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The Courts, Congress and Tax Debts: An Analysis of the Discharge of Tax Debts Before and After the Enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

Cover Page Footnote

J.D Candidate, Fordham University School of Law, 2007; B.S., Fordham University College of Business Administration, 2004. I would like to thank Professor Elizabeth Maresca, Supervising Attorney of Fordham University School of Law's Tax Litigation Clinic, for her insight and advice while researching on behalf of a client the issue that led to this Note. I would also like to thank the members of the Fordham Journal of Corporate & Financial Law, and in particular Aymen Aboushi, Notes & Articles Editor, as well as his outstanding editorial team, for their tireless editing of this Note until the eve of final exams

NOTE

THE COURTS, CONGRESS AND TAX DEBTS: AN ANALYSIS OF THE DISCHARGE OF TAX DEBTS BEFORE AND AFTER THE ENACTMENT OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

*Brian Power**

I. INTRODUCTION

For nearly 100 years, judges and scholars have understood that one of the most important features of bankruptcy protection is the fresh start afforded by a discharge pursuant to the Bankruptcy Code.¹ Indeed, bankruptcy laws play a crucial role in our national economy.² “When the economic structure of a country embraces risk-taking and entrepreneurship, the legal system needs to provide a means to address

* J.D. Candidate, Fordham University School of Law, 2007; B.S., Fordham University College of Business Administration, 2004. I would like to thank Professor Elizabeth Maresca, Supervising Attorney of Fordham University School of Law’s Tax Litigation Clinic, for her insight and advice while researching on behalf of a client the issue that led to this Note. I would also like to thank the members of the *Fordham Journal of Corporate & Financial Law*, and in particular Aymen Aboushi, Notes & Articles Editor, as well as his outstanding editorial team, for their tireless editing of this Note until the eve of final exams.

1. See Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1394 (1985) (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)). *Local Loan Co.* stated that bankruptcy “gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear filed for future effort, unhampered by the pressure and discouragement of preexisting debt.” *Id.* at 244. See also Jeffrey J. Cymrot, *Otherwise Dischargeable Tax Debt: In re Haas and Judicial Construction of 523(a)(1)(C)*, 2 DEPAUL BUS. & COMM. L. J. 25, 25 (2003).

2. Robert J. Landry, III & Nancy Hisey Mardis, *Comment: Consumer Bankruptcy Reform: Debtor’s Prison Without Bars or “Just Desserts” for Deadbeats?*, 36 GOLDEN GATE U. L. REV. 91, 93 (2006).

financial failures.”³ The United States’s modern codification of bankruptcy laws has one basic goal—to promote the role of bankruptcy law in adding to social stability in our society.⁴ Two ancillary goals are: (1) to provide an equitable distribution of assets among creditors, and (2) to provide debtors a fresh start via discharge of their debts.⁵ “Both goals promote stability in dealing with the financial difficulties of people and businesses,”⁶ and thus “add stability to financial transactions and commerce, which in turn provides stability to society as a whole.”⁷

Not all debtors, however, are able to avail themselves of the fresh start that bankruptcy law protection provides. Recent developments in the courts and Congress have resulted in a barrier to the discharge of tax liabilities. Although all citizens subject to the income tax have to file a tax return and pay the tax they owe,⁸ not all are able to pay that tax.⁹ The recent developments discussed below have resulted in obstacles that may prevent those debtors who were unable to pay their tax debts from getting those debts discharged through bankruptcy. This article will discuss one specific tax issue—the discharge of tax debts for taxpayers who file returns after the Internal Revenue Service has already prepared their own returns and assessed taxes against them.

Part II of this article will describe the goals of bankruptcy protection, and statutory rules governing the dischargeability of tax liabilities.¹⁰ Part III will describe the Internal Revenue Service’s authority to prepare returns on behalf of taxpayers and how courts have treated these returns in deciding the discharge of tax debts.¹¹ Part IV will describe congressional action and discuss several critiques that were

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.* at 93-94.

7. *Id.*

8. I.R.C. § 6011(a) (2007). Section 6011(a) states:

When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

Id.

9. This is given from the fact that tax debts are dischargeable through bankruptcy. *See* 11 U.S.C §§ 507, 523 (2007).

10. *See Infra* Part II.

11. *See Infra* Part III.

intended to solve a split among the circuit courts on this issue.¹² Finally, Part V will argue how courts should rule on this issue in pre-reform cases, and will propose that Congress should repeal portions of the Bankruptcy Act and return deference to the courts while ensuring that the goals of bankruptcy protection are met.¹³

II. DISCHARGEABILITY OF TAXES

A. Of “Death and Taxes”¹⁴

The Internal Revenue Code¹⁵ (the “IRC”) requires all individuals subject to tax under the Code to file a “return.”¹⁶ A return must be filed, for calendar year taxpayers, on or before the 15th day of April the following year.¹⁷ Unfortunately for both taxpayers and judges the term “return” is not defined in either the IRC or the Bankruptcy Code.¹⁸ The issue of what constitutes a “return” has been the subject of much litigation under both the IRC and the Bankruptcy Code.¹⁹ This Part will discuss the statutory requirements governing the dischargeability of tax debts under the Bankruptcy Code before the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.²⁰

B. Tax Debts Meet the Bankruptcy Code

Although everyone has to file a tax return and everyone can apply

12. See *Infra* Part IV.

13. See *Infra* Part V.

14. Benjamin Franklin is widely quoted as saying “In this world, nothing can be said to be certain, except death and taxes.” See Letter from Benjamin Franklin to Jean Baptiste-Leroy (1789) reprinted in THE WORKS OF BENJAMIN FRANKLIN (1817).

15. 26 U.S.C. §§ 1-9833 (2007).

16. I.R.C. § 6011(a) (2007).

17. I.R.C. § 6072(a) (2007).

18. *Colsen v. United States (In re Colsen)*, 322 B.R. 118, 122 (B.A.P. 8th Cir. 2005).

19. See *Beard v. Comm’r*, 82 T.C. 766 (1984) (concerning the definition of a return for purposes of penalties under the Internal Revenue Code); *United States v. Nunez (In re Nunez)*, 232 B.R. 778 (B.A.P. 9th Cir. 1999) (concerning whether forms filed by taxpayer after Internal Revenue Service had prepared substitutes constitute returns for the purposes of discharge under Bankruptcy Code Section 523); *Hindenlang v. United States (In re Hindenlang)*, 164 F.3d 1029 (6th Cir. 1999) (stating that the threshold question is what constitutes a return under Bankruptcy Code Section 523).

20. Pub. L. No. 109-8, 119 Stat. 23 (2005).

for bankruptcy protection if they need it, there are some restrictions on what tax debts can be discharged. As discussed above, the Bankruptcy Code allows citizens who have fallen into economic hardship to petition for a discharge of their debts. Once a debtor has sought bankruptcy protection and a discharge is granted, the debtor should be freed from all of their tax debts.²¹ This, however, is not always the final result. For instance, a case may be reopened by a creditor whose debts have been discharged, or by a debtor who feels that a debt should have been discharged but was not.²² Either party may seek to have a court evaluate and decide whether or not a certain debt was rightfully discharged.²³ The “party seeking to establish an exception to discharge of a debt bears the burden of proof.”²⁴ As for the burden of proof in such actions, the Supreme Court has held that a party seeking an exception must prove that the debt is exempted by a preponderance of the evidence.²⁵ Although this rule is applicable to all types of discharged debts, a narrower tax-related ruling can provide more relevant guidance. In cases contesting the dischargeability of tax debts, the 11th Circuit has held that “the Government has the burden to prove that Section 523(a)(1)(B), the exception to discharge provision concerning tax liability, applies to the debtor’s delinquent tax return.”²⁶ There are a number of statutory requirements that must be satisfied in order to have tax debts discharged through bankruptcy.

To determine whether a tax debt is dischargeable, a debtor must make sure that his debts pass a number of tests. The first step in determining the discharge of debts under the Bankruptcy Code presents itself in Section 727.²⁷ Section 727 provides that the court shall grant the debtor a discharge unless the debts in question fall under one of the exceptions found in the Bankruptcy Code.²⁸ Section 523 is one such exception, and lists certain debts that are excepted from discharge.²⁹

21. 11 U.S.C. § 727 (2007).

22. 11 U.S.C. § 350(b) (2007) (“A case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause.”).

23. *Id.*

24. *Klein v. United States (In re Klein)*, 2003 Bankr. LEXIS 18, at *6 (Bankr. D. Fla. 2003) (citing *In re Griffin*, 206 F.3d 1389, 1396 (11th Cir. 2000)).

25. *Id.*

26. *Id.*

27. 11 U.S.C. § 727 (2007).

28. *Id.* § 727(a).

29. 11 U.S.C. § 523 (2007).

Under Section 523(a)(1), four types of tax debts are not dischargeable under Section 727.³⁰

First, a tax of the kind, and for the periods, specified in Section 507(a)(8) of the Bankruptcy Code will not be discharged.³¹ The second tax debt that will not be discharged arises when a tax return is required by the IRC but is not filed.³² Third, an exception to discharge is provided for a tax, with respect to which a return was filed after the due date, and after two years before the date of the filing of the petition.³³ Lastly, tax debts stemming from a fraudulent return, or from which the debtor willfully attempted in any manner to evade or defeat such a tax, is not dischargeable.³⁴

The first test to determine whether a tax debt is dischargeable is found in Section 523(a)(1)(A).³⁵ This section provides that debts listed under Section 507(a) are not discharged.³⁶ Section 507(a) lists the priority order of debts and states that the unsecured claims of governmental units are given eighth priority,³⁷ and are thus not dischargeable unless certain requirements are met.³⁸ These requirements are known as the “Three-Year Rule” and “240-Day Test.” Whether a tax debt is dischargeable under Section 507 depends on when the returns were filed and when the IRS assessed the taxes.³⁹

The “Three-Year Rule” exempts from discharge any taxes that were due within the three-year period prior to the date of the filing of the bankruptcy petition.⁴⁰ This requirement pertains to when returns are filed. Next, we come to the “240-Day Test.” The “240-Day Test” states that if a tax was assessed within 240 days prior to the filing of the bankruptcy petition, it will be classified as an eighth priority, non-dischargeable, tax debt.⁴¹ This is the assessment requirement. The next exception to discharge states that a tax debt will not be discharged unless

30. *Id.* § 523(a)(1).

31. *Id.* § 523(a)(1)(A).

32. *Id.* § 523(a)(1)(B)(i).

33. *Id.* § 523(a)(1)(B)(ii).

34. *Id.* § 523(a)(1)(C).

35. *Id.* § 523(a)(1)(A).

36. *Id.*

37. 11 U.S.C. § 507(a)(8) (2007).

38. *Id.* § 507(a)(8)(A)(i)-(ii).

39. *Id.*

40. *Id.* § 507(a)(8)(A)(i).

41. *Id.* § 507(a)(8)(A)(ii).

a return has been filed.⁴²

The Bankruptcy Code also provides an exception to discharge for any tax if an individual did not file his return on time, but instead filed late, and this late-filing date was after two years prior to the date of the filing of the bankruptcy petition.⁴³ This requirement seems to be aimed at debtors who wait until the last minute before filing all outstanding tax returns.⁴⁴ If a taxpayer files his tax returns after they are due, and this filing is within the two years prior to petitioning for bankruptcy, the tax debts will be excepted from discharge.⁴⁵

The last test to determine whether a tax debt is dischargeable concerns the mental state or intent of the debtor. A tax debt will not be discharged if the debtor “made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.”⁴⁶ The importance of this requirement will be discussed below. Some court decisions holding that late-filed returns are not “returns” for the purposes of discharge seem to have written this test out of the section.⁴⁷ As described in more detail below, some courts have looked to the debtor’s intent in filing a return after the IRS has already prepared substitutes and assessed taxes, and have used this time lapse to prevent the discharge of these debts. There are a number of reasons why courts have come to this conclusion. The definition of a return and how courts have treated late returns will be discussed in more detail below.⁴⁸

42. 11 U.S.C. § 523(a)(1)(B)(i) (2007).

43. *Id.* § 523(a)(1)(B)(ii).

44. United States v. Hindenlang (*In re Hindenlang*), 164 F.3d 1029, 1032 (1999).

The court stated that

[t]his provision appears to serve two purposes. First, the requirement of a two-year waiting period after filing a late return but before seeking discharge prevents a debtor who has ignored the filing requirements of the Internal Revenue Code from waiting until the eve of bankruptcy, filing a delayed but standard tax return form, and seeking discharge the next day.

Id.

45. 11 U.S.C. § 523(a)(1)(B)(ii) (2007).

46. *Id.* § 523(a)(1)(C).

47. United States v. Payne (*In re Payne*), 431 F.3d 1055, 1062 (2005) (Easterbrook, J., dissenting). Judge Easterbrook, in rejecting the majority’s conclusion, stated that

[i]f employment of a document to avoid paying taxes renders that document a non-return, then § 523(a)(1)(C) serves no function, for it supposes that a “return” has been filed (else § 523(a)(1)(B)(i) would foreclose discharge). If a document designed to game the system is not a “return” in the first place, then no court would ever get to § 523(a)(1)(C).

Id.

48. See *infra* Part III.

These requirements must all be met before a tax debt will be discharged. A plain reading of the statute reveals that the rules appear to be aimed at preventing abuse of the bankruptcy system. Courts have also analyzed what Section 523 is meant to address. Courts have noted that Section 523 seems to serve two purposes.⁴⁹ The two-year waiting period after filing but before petitioning for relief will prevent debtors who have ignored their filing requirements “from waiting until the eve of bankruptcy, filing a delayed but standard tax return form, and seeking discharge the next day.”⁵⁰ This waiting period provides “notice and an opportunity to act, giving the IRS time to seek payment by levy or court proceeding.”⁵¹ Also, the fact that discharge is denied if a debtor has filed fraudulent returns, or attempted to evade taxes, “corresponds with the notion that ‘good faith and candor are necessary requisites to obtaining a fresh start.’”⁵²

Inescapable is the observation that the term “return” is used quite frequently in these code sections.⁵³ Even though every individual subject to the tax code must file a return, the term is not defined. If an individual files for bankruptcy, what constitutes a “return” can often play an important role in deciding whether a debt is or is not discharged. Whether a document constitutes a “return” can make it more difficult to evaluate whether a taxpayer has met all of the above requirements. The next part of this Note will discuss how courts have grappled with the issue of how to define a “return” for the purposes of both the IRC and the Bankruptcy Code.

III. WHAT CONSTITUTES A RETURN

As stated above,⁵⁴ the IRC and the Bankruptcy Code do not define “return;”⁵⁵ courts, in evaluating whether a document is a return, have found it “appropriate to look to the IRC to determine the proper

49. *Hindenlang*, 164 F.3d at 1032.

50. *Id.*

51. *Id.*

52. *Id.* (quoting *Industrial Ins. Servs., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1129 (6th Cir. 1991) (citation omitted)).

53. *See* 11 U.S.C. §§ 507, 523 (2007).

54. *See supra* notes 18-19.

55. *United States v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1032-33 (“The Bankruptcy Code simply adopts the term ‘return’ without defining it further.”).

definition of return.”⁵⁶

A good starting point comes from Black’s Law Dictionary, which defines a “tax return” as:

[t]he form on which an individual, corporation, or other entity reports income, deductions, and exemptions and calculates their tax liability. A tax return is generally for a one year period, however, in some cases, the period may be less than a year. A federal tax return is filed with the Internal Revenue Service, and a state return is filed with the revenue department of the state.⁵⁷

Although some courts will mention this definition, most courts then go on to apply a four-prong test to determine whether a filing with the IRS constitutes a “return.”⁵⁸ This test was developed from two Supreme Court cases, *Germantown Trust Co. v. Commissioner*,⁵⁹ and *Zellerbach Paper Co. v. Helvering*.⁶⁰

The Tax Court, in *Beard v. Commissioner*⁶¹ combined the principles laid out in *Germantown* and *Zellerbach*.⁶² The *Beard* court stated that:

The Supreme Court test to determine whether a document is sufficient for statute of limitation purposes has several elements: First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.⁶³

56. *Id.*

57. BLACK’S LAW DICTIONARY 1020 (6th ed. 1991).

58. *See Hindenlang*, 164 F.3d at 1033-34 (stating that “[a] number of bankruptcy courts, and others, have since adopted or approved this basic format”). Although *Hindenlang* was decided in 1999, the four-prong *Beard* test is still in use. *See Colson v. United States (In re Colson)*, 446 F.3d 836, 839 (2006) (quoting *Beard v. Comm’r*, 82 T.C. 766, 774-79 (1984), *aff’d*, 793 F.2d 139 (6th Cir. 1986) (per curiam)) (“Both parties agree that the appropriate criteria for determining whether a document is a return for present purposes are summarized in *Beard v. Commissioner*.”) (internal citations omitted).

59. 309 U.S. 304 (1940).

60. 293 U.S. 172 (1934).

61. 82 T.C. 766 (1984).

62. *United States v Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1033 (1999).

63. *Beard*, 82 T.C. at 777. *See also Hindenlang*, 164 F.3d at 1033 (“The Tax Court, in *Beard v. Comm’r*, combined the principles of *Zellerbach* and *Germantown* to

In most cases considering this issue, the first, second, and fourth prongs are easily disposed of, often by stipulation.⁶⁴ Whether or not sufficient data to calculate tax liability has been provided must be evaluated on a case-by-case basis. The requirement that a document must purport to be a return deals with the physical form of the document on which the data is provided.⁶⁵ This is often satisfied quickly because most of the cases discussed below will note that the returns are forms provided by the IRS.⁶⁶ Next, the document must be signed and executed under penalty of perjury.⁶⁷ This will be judged by whether the taxpayer or debtor has signed the return.⁶⁸ The most contentious requirement is that the return must be an honest and reasonable attempt to satisfy the tax laws.⁶⁹ This prong is the basis for the split described below.

IV. SUBSTITUTES FOR RETURNS

Although all individuals subject to the income tax must file a return, not all do so, or do so correctly. If a taxpayer files a valid return

arrive at the four-part test.”) (internal citations omitted.)

64. See, e.g., *United States v. Nunez (In re Nunez)*, 232 B.R. 778 (B.A.P. 9th Cir. 1999). There is some dispute as to whether or not *In re Nunez* has been overturned. See *Moroney v. United States (In re Moroney)* 352 F.3d 902, 905 n.2 (2003) (describing the subsequent history of *In re Nunez*).

65. See, e.g., *Hindenlang*, 164 F.3d at 1031 (“Hindenlang used the proper Forms 1040.”).

66. See *id.* at 1034 (noting that the first three prongs were satisfied); *Moroney*, 352 F.3d at 905 (“Moroney and the IRS agree that Moroney’s late-filed statements purported to be returns; that they were executed under penalty of perjury; and that they contained sufficient data to permit calculation of Moroney’s taxes.”); *Payne v. United States (In re Payne)* 431 F.3d 1055, 1057 (2005) (“All but the fourth condition is satisfied on Payne’s belated return.”).

67. See *Beard v. Comm’r, Internal Revenue*, 82 T.C. 766, 777 (1984).

68. Compare *Moroney*, 352 F.3d at 905 (“Moroney and the IRS agree that Moroney’s late-filed statements . . . were executed under penalty of perjury . . .”) with *United States v. Hatton (In re Hatton)*, 220 F.3d 1057, 1061 (2000) (stating that an SFR was not a return because “neither document was signed under the penalty of perjury”).

69. See, e.g., *Hindenlang*, 164 F.3d 1029, 1034 (2003) (“The disputed issue is whether Hindenlang’s Forms 1040, filed after the IRS had made a formal assessment, ‘represent an honest and reasonable attempt to satisfy the requirements of the tax law.’”) (citing *United States v. Hindenlang (In re Hindenlang)*, 214 B.R. 847 (S.D. Ohio 1997)); *Moroney*, 352 F.3d at 905 (“Moroney and the IRS’s disagreement concerns whether Moroney’s statements were honest and reasonable attempts to satisfy the filing requirements imposed by the bankruptcy and tax laws.”); see also *Payne*, 431 F.3d at 1057.

and it is accurate, the amount of tax owed or the amount of a refund due is assessed. If it is inaccurate, the Commissioner of the Internal Revenue Service has the authority to adjust the amount owed and notify the taxpayer.⁷⁰ If a taxpayer does not file a return, the IRC provides procedures and authority for the Commissioner to prepare and file a return on that taxpayer's behalf.

A. Authority for Filing of Substitute Returns

As described above, all individuals subject to the IRC must file a return.⁷¹ If an individual required to create and file a return does not do so, the IRC grants authority to the Secretary to prepare returns in their absence.⁷² IRC Section 6020 provides two alternative ways in which this return can be prepared. First, if an individual fails to make a return, but "shall consent to disclose all information necessary"⁷³ to prepare one, then "the Secretary shall prepare such return, which, being signed by such person, may be received by the Secretary as the return of such person."⁷⁴

Second, if an individual does not file a return or files a fraudulent return, the Secretary can prepare a return based on information from other sources.⁷⁵ If no return is filed, or if a fraudulent return is filed, "the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise."⁷⁶ This information used to calculate the tax often comes from third parties.⁷⁷ The return prepared and executed by the Secretary "shall be

70. I.R.C. § 6212 (a) (2007). Section 6212(a) states that:

If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitles A or B or chapter 41, 42, 43, or 44 he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail. Such notice shall include a notice to the taxpayer of the taxpayer's right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.

Id.

71. *See supra* note 16.

72. I.R.C. § 6020 (2007).

73. *Id.* § 6020(a)

74. *Id.*

75. *Id.* § 6020(b)(1).

76. *Id.*

77. *See, e.g.,* United States v. Payne (*In re Payne*), 431 F.3d 1055, 1056 (2005). Judge Posner writing for the majority noted that "the Internal Revenue Service, probably on the basis of an information return submitted by someone from whom Payne had obtained income in 1986 . . ." *Id.*

prima facie good and sufficient for all legal purpose.”⁷⁸

If an individual does not file a return and the Secretary prepares one for him based on outside information, it is known as a substitute for return (“SFR”).⁷⁹ These SFRs have been the subject of much litigation, and courts have ruled on them in a variety of circumstances. In considering SFRs, courts have stated that “[t]he Internal Revenue Code’s deficiency procedures ‘do not require the Commissioner to prepare a return on a taxpayer’s behalf before determining and issuing a notice of deficiency.’”⁸⁰ If the IRS does not prepare SFRs under § 6020(b) they may still assess taxes and attempt to collect those debts.⁸¹

This SFR is a discretionary tool for the IRS. The SFR has different weight depending on what tax issue has arisen. This determination is often complicated by taxpayer-prepared tax returns that are filed after SFRs have been prepared and taxes have been assessed. The discharge of tax liabilities through bankruptcy protection is one such area.

B. Court Treatment of Substitutes for Returns

An issue arose when judges had to decide whether an SFR, or a return filed after an SFR has been prepared and executed, constituted a return for the purpose of dischargeability under the Bankruptcy Code. Courts have split on the issue. The Fourth,⁸² Sixth⁸³ and Seventh⁸⁴ circuits are all in agreement that a Form 1040 filed after the IRS has made an assessment is not “an honest and reasonable attempt to satisfy the tax laws.”⁸⁵ But the Eight Circuit does not agree with this

78. I.R.C. § 6020(b)(2) (2007).

79. *Spurlock v. Comm’r*, 118 T.C. 155, 2002 U.S. Tax Ct. LEXIS 9, *2 n.2 (“Respondent states that the term ‘substitute for return’ is a term used by Respondent for returns or partial returns prepared by Respondent where the taxpayer did not file a return.”).

80. *Geiselman v. United States*, 961 F.2d 1, 5 (1st Cir. 1992) (quoting *Roat v. Comm’r, Internal Revenue Serv.*, 847 F.2d 1379, 1381 (9th Cir. 1988)).

81. *United States v. Bowser* 1989 U.S. Dist. LEXIS 10690, *8 (“[A] rule requiring the Commissioner to prepare a return before issuing a deficiency letter would serve no useful purpose because the deficiency letter itself gives notice to the taxpayer of the amount owed.”).

82. *Moroney v. United States (In re Moroney)*, 352 F.3d 902, 904 (4th Cir. 2003).

83. *United States v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1034 (6th Cir. 1999).

84. *Payne v. United States (In re Payne)*, 431 F.3d 1055, 1058 (7th Cir. 2005).

85. *Gliem v. United States (In re Gliem)*, 2006 Bankr. LEXIS 3147, at *6-7 (U.S.

conclusion, and has stated that “to be a return, a form is required to ‘evinced’ an honest and genuine attempt to satisfy the laws.”⁸⁶ The Ninth Circuit⁸⁷ has not ruled on this exact issue, but a case deciding an ancillary issue will be described below as it will illuminate how this Circuit has ruled on the question of what constitutes a “return.”

V. COURT TREATMENT OF RETURNS VS. SUBSTITUTES FOR RETURNS

A. Introduction

Before analyzing court decisions, an example may help to lay a helpful foundation from which to proceed. This fact pattern will be akin to the cases discussed below. Consider this hypothetical taxpayer: he or she does not file tax returns for 3 years. The IRS becomes aware of this, it investigates, and then prepares SFRs. Once these substitutes are prepared, taxes based on those calculations are assessed. Later, the taxpayer files his returns, albeit a few years late. Three years later, the taxpayer files for bankruptcy, and asks the court to discharge those tax debts. The issue here is whether that late-filed return constitutes a return for the purposes of discharge. As discussed above, courts were split over how SFRs and late-filed returns were to be treated when evaluating whether tax debts were discharged through bankruptcy. This part of the Note will describe the two leading lines of cases concerning this issue.

B. Hindenlang

In *United States v. Hindenlang*,⁸⁸ the United States Court of Appeals for the Sixth Circuit became one of the first appellate courts to rule on this issue. In *Hindenlang*, debtor William Hindenlang did not file tax returns for years 1985 through 1988.⁸⁹ After sending Hindenlang notices of proposed deficiencies, the Internal Revenue Service prepared and sent substitutes for returns for the years at issue.⁹⁰

Bankr. Court for Middle District of Florida, 2006) (stating that, at the time, “[t]here is a three to one split amongst the circuit courts of appeal regarding what constitutes an ‘honest and reasonable attempt’”).

86. *Colsen v. United States (In re Colsen)*, 446 F.3d 836, 840 (8th Cir. 2006).

87. *United States v. Hatton (In re Hatton)* 220 F.3d 1057 (9th Cir. 2000).

88. *United States v. Hindenlang (In re Hindenlang)*, 164 F.3d at 1034 (6th Cir. 1999).

89. *Id.* at 1031.

90. *Id.*

When Hindenlang did not respond or execute the substitutes, the Internal Revenue Service sent statutory notices of deficiency.⁹¹ Because Hindenlang did not petition the tax court to challenge the deficiencies, the Internal Revenue Service was allowed to assess the amounts owed on his account.⁹² Two years after this assessment, in 1993, Hindenlang sent the Internal Revenue Service “what was purported to be individual income tax returns for the years in question.”⁹³ About four years later, Hindenlang filed for chapter 7-bankruptcy protection, and instituted an adversary proceeding to find out whether the tax liabilities at issue were dischargeable.⁹⁴

After noting that there were no factual issues to decide, the court moved to the legal question of what constitutes a return.⁹⁵ Pointing out that there was no statutory definition of return, and laying out the prongs of the *Beard* test, the court set out to apply the four prongs to the specific facts at issue.⁹⁶ The court quickly dispensed with three of the four prongs, leaving only “whether Hindenlang’s Forms 1040, filed after the IRS had made a formal assessment, ‘represent an honest and reasonable attempt to satisfy the requirements of the tax law.’”⁹⁷

The Sixth Circuit stated:

We hold as a matter of law that a Form 1040 is not a return if it no longer serves any tax purpose or has any effect under the Internal Revenue Code. A purported return filed too late to have any effect at all under the Internal Revenue Code cannot constitute “an honest and reasonable attempt to satisfy the requirements of the tax law.”⁹⁸

The court further concluded that:

91. *Id.*; see also I.R.C. § 6212(a).

92. 164 F.3d 1029, 1031.

93. *Id.*

94. *Id.*

95. *Id.* (“There are no material disputed fact issues in this case, so we proceed to the legal issue.”).

96. *Id.*

97. *Id.* at 1034. The Court stated:

First, there is no question that the Forms 1040 submitted by Hindenlang purported to be returns. Hindenlang used the proper form required by the IRS regulations and filed the completed forms with the IRS. Second, Hindenlang executed these forms under penalty of perjury. Third, the forms included all the data needed to calculate Hindenlang’s tax liability. Indeed, as indicated above, the forms were simply mirror images of the Substitutes for Returns completed by the IRS.

Id.

98. *Id.*

[W]hen the debtor has failed to respond to both the thirty-day and the ninety-day deficiency letters sent by the IRS, and the government has assessed the deficiency, then the Forms 1040 serve no tax purpose, and the government thereby has met its burden of showing that the debtor's actions were not an honest and reasonable effort to satisfy the tax law.⁹⁹

The narrow result of this case was that the court ruled that Hindenlang's tax debts were not discharged.¹⁰⁰ In a broader sense, this case had a much larger impact. The court never had a basis in fact for why Hindenlang filed late: because the ruling is as a matter of law, a debtor who, for whatever reason, filed returns after substitutes have been prepared and taxes assessed can never have those debts discharged. That the question is decided as a matter of law seems incongruent to the main goal of bankruptcy: the fresh start. This does not allow for a case-by-case evaluation of every taxpayer. While this ruling will undoubtedly prevent some dishonest debtors from abusing the bankruptcy code, it will also prevent those who do have a legitimate reason for filing late from ever getting their debts discharged. Unfortunately for debtors, this case has provided the basis for most of the other circuit court rulings on this issue.

C. Hatton

The Ninth Circuit Court of Appeals considered the dischargeability of tax debts in *In re Hatton*.¹⁰¹ While the facts in *Hatton* are slightly different from the other cases discussed herein, it is useful to analyze how the court in that case defined the term "return."¹⁰² The main question the court faced was "whether the substitute return prepared by the IRS, the installment agreement signed by Hatton, or a combination of both, constitute a tax "return" under 11 U.S.C. § 523(a)(1)(B)(i)."¹⁰³ The court noted the purpose behind Section 523(a)(1): that "a debtor should not be permitted to discharge a tax liability based upon a required tax return that was never filed."¹⁰⁴ The court had earlier decided "that

99. *Id.*

100. *Id.* at 1035 ("For the reasons stated above, we reverse the judgment of the district court.").

101. *United States v. Hatton (In re Hatton)*, 220 F.3d 1057 (2000).

102. *Id.*

103. *Id.* at 1059.

104. *Id.* at 1060 (citing *California Franchise Tax Bd. v. Jackson (In re Jackson)*, 184

the term ‘return’ should be given a strict construction and interpreted in accordance with its ordinary meaning.”¹⁰⁵

After analyzing the definition of “return” under the *Beard* test,¹⁰⁶ the court ruled that the tax liabilities should be excepted from discharge.¹⁰⁷ The court held that the return and installment agreement did not constitute a return under the four prongs because they were not signed under penalty of perjury, and did not constitute an honest and reasonable attempt to satisfy the tax laws.¹⁰⁸ The court stated that because Hatton “made every attempt to avoid paying his taxes until the IRS left him with no choice,” his “belated acceptance of responsibility . . . does not constitute an honest and reasonable attempt to comply with the requirements of the tax law.”¹⁰⁹

D. Moroney

The Sixth Circuit was not the only court to face this issue, and the majority of courts that have ruled have adopted a similar position. The Fourth Circuit Court of Appeals considered this issue in *Moroney*.¹¹⁰ Debtor Moroney did not submit timely income tax filings for 1990 or 1992.¹¹¹ As a result of this failure to file, the IRS began to examine Moroney’s income tax liabilities in 1994, and prepared substitutes.¹¹² On the basis of these substitutes, the IRS assessed taxes in the amounts of \$23,197.00 for 1990 and \$45,567.00 for 1992.¹¹³ Moroney later filed tax statements for these two years, but there was a dispute as to when they were filed.¹¹⁴ One fact important to this case is that because the tax

F. 3d 1046, 1050 (9th Cir. 1999)).

105. *Id.* (citing *Jackson*, 184 F.3d at 1051).

106. *Id.*

107. *United States v Hatton (In re Hatton)*, 220 F.3d 1057, 1061 (2000). The court stated that

Because Hatton never filed a return and only cooperated with the IRS once collection became inevitable, the bankruptcy court erred in concluding that Section 523 did not except Hatton’s tax liability from discharge.

Id.

108. *Id.*

109. *Id.*

110. 352 F.3d 902 (4th Cir. 2003).

111. *Id.* at 903.

112. *Id.* at 904.

113. *Id.*

114. *Id.* The IRS contended that the returns were filed in 1998. Moroney claimed

liabilities on Moroney's late-filed returns were less than the previous IRS assessments, the IRS abated the tax due based on these late-filed returns.¹¹⁵

Moroney filed for Chapter 7 bankruptcy protection on March 23, 2000.¹¹⁶ After the IRS notified Moroney that, in their view, his tax debts were not dischargeable, the two parties filed cross-motions for summary judgment in the bankruptcy court.¹¹⁷ The facts here are similar to those in *Hindenlang*, and mirror the hypothetical set out above. The bankruptcy court ruled,¹¹⁸ and the district court on appeal affirmed,¹¹⁹ that Moroney's returns did not satisfy the requirement of a return in Section 523, and were therefore excepted from discharge.¹²⁰ Appeal from the district court led to this case.

The question on appeal was "whether delinquent personal income tax filings, submitted years after [the IRS had] already prepared its own assessments, constitute[d] 'returns' for purposes of the bankruptcy code."¹²¹ As in many other cases dealing with this question, the court began with the *Beard* test, quickly ruled that three of the four prongs were satisfied, and focused on "whether Moroney's statements were honest and reasonable attempts to satisfy the filing requirements imposed by the bankruptcy and tax laws."¹²² The issue was then narrowed even further: the IRS and Moroney disagreed "about the relevant time frame in which to assess the honesty and reasonableness of Moroney's belated statements."¹²³ Moroney's position was that the relevant time frame was the time at which the returns were filed.¹²⁴ The

they were filed in 1996. This dispute did not effect the disposition of the case, as "Moroney concede[d] that his forms postdated by at least two years the SFRs prepared by the IRS, and that his forms postdated the original filing deadlines by at least four and six years, respectively." *Id.*

115. *Id.* ("Specifically, the IRS abated \$8,330 of the 1990 tax year assessment and \$14,980 of the 1992 tax year assessment.").

116. 352 F.3d 902, 904 (4th Cir. 2003).

117. *Id.*

118. *Moroney v. United States (In re Moroney)* 2002 Bankr. LEXIS 674 (Bankr. E.D. Va. 2002).

119. *Moroney v. United States (In re Moroney)* 2002 U.S. Dist. LEXIS 22919 (E.D. Va. 2002).

120. *Moroney*, 352 F.3d 902, 904 (2003).

121. *Id.* at 903.

122. *Id.* at 905.

123. *Id.*

124. *Id.*

IRS took the opposite position: “The IRS, however, rejoins that most courts have not ignored a debtor’s delinquency in filing, especially where the IRS’s interim preparation of a SFR renders the debtor’s filing unnecessary.”¹²⁵ The court adopted the IRS position, stating that “to belatedly accept responsibility for one’s tax liabilities, only when the IRS has left one with no other choice, is hardly how honest and reasonable taxpayers attempt to comply with the tax code.”¹²⁶ Importantly, this decision was based on the effort that the IRS had to expend in order to calculate his tax liability, and the underpinnings of the tax system as a whole.¹²⁷

This ruling did not go as far as the holding in *Hindenlang*. Instead, the *Moroney* court held that “income tax forms unjustifiably filed years late, where the IRS has already prepared substitute returns and assessed taxes, do not constitute “returns” for purposes of 11 U.S.C. § 523(a)(1)(B)(i).¹²⁸ Indeed, in an effort to make the outer limits of its decision clear, the court stated that

the government urges a broader rule than we adopt here, namely that any post-assessment filing can never qualify as a return for purposes of Section 523(a)(1)(B)(i). This simply goes too far. Circumstances not presented in this case might demonstrate that the debtor, despite his delinquency, had attempted in good faith to comply with the tax laws.¹²⁹

This rejection of the *Hindenlang* bright-line rule is important, because it shows judicial recognition of a case-by-case analysis to ensure that those who are deserving of discharge are granted it, while those who do not, are not.

As mentioned above, the IRS abated the amount Moroney owed based on his late-filed returns. This is important because the late-filed returns clearly served a purpose—the IRS relied on, and believed them to be accurate. This is in direct contrast to the IRS position that it had wasted time and effort calculating his tax liabilities. If the test was whether the IRS had spent time and effort calculating the non-filer’s tax

125. *Id.*

126. *Id.* at 906.

127. *Id.* (“[A]s a result of his failure, the IRS had to assume the onerous task of estimating Moroney’s taxes without his assistance The very essence of our system of taxation lies in the self-reporting and self-assessment of one’s tax liabilities.”).

128. *Id.* at 907.

129. *Id.*

liability, then why did the IRS abate the tax owed? This seems to conflict with the reason why courts side with the IRS.

The court took notice of this argument. “Rather, because his statements showed lesser liabilities than the IRS had estimated, the IRS abated portions of its prior assessments. In Moroney’s view, his statements must be considered honest and reasonable attempts to comply with the tax laws—after all, the IRS credited them enough to reduce his assessments.”¹³⁰ The court rejected this argument, stating that:

The relevant inquiry is whether Moroney made an honest and reasonable effort to comply with the tax laws, and not whether Moroney’s eventual effort had some effect on his tax liability. Under Moroney’s approach, the availability of discharge would turn on the IRS’s accuracy in assessing taxes, rather than on Moroney’s sincerity and diligence in complying with the tax code.¹³¹

To accept Moroney’s argument would also have another undesirable effect: the IRS would be discouraged from abating any debtor’s tax liabilities, because even the smallest adjustment could lead to the discharge of the entire tax liability.¹³²

The rationale behind the court’s rejection of *Hindenlang*’s holding—that, as a matter of law, these returns can never serve a purpose—is important. The court, although it rejects the discharge here,¹³³ does recognize that there may be taxpayers who do not file on time, but are still deserving of discharge.¹³⁴ In order to ensure that those deserving of discharge are given it, there must be a case-by-case review of the reasons for the late-filing. This allows for taxpayers who need and are deserving of a fresh start to explain themselves. This individual

130. *Id.*

131. *Id.*

132. *Id.* at 907. (“Moroney’s approach would only discourage the IRS from abating debtor’s tax liabilities—especially when any adjustment, no matter how small, would lead to a discharge of the entire tax liability, no matter how large.”).

133. *Id.* The court concluded:

Here we face only a debtor who was apparently too busy, for no less than six years, to file returns, and whose ultimate filing was merely an attempt to lessen the liability that he never wanted to assume. Under these circumstances, we cannot hold that Moroney filed a return in any meaningful sense of that word. We thus affirm the judgment of the district court.

Id.

134. *Id.* (providing an example of “a post-assessment filing that might actually *increase* a taxpayer’s liability”) (emphasis added).

analysis of the case before the court will also allow judges to ferret out those dishonest debtors who are attempting to abuse the protections afforded by the bankruptcy code. The Seventh Circuit later adopted this approach, as will be discussed below.

E. Payne

i. Posner's Majority Opinion

The United States Court of Appeals for the Seventh Circuit ruled on this issue in *In re John Howard Payne*.¹³⁵ The facts in *Payne* are similar to other cases dealing with this issue. Payne did not file tax returns for 1986 to 1992.¹³⁶ The IRS investigated, and assessed taxes for 1986.¹³⁷ Payne filed his 1986 return, and a few months later, in 1992, sought a compromise on the amount owed.¹³⁸ The IRS rejected a compromise, and Payne filed for bankruptcy in 1997.¹³⁹ The bankruptcy court granted a discharge for this 1986 tax owed, and the IRS argued that this debt was exempted from discharge.¹⁴⁰ After laying out the four prongs of the *Beard* test,¹⁴¹ Judge Posner, writing for the majority, stated:

A purported return that does not satisfy all four conditions does not play the role that a tax return is intended to play in a system, which is our federal tax system, of self-assessment. So while a "return" that satisfies the first three conditions comports with the literal meaning of the word, it does not comport with the functional meaning.¹⁴²

Although the majority notes that the *Hindenlang* decision held that "a return filed after the assessment of tax can never be adjudged an honest and reasonable endeavor to comply with the tax law,"¹⁴³ the court, as those in *Hatton* and *Moroney* before it, did not want to extend the holding to a further extent.¹⁴⁴ The majority noted that "[t]here might

135. 431 F.3d 1055 (7th Cir. 2005).

136. *Id.* at 1056.

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.* at 1057.

142. *Id.* The fourth prong is the requirement that a return "evinced an honest and genuine endeavor to satisfy the law." *Id.*

143. *Id.* at 1059-60.

144. *Id.*

as we have said be circumstances beyond a taxpayer's control that prevented him from filing a timely return, or even asking for an extension of the time to file, before the tax was assessed."¹⁴⁵ Because Payne did not offer a valid excuse for his lateness,¹⁴⁶ the court found that his tax debts should be excepted from discharge.¹⁴⁷

Thus, with *Payne*, another circuit court has expressly reasoned that there may be instances in which a taxpayer who did not file until after substitutes had been prepared and taxes assessed should be given the fresh start afforded by discharge through bankruptcy. This was not, however, a unanimous decision. Judge Easterbrook filed a dissenting opinion rejecting this analysis.

ii. Easterbrook's Dissent in Payne

The decision in *Payne* was 2-1, with Judge Easterbrook filing a dissenting opinion.¹⁴⁸ His opinion is based on two premises. The first is that the majority "conflates disclosure with substance."¹⁴⁹ Judge Easterbrook goes on to state that "[t]he portion of the Internal Revenue Code that must be satisfied honestly and reasonably, if a document is to be called a return, is the statute requiring revelation of financial information, not the statute requiring payment."¹⁵⁰ The second premise in his dissenting opinion concerns why Payne filed late returns. The majority stated that Payne's "purpose in filing the belated return was to satisfy a condition precedent to obtaining a discharge, rather than to pay any of the taxes he owed."¹⁵¹ The dissent's problem with this is that "Payne's purpose is a question of fact, and as far as [the dissent] can see the United States does not even *contend* that Payne had such a purpose."¹⁵² This is indicative of a problem common to cases dealing with this issue. Many cases are fully stipulated as to the facts, before

145. *Id.*

146. *Id.* at 1057. In analyzing whether the "honest and reasonable attempt" prong was satisfied, Judge Posner stated that "[a]ll but the fourth condition is satisfied by Payne's belated return. That condition . . . is not satisfied, and not only or even mainly because Payne offers no excuse for having failed to file his 1986 return until six years after it was due." *Id.*

147. *Id.* at 1060 ("The judgment is reversed with directions to deny the discharge.").

148. *Id.* (Easterbrook, J., dissenting).

149. *Id.* at 1061.

150. *Id.*

151. *Id.*

152. *Id.* (emphasis in original).

trial, and there often is no record as to why the returns were filed so late.¹⁵³ Most courts resolve this issue on cross-motions for summary judgment, without a hearing or trial on the reason for the late-filing. This lack of facts often prevents courts from ruling as to whether a late-filed return meets the “honest and reasonable attempt to satisfy the tax laws.”¹⁵⁴

The dissent concluded by stating that “[t]he document that Payne filed is a tax return because it contains all of the required information and may have helped the agency”¹⁵⁵ Looking to why a person filed late would make Section 523(a)(1)(C) useless, because if someone were to use a Form 1040 to evade paying taxes, then under this test it would not be a return—therefore (a)(1)(c) would not be applicable, because you need to have a return filed to reach (a)(1)(c). If the reason for why someone files is relevant in deciding if a document is a return under § 523(a)(1)(B)(i), then the intent in § 523(a)(1)(C) becomes irrelevant, because the government could argue for nondischarge under (B)(i), and never need to reach (C).

It seems that all four cases follow a similar pattern. One court held as a matter of law that late-filed returns filed after substitutes had been prepared and taxes assessed could never be discharged.¹⁵⁶ Three other courts did not go that far, noting that there were some instances in which the debts should be discharged.¹⁵⁷ Though this may be the case, Judge Easterbrook’s dissenting opinion¹⁵⁸ nonetheless had quite an impact. Indeed, as discussed below, the Ninth Circuit was persuaded by Judge Easterbrook’s dissent, and followed his reasoning.

F. Colsen

Not all courts follow the reasoning in *Hindenlang* and subsequent

153. See, e.g., *United States v. Hindenlang (In re Hindenlang)* 164 F.3d 1029, 1032 (1999) (“There are no material disputed fact issues in this case, so we proceed to the legal issue.”); *Moroney v. United States (In re Moroney)* 352 F.3d 902, 904 (2003) (“The IRS and Moroney filed cross-motions for summary judgment before the bankruptcy court”); *In re Payne*, 431 F.3d at 1062 (Easterbrook, J., dissenting) (“But we can’t do that now, because the bankruptcy judge did not make (and was not asked to make) a finding on that subject.”).

154. *In re Payne*, 431 F.3d at 1062 (Easterbrook, J., dissenting).

155. *Id.* at 1062.

156. See *supra* notes 89-101, and accompanying text.

157. See *supra* notes 111-35 and 136-48 and accompanying text.

158. See *supra* notes 149-54 and accompanying text.

cases holding that late-filed returns after SFRs have been prepared and taxes have been assessed are not an honest and reasonable attempt to satisfy the tax laws. The Court of Appeals for the Eighth Circuit recently rejected the *Hindenlang* bright-line rule in *Colsen v. United States*.¹⁵⁹ The facts in *Colsen* are substantially the same as in *Hindenlang*. Debtor Colsen did not file tax returns for 1992-1996.¹⁶⁰ The IRS prepared substitutes, and issued statutory notices of deficiency.¹⁶¹ By the middle of 1999, the IRS had assessed taxes, interests, and penalties.¹⁶² Mr. Colsen filed Forms 1040 for 1992-1998 in late 1999, then waited four years, and filed for Chapter 7 bankruptcy protection.¹⁶³ The Eighth Circuit, before applying the *Beard* test to the facts at issue, discussed how other circuit courts treated this issue.¹⁶⁴ Although the Fourth, Sixth, and Seventh Circuits had all ruled against late-filed returns qualifying as returns for dischargeability, the court discussed Judge Easterbrook's dissent in *Payne*,¹⁶⁵ then stated, "[w]ith due regard to the opinions of the other circuits, we find Judge Easterbrook's arguments persuasive."¹⁶⁶

The Eighth Circuit stated that looking into the reasons why a return was filed late is not required. An inquiry into the circumstances surrounding a document's filing was not required. A tax form, to be categorized as a "return," is only "required to 'evince' an honest and genuine attempt to satisfy the laws."¹⁶⁷ This reasoning was based on the court's analysis of the Supreme Court ruling in *Badaracco*¹⁶⁸—one of the cases that led to the formulation of the *Beard* four-prong test—and that Court's analysis of the fourth prong specifically.¹⁶⁹ The Eighth Circuit stated that "[t]he Supreme Court's objective assessment in *Badaracco* is compatible with the requirements of *Beard*,"¹⁷⁰ and that "the fourth *Beard* criterion contains no mention of timeliness or the

159. 446 F.3d 836 (8th Cir. 2006).

160. *Id.* at 838.

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.* at 839-40 (describing the Fourth, Sixth, and Seventh circuits holdings.).

165. *Id.* at 840.

166. *Id.*

167. *Id.*

168. *See id.*

169. *Id.*

170. *Id.*

filer's intent."¹⁷¹ Further, the *Colsen* court stated that it had been "offered no persuasive reason to create a more subjective definition of 'return' that is dependent on the facts and circumstances of a taxpayers filing."¹⁷² The court declined to do so because "to do so would increase the difficulty of administration and introduce an inconsistency into the terminology of the tax laws."¹⁷³ The court concluded by holding that "the honesty and genuineness of the filer's attempt to satisfy the tax laws should be determined from the face of the form itself, not from the filer's delinquency or the reasons for it . . . [t]he filer's subjective intent is irrelevant."¹⁷⁴

This holding, that the reason for the late filing is irrelevant, goes further than all other circuit court rulings on the issue, and is in direct opposition to the *Hindenlang* holding. At this point, the courts of appeals have provided a wide range of rulings on how to treat late-filed returns when ruling on the dischargeability of tax debts. As discussed above, the four-prong *Beard* test was developed by the Tax Court.¹⁷⁵ This Tax Court definition provided the basis for what constitutes a return, and it would be helpful to see how this definition has withstood the test of time. Before addressing congressional action to solve this problem, a recent Tax Court ruling will be discussed.

G. Tax Court Decisions

The United States Tax Court was the origin of the four-prong *Beard* test.¹⁷⁶ Although the Tax Court has not ruled on the exact issue of whether a return filed after SFRs have been prepared and taxes assessed can qualify as a "return" for debt discharge, they have continued to use the four-prong *Beard* test in other situations. In *Swanson v. Commissioner of Internal Revenue*¹⁷⁷ the court was asked to rule on whether or not a taxpayer's tax liabilities were discharged.¹⁷⁸ After first

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *See supra* notes 62-69.

176. *Id.*

177. 121 T.C. 111 (2003).

178. *Id.* at 122 ("The relevant issue is whether the SFRs prepared by respondent in this case constitute 'returns' within the meaning of 11 U.S.C. sec. 523(a)(1)(B). This is the first opportunity that this Court has had to consider the issue.").

considering and then finding that the Tax Court had jurisdiction to rule on the claim,¹⁷⁹ the court was asked to determine whether the taxpayer's debts were discharged.¹⁸⁰ The *Swanson* case is somewhat different from the other cases discussed in this Note because the taxpayer never filed returns after the Internal Revenue Service had prepared substitutes.¹⁸¹

One interesting line in *Swanson* concerns the level of effort needed to prepare an SFR. The court states that “[t]he preparation of an SFR by the Commissioner is a simple administrative step which allows the assessment and collection process to begin.”¹⁸² This is at odds with how other courts have characterized the effort required to prepare an SFR.¹⁸³ Here, the Tax Court concluded by ruling that the debtor's tax liabilities were not dischargeable.¹⁸⁴

H. The IRS's Position

The IRS has taken the position that a return filed after SFRs have been prepared and taxes have been assessed can never serve a purpose. The IRS has consistently urged the courts in the cases herein to adopt this position,¹⁸⁵ and will likely do so in current and future cases. This area of law is not clear. There does not appear to be one consistent rule for courts to apply when confronted with this issue. Congress attempted to remedy this state of affairs in 2005.

179. *Id.* at 116-19.

180. *Id.* at 120.

181. *Id.* at 122 (“The parties stipulated that petitioner did not file tax returns for these years.”).

182. *Id.*

183. Compare *Swanson v. Commissioner of Internal Revenue* 121 T.C. 111 (2003) with *Payne v. United States (In re Payne)* 431 F.3d 1055, 1057 (2005) (“A return filed after the authorities have borne that burden does not serve the purpose of the filing requirement.”) and *Moroney v. United States (In re Moroney)* 352 F.3d 902, 906 (2003) (“A reporting form filed after the IRS has completed the burdensome process of assessment without any assistance from the taxpayer does not serve the basic purpose of tax returns: to self-report to the IRS sufficient information that the returns may be readily processed and verified.”).

184. *Swanson*, 121 T.C. at 126 (“[T]he unpaid liabilities were not dischargeable under 11 U.S.C. Sec. 523(a)(1)(B) because required returns were not filed.”).

185. See, e.g., *Moroney*, 352 F.3d at 907 (“For its part, the government urges a broader rule than we adopt here, namely that any post-assessment filing can never qualify as a return for purposes of Section 523(a)(1)(B)(i).”).

VI. CONGRESSIONAL ACTION

Congress attempted to solve the courts' disagreements of what constitutes a return when it enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA").¹⁸⁶ The Senate passed BAPCPA on March 10, 2005 by a vote of 74 to 25.¹⁸⁷ On that same day, President Bush issued a statement "supporting the Senate's 'strong bipartisan vote . . . to curb abuses of the bankruptcy system' and urging the House 'to act quickly.'"¹⁸⁸ The House passed BAPCPA on April 14, 2005, by a vote of 302 to 126,¹⁸⁹ and it was signed into law on April 20, 2005.¹⁹⁰ Most of the changes made to the bankruptcy code, with some exceptions, became effective on October 17, 2005.¹⁹¹

At the signing, President Bush made a number of statements about why the BAPCPA was important.¹⁹² The President said, "bankruptcy laws are an important part of the safety net of America . . . they give those who cannot pay their debts a fresh start,"¹⁹³ but "[i]n recent years, too many people have abused the bankruptcy laws."¹⁹⁴ Noting that the goals of bankruptcy laws are to "give those who cannot pay their debts a fresh start,"¹⁹⁵ the President stated:

America is a nation of personal responsibility where people are expected to meet their obligations. We're also a nation of fairness and compassion where those who need it most are afforded a fresh start. The act of [C]ongress I sign today will protect those who legitimately need help, stop those who try to commit fraud, and bring

186. 109 P.L. 9, 119 Stat. 23 (2005).

187. Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 565 (2005); 151 Cong. Rec. S2463 (daily ed. Mar. 10, 2005).

188. Jensen, *supra* note 188 at 565 (quoting Press Release, The White House Office of the Press Secretary, Statement by the President, (Mar. 10, 2005), *available at* <http://www.whitehouse.gov/news/releases/2005/03/20050310-15.html>).

189. *Id.* at 566.

190. Press Release, President Signs Bankruptcy Abuse Prevention, Consumer Protection Act, Apr. 20, 2005, *available at* <http://www.whitehouse.gov/news/releases/2005/04/20050420-5.html>.

191. Landry & Mardis, *supra* note 2 at 92. For a list of changes that went into effect prior to October 17, 2005, see Landry & Mardis, *supra* at 92 n.4.

192. See Jensen, *supra* note 188 at 566-67.

193. *Id.* at 566.

194. *Id.*

195. *Id.*

greater stability and fairness to our financial system.¹⁹⁶

Noble goals abound: protect those who need protection, prevent dishonest debtors from abusing a compassionate system. The BAPCPA appears to address these goals in a manner that all reasonable minds can support.

Nevertheless, the BAPCPA has been criticized for a variety of reasons,¹⁹⁷ with some commentators concluding that it will simply not meet the goals stated above.¹⁹⁸ Although President Bush said that the BAPCPA would “protect those who legitimately need help,”¹⁹⁹ some commentators have noted that “[t]he amendments to the Bankruptcy Code made by the enactment of BAPCPA in 2005 arguably represent a shift away from the policy of bankruptcy law favoring debtors.”²⁰⁰ Its enactment has also affected both lawyers practicing bankruptcy law and debtors, as “the bankruptcy bar faces greater challenges due to new responsibilities and sanctions, and debtors face new uncertainties regarding their ability to find financial solutions under the creditor-

196. *Id.* at 567.

197. *See generally* Landry and Mardis, *supra* note 2 ; Daren Schlecter, Note and Comment: *Before and After The Bankruptcy Abuse Prevention Consumer Protection Act of 2005 Examined Under Recent Case Law: A Curse in Disguise for Consumers?*, 27 WHITTIER L. REV. 787 (2006); Jean Braucher, *Symposium: Consumer Bankruptcy and Credit in the Wake of the 2005 Act: The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need Not Be Futile*, 2007 U. ILL. L. REV. 93 (2007); William Houston Brown, *Taking Exception to a Debtor's Discharge: The 2005 Bankruptcy Amendments Make It Easier*, 79 AM. BANKR. L.J. 419 (2005). For a thorough description of the legislative history of the BAPCPA, *see generally* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005). A review of the entire history of the Act is beyond the scope of this Note.

198. *See* Landry and Mardis, *supra* note 2, at 92. (“The substantive revisions to the Code, on the whole, are generally creditor-oriented.”)

199. Press Release, *supra* note 190.

200. Landry and Mardis, *supra* note 2, at 96. The authors state that [f]or eighty years the Bankruptcy Act of 1898, with various amendments, stayed in effect. The Bankruptcy Reform Act of 1978 . . . significantly changed bankruptcy law. Even though the Bankruptcy Code significantly changed substantive bankruptcy, it did not alter the fundamental policy in favor of debtors. In fact, some argue that it enhanced a policy in favor of debtors. Since 1978, the Bankruptcy Code has been amended numerous times However, none of these amendments altered the underlying policy of bankruptcy law in favor of debtors. The amendments . . . made by the enactment of BAPCPA in 2005 arguably represent a shift away from the policy of bankruptcy law in favor of debtors.

Id.

driven new law.”²⁰¹

Because the BAPCPA was passed just a few years ago, there have not been many cases analyzing its effects. “As with all new statutory law, the exact meaning and implications of the act will not be known until courts begin to sort out its myriad provisions via statutory construction. There are many unsettled areas.”²⁰² The ultimate judgment of the BAPCPA will take some time to develop. This is not to say that it has not had an immediate impact.

Although widely criticized,²⁰³ the BAPCPA has lowered the numbers of annual bankruptcy petition filings.²⁰⁴ The Administrative Office of the U.S. Courts has stated that 1,112,542 bankruptcy cases were filed in fiscal year 2006, ending September 30, 2006.²⁰⁵ This is a more than 37 percent drop from the same period in 2005.²⁰⁶ More specifically, Chapter 7 filings dropped more than 38 percent, from 1,346,201 in 2005 to 833,147 in 2006.²⁰⁷ Although Democrats have taken back both houses of Congress,²⁰⁸ insiders do not see a reform of BAPCPA on the horizon.²⁰⁹ Former Bankruptcy Review Commission Chair Brady Williamson has opined that the reform of BAPCPA will take place on a longer timeline than the current two-year Congress, and that “in this longer timeframe more can be done to change the tone of the public dialogue and thus improve both the consumer and commercial bankruptcy system.”²¹⁰

Court decisions on current and future cases will be important in seeing what parts of the BAPCPA are helpful to both debtors and creditors, and what parts do not accomplish the Act’s goals. The

201. *Id.* at 119.

202. *Id.*

203. *See supra* notes 198-202 and accompanying text.

204. *See* U.S. Courts, Bankruptcy Filings Decline in FY 2006, *available at* http://www.uscourts.gov/press_release/bankruptcyfilings120506.html, (last visited Mar. 13, 2007).

205. *Id.*

206. *Id.*

207. *Id.*

208. *See* Legislative Highlights, *Insiders Say Radical Overhaul of BAPCPA Not Likely in Congress Under New Management*, 26-1 ABIJ 8 (Feb. 2007) (“Despite the Democrat Party takeover of both houses of Congress after the November election, a bipartisan group of Washington insiders sees little chance of major changes to BAPCPA.”).

209. *Id.*

210. *Id.*

BAPCPA was primarily intended to solve problems experienced by both creditors and debtors.²¹¹ As discussed above, courts were split over the treatment of substitutes versus late-filed returns in determining the dischargeability of tax debts.²¹² Congress and the President attempted to solve this split when they enacted BAPCPA. To that end, Section 714 of BAPCPA inserted the following paragraph into Section 523:

For the 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.²¹³

Under the new BAPCPA provisions, a return “filed under [Section] 6020(a) of the Internal Revenue Code are considered properly filed, and returns filed under [Section] 6020(b) of the IRC are not considered properly filed.”²¹⁴ Congress’ goal was to make sure that returns prepared under Section 6020(a) were considered returns for dischargeability, but not those prepared under Section 6020(b). This is in some way related to the idea of a “fresh start.” Taxpayers who make the effort to get their taxes done pursuant to Section 6020(a) can benefit from the fresh start; those who do not make an effort, and instead have returns prepared under Section 6020(b), cannot.

Beginning with the first sentence, if a return for the purposes of this section must satisfy all non-bankruptcy law, including applicable filing requirements, then a return that does not satisfy applicable timing requirements is not a return for the purposes of this section, and any debts arising from that return are not dischargeable. This seems to indicate that if a taxpayer files late, even if by a day, they will be

211. See Schlecter, *supra* note 198, at 788. The author notes that “[a]ccording to congressional reports on the BAPCPA, its purpose is to ‘improve the bankruptcy system by deterring abuse, setting enhanced standards for bankruptcy professionals, and streamlining case administration.’” *Id.* The deterrence of abuse seems to benefit creditors, while increasing standards on bankruptcy professionals, and easing case administration problems, appears to be aimed at debtors.

212. See *supra* Part V.

213. 109 P.L. 9, 704 (2005).

214. Steven B. Kass, *Discharge of Unfiled Taxes under BAPCPA: No More “Super” Discharge?*, 25-5 ABIJ 10 (June 2006).

prevented from seeking the debt's discharge, regardless of the reason why.

The first part of the second sentence indicates that debts arising from returns filed under Section 6020(a), or similar state or local law, are dischargeable. The returns referenced here are those the taxpayer signs under penalty of perjury and through which the taxpayer traditionally provides information to the IRS. The next part of the second sentence broadens the definition of return to include any written stipulation to a judgment or any final order entered into by a non-bankruptcy tribunal. The second part of the second sentence thus seems to indicate that any debt arising out of an agreement between the IRS and the taxpayer, or the judgment of a United States District Court²¹⁵ or United States Tax Court²¹⁶ trial would be dischargeable, so long as no substitutes had been prepared or taxes based on substitutes assessed. So, for example, if a taxpayer filed an inaccurate return and the IRS sent a notice of deficiency, and then the debtor and the IRS settled prior to trial, the resulting tax debt would be dischargeable.

The last part of the second sentence is aimed at solving the split among the circuits. If a taxpayer does not file, and the IRS invokes Section 6020(b) to prepare returns and assess taxes, then the tax liability due is never dischargeable. This rule seems discordant with the stated goals of the bankruptcy laws. As described above, most cases are solved on cross motions for summary judgment. This means that there are often very little facts in dispute, and are based on detailed stipulations. These detailed stipulations prevent an application of the facts to the fourth prong of the *Beard* analysis.

The language of the statute hints at the problem that Congress was intending to solve with its enactment. Apparently, Congress believed that Section 6020(a) would catch all taxpayers who are deserve to have their tax debts discharged in bankruptcy, while Section 6020(b) would catch all dishonest taxpayers who are not deserving of such protection. This distinction, however, is not as simple as the statute might otherwise indicate. For example, as courts have noted there may be times when taxpayers have legitimate reasons for not filing returns until well after the IRS has prepared substitutes and assessed taxes. Furthermore, this new statute may only complicate the issues unnecessarily, as there was already a statute on the books designed to catch those dishonest people

215. I.R.C. § 7422 (2006).

216. I.R.C. § 6213 (2007).

intent on using the bankruptcy code to discharge fraudulent debts.

Indeed, there is already a solution to Congress's concerns regarding fraudulent returns and willful attempts to evade paying fairly-assessed tax liabilities: Section 523(a)(1)(C)²¹⁷. A court could have both sides stipulate to most facts at issue, but have the parties provide evidence as to why the return was filed so late. If there is a legitimate reason for filing late and an attempt to comply with the tax laws, the court can grant a discharge. If these facts are not found in the debtor's favor, the court can deny discharge under Section 523(a)(1)(C). To examine a debtor's intent when deciding whether a document falls within the definition of a return removes 523(a)(1)(C) from Section 523. Analyzed under the four-prong *Beard* test, a document filed by a taxpayer that is fraudulent on its face would be found to not constitute an honest and reasonable attempt, would not fit within the definition of a return, and would be excepted from discharge under Section 523(a)(1)(b). This analysis will soon remove any need to look at Subsection (C).

VII. CONCLUSION

Congress should repeal Section 714 of the BAPCPA. By denying discharge to tax debts that arise from returns that violate applicable filing requirements, as well as to tax debts that arise from returns filed under Section 6020(b), Section 714 clearly conflicts with the primary goal of bankruptcy—to provide a “fresh start.” To prevent the fraudulent use of the bankruptcy code by a few, Section 714 punishes many—even those who may have entirely legitimate reasons for not filing. By repealing this section and allowing the courts to review the intent of the debtor on a case-by-case basis, Congress will be better able to protect those debtors who truly need it, and to prevent abuse of the bankruptcy system. Indeed, these decisions are native soil for the courts, and with a developed body of evidence they will make the appropriate decision as to whether or not a debtor should be granted a discharge for their tax debts.

By looking at returns on a case-by-case basis, judges will effectively evaluate whether a return should be exempted from discharge. Although many facts can be stipulated to for purposes of judicial economy, parties should produce evidence regarding the reason for the late filing. Both the *Hindenlang* and *Colsen* decisions, as well as

217. 11 U.S.C. § 523(a)(1)(C) (2005).

Congress's solution, go too far in both directions. As the *Moroney* and *Payne* courts have stated, there may be times when there is a reason for filing late that satisfies the *Beard* test. Congress should repeal Section 714 of the BAPCPA, and allow courts to make a determination on a case-by-case basis.