purports to be a return; 2) is signed under penalty of perjury; 3) contains sufficient data to calculate tax liability; and 4) represents an honest and reasonable attempt to satisfy the requirements of the tax law.[11] Any 1040 form satisfies the first three elements. The fourth element's honest and reasonable attempt to satisfy the requirements of the tax law is then interpreted with 11 U.S.C. Â§523(a)(*). In short, the majority looks to 11 U.S.C. Â§523(a)(*) as adjusted by the *Beard* test; while the minority ignores the *Beard* test and focuses exclusively on the strict definition in the floating paragraph. The former acts as a court of equity; the latter can deliver the inequitable results referenced above.

The _Beard_ Weighing Test

The *Beard* test reviews essentially only the fourth element, and the test or standard of what is "honest and reasonable" may differ from one judge to the next. In short, leniency becomes a subjective element delivered by the discretionary opinion of the presiding judge. One judge's "honesty" could well be another's "lack of honesty." After watching jurisprudential authority of the judge, practitioners could well discover that a *Beard* test judge may resemble the minority, but on rare occasions. Alternatively, practitioners may discover another *Beard* test judge may resemble pre-BAPCPA's jurisprudence but on rare occasions. It is the latter school of jurists that create a third tier of reviewers whose opinions would virtually follow the pre-BAPCPA's decisions.

Strict Statutory Construction

The debate between the majority and minority essentially is about how to handle the floating paragraph. Do you read the statute alone? Or, do you need to interpret the statute as it has a need for interpretation?

For over two decades, the U.S. Supreme Court has determined that bankruptcy is handled by strict statutory construction. In short, the plain meaning of the statutory language can hopefully determine the result through a simple analysis of the text or provision governing the subject matter. Only if the statutory provision is not specific does the U.S. Supreme Court engage in holistic statutory interpretation.[12] If the court can determine at the outset that the statutory provision is unambiguous on its face, the highest court will ordinarily rule by strict analysis and avoid concepts of equity or other concerns.

One of the more important concepts underlying strict statutory construction is that it precludes the bankruptcy court from reviewing and analyzing legislative history to mold a solution to the problem. Furthermore, U.S. Supreme Court utilization of strict statutory construction reduces the bankruptcy court judge's equitable powers in delivering rulings not authorized (at least by the specific written provisions) of the Bankruptcy Code.

Many cases rule on strict statutory construction.[13] The minority's position is based upon a strict statutory construction. The minority opinion adheres to strong precedent. The minority, by adhering to a strict review of the floating paragraph, determines that Â§523(a)(*) cannot be read any differently than its simple meaning.

The majority, on the other hand, looks upon the language of the floating paragraph together with 11 U.S.C. Â§523(a)(1) and employs the "holistic statutory construction" in which the court reviews sections of the Bankruptcy Code that are relevant to dispose of the issue. In any court, bad debtors who enter the

court will not receive a discharge of the tax obligations. In a*Beard* court, however, an honest and reasonable “debtor” will receive a discharge.

As time progresses and the cases continue to be ruled upon and published by the various circuits, future decisions of the majority may include analysis of the legislative history of 523(a)(*) to determine what Congress intended (something that is not uncommon for floating paragraphs). This unfortunately may deliver dubious and unpredictable results. Courts, however, may sway from such since circuit courts have been criticized for interpreting inconclusive legislative history to supersede the express language of the statute.[14]

On a few occasions, strict statutory interpretation succumbs to interpretation when it delivers irrational conclusions.[15]

Courts well understand that Congress, made of human judgment, can err. Especially when enacting legislation. Also, Congress usually enacts legislation without envisioning all circumstances. Because so many variables exist in an economy of over 300 million people, one factual circumstance could easily fall under the radar of the drafters and deliver a result that the plain meaning of the statute fails to appropriately handle; thereby, demanding that a court mold opinions beyond the literal meaning of the statute. Some people define the court’s ability to do so as “dynamic” or “nautical” statutory analysis. Because legislative amendment is a slow process, some courts justify dynamic or nautical rulings. Alternatively, the minority limits itself to strict statutory construction and avoids “dynamic”[16] or “nautical”[17] interpretation because the minority surmises that statutory corrections may only be implemented by congressional action.

Conclusion

The split of authority is well established as this issue has been addressed by the First, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, 10th, and 11th circuits. Presently, the U.S. Supreme Court has denied review. The minority’s following of the unambiguous language of the Bankruptcy Code for a logical interpretation often delivers an inequitable result. The Â§523(a)(*) inequitable consequences by the minority are not autonomous in the bankruptcy world. Because of this, the minority position could even possibly evolve to become a majority. Until there is a Supreme Court review, the division will remain and the number of published decisions will swell. Should the issue of large tax debt discharge arise, a thoughtful practitioner may require debtor planning to include a residential move to one of the circuits that follows the present majority.

[1] Bankruptcy Abuse Prevention and Consumer Protection Act.

[2] If April 15, 2016, ends during a weekend, or conflicts with a unique Washington, D.C., holiday of middle of April (Emancipation Day), the return date will be extended to first open business day.

[3] *Beard v. Comm’r of Internal Revenue*, 82 T.C. 766 (1984).

[4] *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); *In re Colsen*, 446 F.3d 836 (8th Cir. 2006); *In re Smith*, F.3d (9th Cir. 2016); and *In re Justice*, 812 F.3d 738 (11th Cir. 2016).

[5] That section reads: “(a) Preparation of return by Secretary. If any person shall fail to make a return required by this title or by regulations prescribed thereunder, but shall consent to disclose all information necessary for the preparation thereof, then, and in that case, the Secretary may prepare such return, which, being signed by such person, may be received by the Secretary as the return of such person.”

[6] That section reads: “(b) Execution of return by Secretary. (1) Authority of Secretary to execute return. If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through

testimony or otherwise. (2) Status of returns. Any return so made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes."

[7] *In re Fanzy*, 779 F.3d 1, 4 (1st Cir. 2015); *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014); and *In re McCoy*, 666 F.3d 924, 932 (5th Cir. 2012).

[8] *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014).

[9] Form 4868.

[10] 11 U.S.C. Â§Â§523(a)(1) and (8).

[11] The actual language is: "(1) [I]t must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law."

[12] *United Sav. v. Timbers of Inwood Forest*, 484 U.S. 365, 371 (1988) (Justice Scalia) ("Statutory construction, however, is a holistic endeavor. A position that may seem ambiguous in isolation is often clarified by the remainder of the statutory schemeÂ — because the same terminology is used elsewhere in a context that makes its meaning clear....").

[13] *Dewsnup v. Timm*, 502 U.S. 410 (1992); *Norwest Bank Worthing v. Ahlers*, 485 U.S. 197 (1988); *United Savings Assn v. Timbers of Inwood Forest*, 484 U.S. 365 (1988); *Patterson v. Shumate*, 112 S. Ct. 2242 (1992); *Union Bank v. Wolas*, 502 U.S. 151 (1991); *Toibb v. Radloff*, 501 U.S. 167 (1991); *Pennsylvania DPW v. Davenport*, 495 U.S. 552 (1990); and *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989).

[14] *Wheeling-Pittsburg Steel Corp. v. United Steel Workers of America*, 791 F.2d 1074 (3d Cir. 1986) (legislative intent trumps plain meaning of Â§1113 of the Bankruptcy Code).

[15] Criminal restitution discharge in Ch. 13 created a war of interpretation. *Pennsylvania Dept. of Public Welfare Davenport*, 495 U.S. 552 (1990).

[16] Dynamic statutory interpretation looks into three factors: 1) statutory text; 2) original legislative expectations; and 3) subsequent evolution of the statute. William N. Eckridge, Jr., *Dynamic Statutory Interpretation*, 135 U. PA. L. Rev. 1479, 1483 (1987).

[17] T. Alexander Aleinkoff, *Updating Statutory Interpretation*, 87 Mich. L. Rev. 20, 21 (1987) ("Congress builds a ship and charts its initial course, but the ship's ports-of-call, safe harbors, and ultimate destination may be a product of the ship's captain, the weather, and other factors not identified at the time the ship sets sail.").

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