DON'T LOOK A GIFT HORSE IN THE MOUTH: THE FIFTH CIRCUIT'S MCCOY DECISION NEEDLESSLY CREATES A TAXING SITUATION FOR BANKRUPT TAXPAYERS

I. INTRODUCTION

Income tax debts may be eligible for discharge under Chapter 7 or Chapter 13 of the Bankruptcy Code.[1] First an income tax return must be filed with a taxing authority.[2] Second, if the return if timely filed, there must be at least three years from the filing date to the date of the petition.[3] Third, if the return is filed late, there should be more than two years from the filing of the return to the date of the bankruptcy petition.[4] The foregoing rules apply to both federal and state taxing authorities.[5]

In 2005, when Congress passed a substantial modification to the Bankruptcy Code, the code section that sets out a list of nondischargeable debts, 11 U.S.C § 523, was amended to include an unnumbered provision, often referred to as the "hanging" paragraph.[6] The unnumbered paragraph follows § 523(a)(19) and states in relevant part: the term 'return' means a "return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements)."[7] This 2005 change led to *McCoy v. Miss. State Tax Comm'n* (*In re McCoy*), in which the Fifth Circuit court ruled that the failure to file a tax return, in the time required by Mississippi tax law, failed to satisfy the "applicable nonbankruptcy law" referred to in the hanging paragraph and tax due was not dischargeable.[8]

However in ruling so, the Fifth Circuit has interpreted the law in such a way that violates various canons of statutory construction.[9] If the court in *McCoy* is correct, this provision, allowing discharge in the case of late returns filed more than two years prior to bankruptcy, no longer has meaning. This article will explore the impact the *McCoy* decision has had and will continue to have on the area of bankruptcy tax and a taxpayer's ability to discharge tax obligations in bankruptcy.

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1. See Rex B. Bushman, Are Income Taxes Dischargeable in Bankruptcy?, Utah B.J., Jun. 10, 1997, at 12, 12-13.

2. *Id.* at 13.

3. *Id.*

4. *Id.*

5. *Id.*

6. Morgan D. King, *What is a Tax Return?*, NORTON BANKR. L. ADVISER, Nov. 2010, at 7, 9 [hereinafter King, *Tax Return*].

7. *See id.* (referencing 11 U.S.C. § 523(a)(19) (2012)).

8. *See* McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012).

9. *See* Morgan D. King, *Tolstoy, Discharging Taxes, and the Fifth Circuit*, NORTON BANKR. L. ADVISER, Apr. 2012, at 9, 11-12 [hereinafter King, *Discharging Taxes*].

Part I of this article discusses the real life implications of the *McCoy* decision and gives a brief overview of the bankruptcy process. Part II of this article briefly discusses the law pre-amendment. Part III of this article discusses the law post-amendment and the cases prior to the 2010 IRS Chief Counsel Notice. Part IV discusses whether a late-filed return qualifies as a "return" for discharge purposes. Part V discusses the 2010 IRS Chief Counsel Notice. Part VI discusses the cases post-IRS Chief Counsel Notice. Part VII discusses the current assessment of this taxing situation. Finally, Part VIII discusses the flaws in the *McCoy* interpretation of the amendment.

II. REAL LIFE IMPLICATIONS OF FIFTH CIRCUIT DECISION

A. *Hypothetical One*

You live on the Gulf Coast, in New Orleans, Louisiana late August 2005. Hurricane Katrina makes landfall. There is some damage and you expect to return home soon. The next day, the levees break and, the city and surrounding parishes are flooded and the city is underwater.[10] You had no idea your life would be turned upside down. You have lost everything and don't know if you want or even could ever return back to the city. If you are fortunate, you return home late October, early November. If you are lucky you return back home early 2006. If you are not so fortunate, it takes you years to get back home.[11]

The Internal Revenue Service allows special casualty loss deductions and special filing extensions.[12] You are still struggling to put back the pieces of your life and you file your tax returns late. The Internal Revenue Service waives the penalty for a late filing because of the natural disaster.[13]

You only have the clothes on your back. You've lost everything, and you want to file for bankruptcy. The Bankruptcy

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10. Joseph B. Treaster & N.R. Kleinfield, *Levee Breaks Devistate New Orleans*, N.Y. TIMES, Aug. 31, 2005, http://www.nytimes.com/2005/08/31/world/americas/31iht-katrina.html.

11. *See The Time in Between: Waiting after Katrina and Sandy*, CREATIVE TIME REP. (Aug. 29, 2013), http://creativetimereports.org/2013/08/29/the-time-in-between-waiting-after-katrina-and-sandy (reporting that "[f]ifteen months after Katrina hit, 100,000 residents were still living in temporary FEMA trailers, while tens of thousands were scattered to the four corners of the country").

12. Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, 119 Stat 2016; *see generally* Treas. Reg. § 301.7508A-1(a) to (c)1 (explaining the practical application of filing extensions due to disasters like Hurricane Katrina).

13. Katrina Emergency Relief Act of 2005, Pub. L. No. 109-73, 119 Stat 2016; *see generally* Treas. Reg. § 301.7508A-1(a) to (c)1 (explaining the practical application of filing extensions due to disasters like Hurricane Katrina).

Code provides you an opportunity to have those taxes discharged in bankruptcy.[14]

However, New Orleans is in the Fifth Circuit. Let's say Katrina happened in 2013 and not 2005. The Fifth Circuit in 2012 ruled, a late filed return will not be considered a "return" for discharge purposes.[15] Therefore, you would not be able to discharge your tax liabilities in bankruptcy.

B. *Hypothetical Two*

There can be many reasons taxpayers file late. Even though the conduct of filing late rises to a penalty, the IRS may forgive the late penalty.[16] The IRS will forgive a late penalty if a taxpayer can show that the failure to timely file a tax return was "due to reasonable cause and not due to willful neglect."[17] However, the underlying tax liability cannot be discharged in bankruptcy.[18] For example, a soldier files a return after the deadline. There is no IRS penalty for late filing because there was "reasonable cause" for the late filing and not "willful neglect."[19] However, the soldier's tax liability cannot be discharged in bankruptcy.[20]

A taxpayer could even get sick and file a tax return after the deadline. The IRS could find that the taxpayer's illness was a "reasonable cause" and waive the late filing penalty. But once again, the taxpayer's tax liability will be nondischargeable in bankruptcy. A taxpayer should not be penalized for an unforeseen event that the taxpayer could not have prevented. These scenarios are examples of the consequences of the Fifth Circuit *McCoy* decision.

C. *Bankruptcy Process*

Congress enacted the bankruptcy laws with the fundamental goals of giving an honest debtor a financial "fresh start."[21] This is accomplished through the bankruptcy discharge, which is a

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14. *See* Bushman, *supra* note 1.

15. McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924, 932 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012).

16. *See* Internal Revenue Manual, Introduction and Penalty Relief, § 20.1.1.3.5, http://www.irs.gov/irm/part20/irm_20-001-001r-cont01.html (last updated November 25, 2011).

17. *Id.*

18. *See In re McCoy*, 666 F.3d at 924 (upholding the bankruptcy court's denial of discharge of tax liability as reported on a late filed return).

19. I.R.C. § 6651(a).

20. *See In re McCoy*, 666 F.3d at 927-28.

21. I.R.S. Publ'n 908, Bankr. Tax Guide, at 2 (Oct. 17, 2012).

permanent injunction, court ordered prohibition, against the collection of certain debts as a personal liability of the debtor.[22] Bankruptcy proceedings begin with the filing of either a voluntary petition in the United States Bankruptcy Court, or in certain cases an involuntary petition filed by creditors.[23] Generally, when a debt owed to another person or entity is canceled, the amount canceled or forgiven is considered taxable income to the person owing the debt.[24] If a debt is canceled under a bankruptcy proceeding, the amount canceled is not income.[25]

The bankruptcy court may enter an order discharging the debtor from personal liability for certain debts, including taxes.[26] For individuals in chapter 7 cases, the following tax debts, including interest, are not subject to discharge: taxes entitled to eighth priority, taxes for which no return was filed, taxes for which a return was filed late after 2 years before the bankruptcy petition was filed, taxes for which a fraudulent return was filed, and taxes that the debtor willfully attempted to evade or defeat.[27]

III. SECTION 523(A) PRE-BAPCPA

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), neither the Bankruptcy Code nor the Internal Revenue Code defined "return."[28] A document qualified as a "return" for purposes of § 523(a) if it met the following four part test established by the U.S. tax court in *Beard v. Commissioner*: (1) there must be sufficient data to calculate tax liability; (2) the document must purport to be a return; (3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and (4) the taxpayer must execute the return under penalties of perjury.[29]

Income taxes could be discharged in a Chapter 7 bankruptcy if five requirements were satisfied.[30] Income taxes were dischargeable if:

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22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.* at 25.
27. *Id.*
28. *In re* Payne, 431 F.3d 1055, 1057 (7th Cir. 2005).
29. Beard v. Comm'r, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).
30. King, *Tax Return*, *supra* note 6, at 8.

> 1) the taxpayer filed his or her return more than two years before the bankruptcy; 2) the most recent due date for filing the return was over three years old; 3) the tax was assessed more than 240 days prior to the bankruptcy; 4) the tax return was not fraudulent; and, 5) the taxpayer had not attempted to evade or defeat the tax.[31]

If a debtor met the five requirements, their income tax liability qualified as dischargeable debt.[32]

A debtor simply had to file a tax return more than two years prior to filing for Chapter 7 bankruptcy (commonly known as the "two year rule").[33] Filing the return untimely did not disqualify the tax from dischargeability.[34] However, the tax return could not be fraudulent, frivolous or filed after the IRS had had both filed a substitute return and assessed the tax due.[35]

IV. SECTION 523(A) POST-BAPCPA

The lack of any definition for "return" in either the Bankruptcy Code or the Internal Revenue Code has spawned a long debate as to what constitutes a return for discharge purposes.[36] Some courts have found that returns filed by the debtor after an assessment by the IRS pursuant to I.R.C. § 6020(b) are returns for purposes of dischargeability.[37] Other courts have found that returns filed by the taxpayer after the IRS has assessed the tax are not returns for purposes of dischargeability because they serve no tax purpose.[38] Yet, some courts have used the failure to timely file a tax return as a basis to find the taxes nondischargeable under the evasion provision.[39]

The evasion provision does not discharge an individual debtor from any debt "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade

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31. *Id.* (citations omitted).
32. *Id.*
33. *Id.* at 7-8.
34. *Id.*
35. *Id.*
36. *See, e.g., In re* Payne, 431 F.3d 1055, 1057 (7th Cir. 2005); King, *Discharging Taxes*, *supra* note 9 at 9.
37. *See, e.g.*, Colsen v. United States (*In re* Colsen), 446 F.3d 836, 840-41 (8th Cir. 2006); Izzo v. United States, 287 B.R. 158, 161-62 (Bankr. E.D. Mich. 2002).
38. *See, e.g., In re Payne*, 431 F.3d at 1058; Moroney v. United States (*In re* Moroney), 352 F.3d 902, 905-06 (4th Cir. 2003).
39. *See, e.g.*, United States v. Fretz (*In re* Fretz), 244 F.3d 1323, 1329-31 (11th Cir. 2001); Hassan v. United States (*In re* Hassan), 301 B.R. 614, 621 (Bankr. S.D. Fla. 2003).

or defeat such tax."[40] Permitting a debtor to evade the collection of taxes would not serve the balance that § 523(a)(1)(C) strikes between the "fresh start" policy and the policy of preventing tax evasion; it would only give an advantage to dishonest debtors.[41] Possible evasive actions include a repeated failure to pay taxes; filing a blank or incomplete tax return; and hiding money or property.[42]

As part of the BAPCPA, § 523(a) of the Bankruptcy Code was amended effective October 17, 2005.[43] The amendment added language to Bankruptcy Code that addressed how a debtor could fail to file a tax return more than two years prior to the filing for bankruptcy.[44] An unnumbered "dangling paragraph" was added to Bankruptcy Code § 523(a):

> For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or 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.[45]

BAPCPA also "added some language to § 523(a) which does not appear to delete or change the two-year rule per se."[46]

> A discharge under section 727, 1141, 1228(a),1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt with respect to which a return, or equivalent report or notice, if required, was not filed or given; or was filed or given after the date on which such return, report, or notice was last due, under applicable law

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40. 11 U.S.C. § 523 (a)(1)(C) (2012).

41. Griffith v. United States (*In re* Griffith), 206 F.3d 1389, 1395 (11th Cir. 2000).

42. *See* United States v. Fegeley (*In re* Fegeley), 118 F.3d 979, 983-84 (3d Cir. 1997); Volpe v. United States (*In re* Volpe), 377 B.R. 579, 588 (Bankr. N.D. Ohio 2007); Cole v. United States (*In re* Cole), 328 B.R. 237, 242 (Bankr. M.D. Fla. 2005).

43. Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 750 (Bankr. N.D. Miss. 2008).

44. King, *Tax Return*, *supra* note 6, at 7.

45. 11 U.S.C. § 523(a) (2012).

46. King, *Discharging Taxes*, *supra* note 9, at 9.

> or under any extension, and after two years before the date of the filing of the petition.[47]

This added language was probably meant to eliminate some of the questions that are evident from the historical debate, evidenced by case law, over late-filed returns.

Internal Revenue Code § 6020(b) states:

> (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 therefore, 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.[48]

For decades, a Chapter 7 debtor had to file a federal and state tax return at least two years prior to filing for bankruptcy to get the taxes discharged.[49] Since the enactment of BAPCPA, the two-year rule applies to Chapter 7 debtors as well as Chapter 13 debtors.[50] Thus, Hurricane Katrina survivors, referenced in the earlier hypothetical, could have their tax obligations discharged in bankruptcy as long as they filed their tax returns at least two years prior to filing their bankruptcy petition.[51] According to the decades old "two-year rule", filing their returns late should not disqualify their tax returns as "returns" for discharge purposes.[52]

"A number of courts, primarily within the Fifth Circuit, have held that . . . BAPCPA creates a new rule: That a late-filed tax return is, for that reason alone, not a return, and hence the related taxes are not dischargeable."[53] The late-filed return, whether or not following a return filed pursuant to IRC § 6020(b), does not meet "applicable filing requirements" of nonbankruptcy law and tax liabilities attributable to such returns cannot be

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47. 11 U.S.C. § 523 (a)(1)(B).
48. I.R.C. § 6020(b) (2012).
49. King, *Discharging Taxes, supra* note 9, at 9.
50. *Id.*
51. *See id.* (explaining the "two-year rule," and its practical application); *see also* 11 U.S.C. § 523(a)(1)(B)(i)-(ii) (2012).
52. King, *Discharging Taxes, supra* note 9, at 10 (citing 11 U.S.C. § 523 (a)(1)(B)).
53. *Id.* at 9.

discharged.[54] However, "the IRS settled this issue by explicitly stating that it was no longer the IRS's position that a late-filed tax return was never a "return" for purposes of discharging taxes in bankruptcy."[55]

A. In Re Hindenlang-*1999*

William C. Hindenlang filed Forms 1040 after the Internal Revenue Service had calculated its own assessment of Hindenlang's liability.[56] Some years later, Mr. Hindenlang filed for bankruptcy relief and sought a discharge determination.[57] The IRS argued that returns filed after the IRS has already made its own assessment serve no useful purpose.[58] The Sixth Circuit agreed with the IRS and adopted a per se rule that the filing of a tax return by the taxpayer after the IRS has made an assessment served no useful purpose and was therefore not a "return."[59] The court held that: (1) tax forms filed by debtor after the IRS assessed the deficiencies were not "returns" for purposes of the discharge exception for taxes for which the required return was not filed, and (2) as a matter of law, a document is not a federal tax "return" if it serves no tax purpose or has no effect under the Internal Revenue Code.[60]

B. In Re Payne-*2005*

In *In re Payne*, Mr. Payne did not file his federal income tax return for 1986 until 1992.[61] In 1989, the IRS discovered Payne did not file an income tax return for 1986.[62] In 1990, the IRS assessed Payne for federal income taxes past due.[63] In 1992, Payne attempted to compromise with the IRS.[64] A few years later, in 1997, Payne filed for bankruptcy.[65] In 1998, he received

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54. *See* Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 751 (Bankr. N.D. Miss. 2008); *see also* Links v. United States (*In re* Links), No. 08–3178, 2009 WL 2966162, at *4-5 (N.D. Ohio Aug. 21, 2009).

55. King, *Discharging Taxes*, *supra* note 9, at 9.

56. United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1031 (6th Cir. 1999).

57. *Id.*

58. *Id.* at 1034.

59. *Id.*

60. *Id.* at 1034-35.

61. *In re* Payne, 431 F.3d 1055, 1056 (7th Cir. 2005).

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

a discharge of his unpaid 1986 tax liability.[66] Payne offered no excuse for filing his return six years late.[67] The court denied Payne's discharge.[68] However, the court did acknowledge that circumstances can arise that are beyond a taxpayer's control that can prevent the taxpayer from timely filing a return or even requesting an extension of time to file the return before the tax is assessed.[69]

C. In Re Creekmore-*2008*

Several of the opinions adopting the more expansive rule assert that Congress must have intended this when it added the hanging paragraph.[70] According to the Bankruptcy Court in *Creekmore*, "BAPCPA's amendment to § 523(a) changed the existing law by creating a definition for 'return' that required a timely filing if the underlying tax debt was to be discharged in bankruptcy."[71] The court went on to say,

> The definition of "return" in amended § 523(a) apparently means that a late filed income tax return, unless it was filed pursuant to § 6020(a) of the Internal Revenue Code, can never qualify as a return for dischargeability purposes because it does not comply with the 'applicable filing requirements' set forth in the Internal Revenue Code.[72]

"Then, in the next paragraph, the *Creekmore* opinion goes beyond 'apparently' to boldly announce that 'Congress has now definitively addressed this issue.'"[73] There is no legislative history accompanying the October 17, 2005 enactment.[74] In the absence of specific legislative history, why should one assume Congress intended to sweep away the two year waiting period for late-filed returns? Further, why should one assume that the enactment only applies to state and not federal income taxes?

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66. *Id.*

67. *See id.* at 1057. Although Paynes' attorney stated during oral arguments that it was a "difficult" time in his life, the court disregarded the statement as being entitled no weight. *Id.*

68. *Id.* at 1060.

69. *Id.* at 1059-60.

70. King, *Discharging Taxes*, *supra* note 9, at 10.

71. Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 751 (Bankr. N.D. Miss. 2008).

72. *Id.* at 751.

73. King, *Discharging Taxes*, *supra* note 9, at 10 (quoting *In re Creekmore*, 401 B.R. at 752).

74. *Id.*

"Even if it can be said that 'applicable filing requirements' is more specific than 'two years,' changing the usual interpretation of the pre-existing general statute requires clear legislative intent."[75] The "applicable filing requirements" language could mean simply that the return meets the four-part-test enunciated by the Supreme Court in *Beard*: the return is filed on the proper form, the return has no material omissions, the return is signed under penalties of perjury, and the return contains sufficient information so that tax can be calculated.[76] However, a look at the legislative history reveals not a scintilla of evidence that the "*McCoy* Rule" was the intended result of the BAPCPA amendments.[77]

Section 6072(a) of the Internal Revenue Code sets forth when a tax return is timely filed:

> [R]eturns made on the basis of the calendar year shall be filed on or before the 15th day of April following the close of the calendar year and returns made on the basis of a fiscal year shall be filed on or before the 15th day of the fourth month following the close of the fiscal year . . . .[78]

The *Creekmore* court stated that it "would hasten to point out the "safe harbor" that can be found in § 6020(a) of the Internal Revenue Code."[79] "The *Creekmore* opinion blunders by positing that the reference to an agreed substitute-for-return (SFR) under § 6020(a), provided by the new paragraph, is a 'safe harbor,' which allows the taxpayers' late-filed returns to be deemed valid returns; all they have to do is 'agree' to the return prepared by the IRS."[80]

This argument is unsound.[81] "Taxpayers are never asked whether they "agree" or "disagree" to the filing of a SFR."[82] "If given an opportunity to agree or not, it is to a proposed assessment that may or may not arise months, or years, after an SFR is filed."[83]

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75. *Id.*

76. Beard v. Comm'r, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)).

77. King, *Discharging Taxes*, *supra* note 9, at 10 (citing McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012)).

78. *Id.*

79. Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 752 (Bankr. N.D. Miss. 2008).

80. King, *supra* note 9, *Discharging Taxes*, at 10.

81. *Id* at 11.

82. *Id.*

83. *Id.*

The *Creekmore* court fails to comprehend the IRS assessment time period, and contrary to its opinion, for taxpayers the mere lateness of the filing of their 1040 would result in nondischargeability, giving them no opportunity for redemption through a § 6020(a).[84] The 2010 IRS Chief Counsel Notice makes clear that not every tax for which a return was filed late is non-dischargeable.[85] Rather, dischargeability of a late filed return is determined based on the date the return was filed or the date of the assessment.[86]

Judge Easterbrook noted in his dissenting opinion in *In re* Payne, "[a]fter the 2005 legislation, an untimely return can not lead to a discharge-recall that the new language refers to 'applicable nonbankruptcy law (including applicable filing requirements).'"[87] The bankruptcy court in *In re* Creekmore agreed with Judge Easterbrook's dissent in *In re* Payne.[88] The court in *Creekmore* acknowledged that its reading of the unnumbered, dangling paragraph was harsh.[89] Other courts have followed this reasoning.[90]

D. In Re Links-*2009*

In the *Links* case, Jeffery T. Links worked as a self-employed realtor for tax years 2000 through 2006.[91] "While working as a realtor, the Plaintiff failed to pay federal income taxes or have deductions withheld from his earnings."[92] However, for many of the tax years at issue, Mr. Links requested and was granted extensions to file his federal income tax returns.[93] On April 30, 2007, Mr. Links filed for relief under Chapter 7 of the United States Bankruptcy Code.[94] The court ordered a discharge on August 31, 2007.[95]

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84. *Id.*

85. *See* I.R.S. Chief Couns. Notice CC-2010-016 (Sept. 2, 2010).

86. *Id.*

87. *In re* Payne, 431 F.3d 1055, 1060 (7th Cir. 2005).

88. I.R.S. Chief Couns. Notice CC-2010-016 (September 2, 2010); *In re Payne*, 431 F.3d at 1060-63; Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 751 (Bankr. N.D. Miss. 2008).

89. *In re Creekmore*, 401 B.R. at 751.

90. *See* McCoy v. Miss. State Tax Comm'n, No. 3:09-CV-575, 2011 WL 8609554, at *1 (S.D. Miss. Feb. 8, 2011); Links v. United States (*In re* Links), No. 08-3178, 2009 WL 2966162, at *5 (Bankr. N.D. Ohio Aug. 21, 2009); Weiland v. Miss. (*In re* Weiland),465 B.R. 108, 111 (Bankr. N.D. Miss. 2011).

91. *In re Links*, 2009 WL 2966162, at *1.

92. *Id.*

93. *Id.*

94. *Id.* at *2.

95. *Id.*

The Internal Revenue Service took the position that a tax return submitted after the relevant due date does not meet the "return" requirement and is nondischargeable under 11 U.S.C. § 523(a)(1)(B)(i).[96] The Service maintained that because Mr. Links, even after accounting for extensions, submitted his 2002 federal income tax return six months late, his federal income tax obligation is a nondischargeable debt.[97] The Service relied upon *In re Creekmore* and the definition of "return" set forth in § 523 (a).[98] The Court agreed and determined that Mr. Links' income tax liability for tax year 2002 was a nondischargeable debt.[99]

V. DOES A LATE-FILED RETURN QUALIFY AS A "RETURN?"

The IRS successfully argued in *Links* and *Creekmore* that this language means a return failing to comply with the "applicable filing requirements"—a return that is filed late—is by definition not a return for purposes of the two-year filing rule.[100] These courts have held that, because of the parenthetical language "(applicable filing requirements)," a late-filed return is, by definition, not a "return."[101]

The Bankruptcy Court in *Links v. United States (In re Links)*, noted that the IRS position was that a "tax 'return submitted after the relevant due date does not meet the definition of 'return' and is non-dischargeable under 11 U.S.C. § 523(a)(1)(B)(i)."'[102] The *Links* court cited *Creekmore v. IRS (In re Creekmore)*, supporting the same Government argument.[103] The *Links* court concluded, "[h]aving not been presented with any argument to the contrary, the Court finds the conclusion reached in *In re Creekmore* to be sound."[104]

The court in *Creekmore* concluded that "a late filed income tax return, unless it was filed pursuant to § 6020(a) of the Internal Revenue Code, can never qualify as a return for dischargeability purposes."[105] The weight of pre-BAPCPA

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96. *Id.*
97. *Id.* at *4.
98. *Id.*
99. *Id.* at *9.
100. King, *Tax Return*, *supra* note 6, at 9.
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748, 751-52 (Bankr. N.D. Miss. 2008).

authority was that such a return, though filed late, nevertheless constituted a valid return if filed prior to the assessment.[106]

VI. INTERNAL REVENUE SERVICE RECANTS PRIOR VICTORIES IN *CREEKMORE* AND *LINKS*

These decisions recently carved an alarming path in interpretation of the new text.[107] "The decisions turned the two-year rule upside down."[108] However, in an even more recent and surprising move, the IRS reversed itself on this issue in a case pending in the Northern District of Illinois.[109] The new IRS position flipped the rule right-side up again.[110] It concluded that the decisions in the three prior cases were incorrect and "that it will no longer claim that taxes reported on and assessed in accordance with late-filed returns are excepted from discharge under section 523(a)(1)(B)(1)."[111] The IRS withdrew its argument in *In re Sharp*:

> Although the foregoing authorities [*Creekmore* and *Links*] suggest that the plain language of the added definition of "return" at the end of amended section 523(a) unambiguously excludes any return that does not meet all "filing requirements," including timeliness of filing, the Internal Revenue Service has concluded that the definition is ambiguous and that the better view is that Congress did not intend to repeal the longstanding law that taxes assessed in accordance with a return filed late are governed primarily by section 523(a)(1)(B)(ii) rather than (i), so that the tax is dischargeable if more than two years elapse between the filing of the return and the bankruptcy petition.[112]

In 2010, the Internal Revenue Service gave back the victories it had won in *Creekmore* and *Links* in a Chief Counsel Notice.[113] According to the Service, Chief Counsel (CC) Notices are directives that provide interim guidance, furnish temporary

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106. King, *Tax Return*, *supra* note 6, at 9.

107. *Id.* at 7.

108. *Id.*

109. *Id.*

110. *Id.*

111. Creditors United States' Withdrawal of Its Argument That Timeliness is a Part of the Definition of "Return" in 11 U.S.C. § 523(a) at 2, *In Re* Sharp, No. 08-01003 (Bankr. N.D. Ill. Sept. 18, 2009).

112. *Id.*

113. I.R.S. Chief Couns. Notice CC-2010-016 (September 2, 2010).

procedures, describe changes in litigating positions, or announce personnel matters or other types of administrative information.[114] The purpose of the Notice was to provide guidance on the application of the discharge exception under § 523(a)(1)(B)(i) of the Bankruptcy Code for a debt with respect to which a return was not filed in cases in which the taxpayer filed a Form 1040 after the due date.[115]

The Internal Revenue Service declared that for bankruptcy cases filed on or after October 17, 2005, a tax debt related to a late-filed Form 1040 may be discharged.[116] The Service reached this outcome because § 523(a), read as a whole, does not create a rule that every tax for which a return was filed late is nondischargeable.[117] The Service also came to this conclusion based on the cardinal principle of statutory construction stating that a statute should be construed so that no clause, sentence, or word is rendered superfluous.[118]

> If the parenthetical '(including applicable filing requirements)' in the unnumbered, [dangling] paragraph created the rule that no late-filed return could qualify as a return, the provision in the same paragraph that returns made pursuant to section 6020(b) are not returns for discharge purposes would be entirely superfluous because a section 6020(b) return is always prepared after the due date.[119]

The Service also said that § 523(a), for discharge purposes, allows an income tax for any given year to be partially dischargeable and partially nondischargeable.[120]

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt for a tax or a customs duty of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed; with respect to which a return, or

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114. Chief Counsel (CC) Notices, INTERNAL REVENUE SERVICE, http://apps.irs.gov/app/picklist/list/chiefCounselNotices.html (last visited Oct. 26, 2013).

115. *Id.*

116. I.R.S. Chief Couns. Notice CC-2010-016 (September 2, 2010).

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

> equivalent report or notice, if required (1)was not filed or given; or (2) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or (3) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.[121]

Section 507 (a)(8)(A) includes three alternative rules that confer priority (and nondischargeability) on income taxes.[122]

Section 507(a)(8)(A)(ii) generally confers priority (and nondischargeability) to income taxes that were assessed within 240 days of the bankruptcy petition.[123] Section 507 (a)(8)(A) gives priority to:

> [A]llowed unsecured claims of governmental units, only to the extent that such claims are for 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 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 before the date of the filing of the petition, exclusive of—(I) any time during which an offer in compromise with respect to that tax was pending 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; or (iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case . . . .[124]

The Chief Notice concluded "a Form 1040 is not disqualified as a 'return' under § 523(a) solely because it was filed late."[125]

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121. 11 U.S.C. § 523(a)(1) (2012).
122. I.R.S. Chief Couns. Notice CC-2010-016 (September 2, 2010).
123. *Id.*
124. 11 U.S.C. § 507(a)(8)(A) (2010).
125. I.R.S. Chief Couns. Notice CC-2010-016 (September 2, 2010).

VII. POST 2010 IRS CHIEF COUNSEL NOTICE

A. In Re Cannon-*2011*

The IRS asserted that Eric and Robin Cannon's tax liabilities for three tax years were not dischargeable because the assessments for those years were not based upon returns prepared by the taxpayers, but instead were based upon the substitute returns created by IRS. [126] The court held that the Cannons' late returns did not qualify as "returns" for nondischargeability purposes, and therefore the Cannons' tax liabilities for associated tax years were nondischargeable.[127]

The court ruled,

> Late federal income tax returns filed by debtors, which were not prepared pursuant to statutory "safe harbor" for late returns that provided for government's preparation of required return with taxpayer's consent and disclosure of necessary information, but were filed by debtors after assessment was made based upon substitute returns, did not qualify as "returns" under definition of "return" added to Bankruptcy Code provision governing exceptions to discharge by Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), and therefore debtors' tax liabilities for associated tax years were nondischargeable.[128]

This decision appears to follow the rule announced by *Hindenlang*, and its progeny, no more, no less.

B. Weiland v. Mississippi-*2011*

Richard C. Weiland, Jr. filed a Chapter 7 bankruptcy case, and he contended that his debt to the Mississippi Department of Revenue was dischargeable because taxes were due more than 3 years before the date that the bankruptcy petition was filed.[129] The court determined that, because Mr. Weiland did not file a state tax return for the 2002 tax year, the amount owed by the debtor for that year was non-dischargeable "under 11 U.S.C.

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126. *In re Cannon*, 451 B.R. 204, 205 (Bankr. N.D. Ga. 2011).
127. *Id.* at 206.
128. *Id.* at 205-06.
129. *In re Weiland*, 465 B.R. 108, 109 (Bankr. N.D. Miss. 2011).

§ 523(a)(1)(B)(i)."[130] Mr. Weiland did not timely file his 2005 state tax return.[131] Therefore, part of the debt for the 2005 tax year was non-dischargeable "under 11 U.S.C. § 523(a)(1)(B)(ii)."[132]

C. In Re McCoy-*2012*

Just when tax professionals thought a ruling—that a late-filed tax return is, by definition, not a return—was killed off by the IRS, along came the Fifth Circuit, in *In re McCoy*,[133] finding the rule still alive.[134] Despite the 2010 Internal Revenue Service Chief Counsel Notice, on January 4, 2012, the Fifth Circuit Court of Appeals affirmed *McCoy*.[135] The Chief Counsel Notice was part of the record in *McCoy* and the court even referred to it.[136] The Fifth Circuit ruled a late-filed tax return did not qualify as a "return" for discharge purposes[137], rejecting the 2010 Notice in which the Internal Revenue Service conceded its past court victories and declared a form 1040 is not disqualified as a "return" under § 523(a) solely because it was filed late and is dischargeable.[138]

In this case, Ms. Linda Trenett McCoy filed for bankruptcy in September 2007, and was granted a discharge by the Bankruptcy Court pursuant to 11 U.S.C. § 727.[139] Section 727(a) states:

> The court shall grant the debtor a discharge, unless— (1) the debtor is not an individual; (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—(A) property of the debtor, within one year before the date of the filing of the petition; or(B) property of

130. *Id.* at 110.

131. *Id.*

132. *Id.* at 111.

133. McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012).

134. King, *Discharging Taxes*, *supra* note 9, at 9.

135. *In re McCoy*, 666 F.3d at 931-32.

136. *See id.* at 930.

137. *Id.* at 932.

138. *See* I.R.S. Chief Counsel Notice CC-2010-016 (Sept. 2, 2010).

139. *In re McCoy*, 666 F.3d at 925.

> the estate, after the date of the filing of the petition; (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case; (4) the debtor knowingly and fraudulently, in or in connection with the case—(A) made a false oath or account; (B) presented or used a false claim;(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or (D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs.[140]

After Ms. McCoy was granted a discharge, she filed an adversary proceeding in the Bankruptcy Court against the Mississippi State Tax Commission on December 3, 2008, seeking to have two years of her pre-petition state income tax debts discharged.[141]

The Mississippi State Tax Commission argued McCoy's complaint should be dismissed because her 1998 and 1999 tax returns were filed late and therefore did not qualify as "returns" under the definition provided in amended 11 U.S.C. § 523 (a).[142] The Mississippi Tax Commission further argued that, because the late-filed income tax returns did not qualify as "returns" for discharge purposes, McCoy's income tax debt to the state of Mississippi could not be discharged in bankruptcy.[143]

The Bankruptcy Court agreed with the Mississippi Tax Commission's interpretation of § 523(a) and dismissed McCoy's complaint August 31, 2009, because she failed to timely file her Mississippi income tax returns.[144] The court reasoned that her returns were not "returns" for the purposes of discharge because

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140. 11 U.S.C. § 727 (a) (2012).
141. *In re McCoy*, 666 F.3d at 925.
142. *Id.*
143. *Id.*
144. *Id.* at 926.

they were filed late.[145] The court determined that the Bankruptcy Code requires the filing of a "return" for the discharge of income tax debts.[146] McCoy appealed the Bankruptcy Court's decision to the district court.[147] The District Court affirmed the Bankruptcy Court's ruling.[148] Then McCoy appealed the dismissal of her case to the Fifth Circuit.[149] She argued that the Court should adopt the *Hindenlang* test for determining whether filings constitute "returns" for discharge purposes.[150]

The Fifth Circuit affirmed the District Court's ruling.[151] The Court said that "§ 727 of the Bankruptcy Code permits the discharge of debts in Chapter 7 bankruptcies, but contains several exceptions, including those outlined in § 523."[152] According to the Fifth Circuit, before the passage of BAPCPA, "the term 'return' was not defined for § 523(a) purposes and so courts relied on a four-part test outlined in *Hindenlang*."[153]

The court ruled: "The new definition of 'return' under § 523(a)(*) requires that a return meet the filing requirements of nonbankruptcy law."[154] The Mississippi Bankruptcy Court dismissed the debtor's argument that since her returns were filed before the additional tax was assessed, they should be deemed valid returns.[155] The Court went on to argue that the Courts in *Hindenlang*, *In re Payne*, *In re Moroney*, and *In re Hatton* all dealt with federal income taxes only.[156]

D. In Re Hernandez-*2012*

Just one short week after the *McCoy* decision was handed down, a San Antonio bankruptcy court issued the *Hernandez* decision, applying the reasoning of *McCoy* to federal income tax

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145. *Id.*
146. *Id.* at 925.
147. *Id.* at 926.
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.* at 925.
152. *Id.* at 926.
153. United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1033 (6th Cir. 1999) ("(1) it 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.").
154. *In re* McCoy, 2009 WL 2835258, at *7 (Bankr. S.D. Miss. 2009).
155. *Id.* at 6.
156. *In re McCoy*, 2009 WL 2835258, at *6 (*referring to In re* Payne, 431 F.3d 1055 (7th Cir. 2005); Moroney v. United States (*In re* Moroney), 352 F.3d 902 (4th Cir. 2003); *In re Hatton*, 220 F.3d 1057 (9th Cir. 2000)).

debts and the Internal Revenue Code.[157] The court stated that "[a]lthough the *McCoy* holding applied to a state tax regime, its logic applies with equal (if not greater) force to the federal taxing scheme."[158] The court went on to state: "The Fifth Circuit necessarily addressed directly how to read the added paragraph's discussion of section 6020 of title 26. The court would be unlikely to retreat from that analysis when presented with a set of facts that directly implicate section 6020." [159] The court also noted, "[a]nticipating consistency on the part of the circuit court, this court concludes that late-filed tax returns cannot be treated as filed, for purposes of section 523(a)(1), save for returns that comport with the requirements of section 6020(b) of title 26."[160]

E. In Re Shinn-*2012*

Scott Shinn filed a chapter 7 petition on December 10, 2010.[161] "His case was processed as a no-asset case, creditors received no distribution, and he received a general discharge of his prepetition debts, not including his debts [to] . . . the Internal Revenue Service . . . ."[162] The Seventh Circuit relied on the *McCoy* decision in reaching its holding.[163] The court stated, "the only circuit court of appeals that has addressed the new definition, has construed it the same way."[164]

> On the basis of these well-reasoned opinions, as well as Judge Easterbrook's *dictum,* this Court holds that the new definition of "return," added by BAPCPA to section 523(a), means that an untimely filed 1040 cannot be considered to be a return for dischargeability purposes, unless the narrow exception in IRC § 6020(a) applies.[165]

The court went on to state, "[t]aking an eyebrow-raising position, the IRS asks this Court not to follow *McCoy.* Instead, the IRS wants the Court to adopt the holding of *Hindenlang,*

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157. Hernandez v. United States *(In re* Hernandez*),* No. 10-53962-C, slip op. at 3-5 (Bankr. W.D. Tex. Jan. 11, 2012).

158. *Id.* at 5.

159. *Id.*

160. *Id.*

161. Shinn v. IRS (*In re* Shinn), No. 10-83750, slip op. at 1 (Bankr. C.D. Ill. Mar. 22, 2012).

162. *Id.*

163. *In re Shinn,* slip op. at 5-6; *see* McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924, 932 (5th Cir.), *cert. denied,* 133 S. Ct. 192 (2012).

164. *In re Shinn,* slip op. at 5-6 (citing *In re McCoy,* 666 F.3d at 932).

165. *Id.* at 6.

which states that a 1040 is too late to be a return only if filed after the IRS has already assessed the tax liability."[166] According to the court, "the IRS aggressively pushed this position in the federal courts for many years, without much success at the bankruptcy court level, but ultimately gaining traction among the circuit courts."[167] "The latter success was achieved notwithstanding that the position was seriously flawed as a matter of statutory interpretation, as pointed out by Judge Easterbrook and by the Eighth Circuit in *Colsen*."[168]

The court notes that "Congress was made aware of the IRS's position during the eight years that bankruptcy reform legislation was pending prior to the 2005 enactment of BAPCPA."[169] "Yet, when Congress settled on a definition of 'return,' it did not adopt the long-sought-after rule advocated by the IRS in so many bankruptcy cases."[170] The court also stated:

> In its argument before this Court, the IRS does not attempt to explain how the new definition came to be included in BAPCPA or why its preferred definition was left on the cutting room floor. In effect the IRS is asking this Court to adopt its position not *because of* the language of the new definition, but *in spite of* that language. This Court is simply not inclined to engage in the judicial legislation to which that would amount.[171]

F. In Re Perry-*2012*

Mr. Daryl Zain Perry did not file timely returns for the years at issue, and the IRS filed substitute returns.[172] He did not assist or consent in the preparation of these substitute returns under I.R.C. § 6020(b).[173] The IRS contended that he did not file tax returns for the affected years and pointed to the meaning of

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166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*; *see* Freytag v. Comm'r, 501 U.S. 868, 874 (1991) (courts are not at liberty to create a statutory exception where Congress has declined to do so); Crawford v. Indiana Dept. of Corr., 115 F.3d 481, 484 (7th Cir. 1997) (courts should not engage in arbitrary line-drawing or create unstated exceptions whenever it seems the Legislature overlooked something).
172. *See* Perry v. United States (*In re* Perry), No. 11-81998, Adv. No. 12-080006, slip op. at 1 (Bankr. M.D. Ala. Aug. 15, 2012).
173. *Id.* at 2.

the term "return" under the hanging paragraph of § 523(a)(19).[174] The bankruptcy court agreed that the hanging paragraph excluded a late-filed return; therefore Perry's filings were not "returns."[175] This is consistent with *Hindenlang*.

The court recognized, "the courts that have addressed the effect of the hanging paragraph have unanimously concluded that it excludes a late-filed return."[176] "A late return otherwise fails to meet the definitional requirements for 'return' enumerated in the hanging paragraph because it does not 'satisfy the requirements of applicable non-bankruptcy law (including applicable filing requirements).'"[177]

G. In Re Martin-*2012*

The Colorado bankruptcy court criticized *McCoy* and its reasoning.[178] According to the court in *Martin*, some courts have incorrectly interpreted "applicable filing requirements" in the BAPCPA Amendment to encompass the time for filing a tax return.[179] "Under this reading any late-filed return, other than one prepared pursuant to section 6020(a) of the Tax Code, or a similar provision in a State or local law, will never meet the BAPCPA definition of a 'return,' and all taxes relating to late-filed returns are non-dischargeable under § 523(a)(1)(B)(i).[180]

"This interpretation says too much" and essentially renders § 523(a)(1)(B)(ii) superfluous.[181] "Section 523(a)(1)(B)(ii) provides that taxes for which a return was filed 'after such return was last due' and less than 2 years prior to the date of bankruptcy are not discharged."[182] "This section refers specifically to late-filed tax returns, and is the only place in § 523(a) where late filing is

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174. *Id.*

175. *Id.* at 3.

176. *In re Perry*, slip op. at 3; *see* Wogoman v. IRS, 475 B.R. 239 (B.A.P. 10th Cir. 2012) (holding that the Form 1040 filed by debtors approximately 17 months after the IRS had assessed their tax liability is not a return that satisfies the filing requirements of applicable nonbankruptcy law); *see also* Cannon v. IRS, 451 B.R. 204 (Bankr. N.D. Ga. 2011); Links v. United States (*In re* Links), No. 08–3178, 2009 WL 2966162 (Bankr. N.D. Ohio Aug. 21, 2009); Creekmore v. IRS (*In re* Creekmore), 401 B.R. 748 (Bankr. N.D. Miss. 2008); Pansier v. Wis. Dep't of Revenue, No. 10–C–0550, 2010 WL 4025884 (E.D. Wis. Oct. 14, 2010)).

177. *In re Perry*, slip op. at 1.

178. Martin v. United States (*In re* Martin), 482 B.R. 635, 638 (Bankr. D. Colo. 2012).

179. *Id.* at 638-39 (referring to McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924, 932 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012)).

180. *Id.*

181. *Id.*

182. *Id.*

specifically referenced."[183] "To read 'return' in § 523(a)(1)(B)(i) as meaning 'timely-filed return' would make the discharge exception of § 523(a)(1)(B)(ii) entirely coincidental with that of § 523(a)(1)(B)(i), except in the case of tax returns prepared under section 6020(a) of the Tax Code more than 2 years prior to bankruptcy."[184]

The Court rejected the *McCoy* interpretation of the BAPCPA Amendment in which timeliness of a return was deemed an "applicable filing requirement."[185] The court concluded, "'applicable filing requirements' must refer to considerations other than timeliness, such as the form and contents of a return, the place and manner of filing, and the types of taxpayers that are required to file returns."[186]

The court acknowledged that in *dicta* in *Payne,* Judge Easterbrook said the following regarding the BAPCPA Amendment: "[a]fter the 2005 legislation, an untimely return cannot lead to a discharge—recall that the new language refers to 'applicable nonbankruptcy law (including applicable filing requirements).'"[187] The court concludes, however, "Judge Easterbrook may have made this aside without fully considering the implications of his statement or the interplay between § 523(a)(1)(B)(i) and § 23(a)(1)(B)(ii)."[188]

VIII. CURRENT ASSESSMENT OF THIS TAXING SITUATION

A number of bankruptcy cases addressing whether taxes can be discharged when a return is filed late employ the same reasoning as *McCoy,*[189] while some courts reject the "*McCoy* Rule."[190]

McCoy has confused the issue so that two bankruptcy judges in the District of Massachusetts, one in the Eastern District and the other in the Central District, just last year came out on two different sides of the "*McCoy* Rule."[191] The Massachusetts bankruptcy court in *In re Pendergast* followed the *McCoy*

183. *Id.*

184. Martin v. United States (*In re* Martin), 482 B.R. 635, 639 (Bankr. D. Colo. 2012).

185. *Id.*

186. *Id.*

187. *Id.* at 640 n.5.

188. *Id.*

189. King, *Discharging Taxes, supra* note 9, at 9.

190. *Id.* n.13 (citing Geiger v. IRS (*In re* Geiger), No. 05-87505, Adv. No. 06-8062, 2008 WL 1902048, at *5, *9 (Bankr. C.D. Ill. Apr. 28, 2008), *aff'd in part,* 408 B.R. 788 (C.D. Ill. 2009) (spouse's return was filed untimely but still found dischargeable).

191. See *In re* Brown, 489 B.R. 1 (Bankr. D. Mass. 2013); *In re* Pendergast, 494 B.R. 8 (Bankr. D. Mass. 2013).

decision, despite recognizing "that there is something unsavory about saying that a 'late-filed return' is not a return under 11 U.S.C. § 523(a) by virtue of its tardiness":

> Unfortunately, I must respectfully disagree with my colleagues. The fact that 11 U.S.C. § 523(a)(1)(B)(ii) applies to only a small number of cases does not render it a nullity. So long as there is at least one situation where an untimely return is still considered a "return" for purposes of 11 U.S.C. § 523(a), 11 U.S.C. § 523(a)(1)(B)(ii) will apply and have meaning. I am also unpersuaded that the reference to 26 U.S.C. § 6020(b) is superfluous under this construction. As elucidated by the United State Court of Appeals for the Fifth Circuit in *In re McCoy*, the reference "simply explains that returns filed pursuant to § 6020(a) do qualify as returns for discharge purposes, while those filed pursuant to § 6020(b) do not."[192]

The Massachusetts bankruptcy court in *In re Brown* rejected the *McCoy* reasoning:

> I believe the MDOR's interpretation of § 523(a) is ill-conceived and unjustified. Interpreting the definitional paragraph of § 523(a) to mean that all late-filed Massachusetts tax returns are not returns renders virtually meaningless § 523(a)(1)(B)(ii), arguably the most frequently resorted-to subsection of § 523(a)(1). The interpretation of the definitional paragraph advanced by the MDOR and the decisions upon which it relies, rewrites § 523(a)(1)(B)(ii) so that it no longer covers late-filed returns filed more than two years prior to bankruptcy but merely covers late filed returns prepared pursuant to § 6020(a) of the Internal Revenue Code or similar statutes. The *IRS Chief Counsel Notice* CC–2010–016, 2010 WL 3617597 (Sept. 10, 2010), refers to the number of § 6020(a) returns as "minute" and observes that taxpayers do not even have the right to demand that the IRS prepare such returns on their behalf. For all practical purposes, therefore, the

192. *In re* Pendergast, 494 B.R. at 15 (citation omitted).

> interpretation advocated by the MDOR renders § 523(a)(1)(B)(ii) a nullity.[193]

The Massachusetts bankruptcy court in *In re Perkins adopted the Brown* reasoning in its entirety, thus rejecting the "*McCoy* Rule."[194]

The court in *In re Smyth* stated in dicta that a late-filed return is a "return" for discharge purposes:

> The Ninth Circuit Court of Appeals has not addressed this issue. The Fifth Circuit Court of Appeals (Fifth Circuit), however, recently held that a debtor's failure to file income taxes by April 15 of each year (or by date of approved extensions), makes a Form 1040 not a "return" under § 523(a)(*) because the filing does not meet the filing requirements. The Fifth Circuit holding appears to indicate that if a debtor files his or her return even one day late, and the filing does not fall under the "safe harbor" provision of § 6020(a), the late-filed Form 1040 does not comply with the "applicable filing requirements" and is not dischargeable.
>
> The I.R.S. proposes a more moderate position than the Fifth Circuit. Under the I.R.S.'s position, a Form 1040 filed after the filing deadline could still satisfy the "applicable filing requirements" as long as it was filed pre-assessment. The I.R.S. asserts that its position is consistent with promoting and reinforcing our self-filing requirement, which is the foundation of our taxation scheme. The Court favors the I.R.S.'s position.[195]

"'The due date of the return is dispositive and the date the return is actually filed is immaterial' in determining whether a debtor's tax obligation is dischargeable."[196]

Inconsistent rulings and interpretations, regarding what the BAPCPA "hanging" paragraph means, have created a rather taxing situation for taxpayers. The continuing jurisprudence of

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193. *In re Brown*, 489 B.R. at 5.

194. *See* Perkins v. Massachusetts Dep't of Rev. (*In re* Perkins), No. 12-3030, slip op. at 1 (Bankr. D. Mass. Apr. 8, 2013).

195. Smythe v. United States (*In re* Smythe), No. 10-49799, Adv. No. 11-04077, slip op. at 4 (Bankr. W.D. Wash. Mar. 12, 2012) (citations omitted).

196. United States v. McDermott, 286 B.R. 913, 915 (M.D. Fla. 2002) (quoting Wood v. United States, 78 B.R. 316, 320 (Bankr. M.D. Fla. Sept. 16, 1987)).

the "hanging" paragraph has definitely left taxpayers hanging in the balance. Courts have yet to reach an agreement as to what constitutes a "return" for discharge purposes.[197] The debate is ongoing.

IX. FLAWS IN THE *MCCOY* RATIONALE

A. McCoy *Lacks Sufficient Analysis*

"Few of the opinions adopting the "*McCoy* Rule" have offered analysis other than to copy each others' conclusions."[198]

> These opinions boil down to one basic assumption: The addition of the parenthetical words in the first sentence of the 'hanging paragraph' following 11 U.S.C.A. § 523(a)(19)—'including applicable filing requirements'—means that a tax return that is not filed on time is, by definition, not a tax return."[199]

The Bankruptcy Code does not say this.[200] Section 523(a)(1)(B), states that for a tax to be excepted from discharge based on when it was filed, that return must be *both* filed late *and* filed within two years of the bankruptcy petition.[201]

B. McCoy *Violates Canons of Statutory Construction*

The "*McCoy* Rule" violates relevant canons of statutory construction.[202] According to *McCoy* and the *McCoy* line of cases, if the return is even one day late the tax will not be dischargeable.[203] If the tax is already non-dischargeable because the return is tardy, why does the same statute exempt tax from discharge on returns that have been filed for less than two years? Courts carefully avoid any interpretation that makes statutory language meaningless.[204] In the absence of legislative history justifying it, nullifying § 523(a)(1)(B)(ii) violates the rule of statutory construction that no statute should be interpreted to render a portion of it superfluous.[205]

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197. *See* King, *Discharging Taxes*, *supra* note 9 (the debate regarding the hanging paragraph continues without clear direction from the courts or Congress).

198. *Id.* at 10

199. *Id.*

200. *Id.*

201. *Id.*

202. King, *Discharging Taxes*, *supra* note 9, at 11.

203. *See* McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924, 932 (5th Cir.), *cert. denied*, 133 S. Ct. 192 (2012).

204. King, *Discharging Taxes*, *supra* note 9, at 11.

205. *Id.* at 4.

McCoy also allows the general to trump the specific, violating another canon of statutory construction.[206] Specific language cannot override general terms that relate to the same issue, unless there is clear intention otherwise.[207] *McCoy* replaces the specific term "late and filed within two years if bankruptcy" with a general term "applicable filing requirements."[208] "However, inclusive the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the same enactment."[209]

C. McCoy *Lacks Legislative Support*

Legislative Intent does not support *McCoy*.[210] There is no available legislative history of Congress' intent in enacting BAPCPA.[211] Congress did not eliminate the late-return provision that requires at least two years to pass prior to the bankruptcy for the tax to be discharged.[212]

> If it is congressional intent that an untimely filed return can never satisfy the two-year rule, then how do the courts explain the text under § 523(a)(1) that only excepts from discharge those taxes where either no tax return was filed at all, or the return was filed late and within two years before the bankruptcy?[213]

One cannot find an untimely return filed more than two years before the bankruptcy anywhere in the short list of exclusions.[214]

"If Congress intended to make late-filed returns excepted from discharge, instead of all the 'apparently' and 'carve-out' argument, it simply could have amended § 523(a)(1)(B) to say: 'for a tax for which the tax return was filed late.'"[215]

The court in *In re Shinn* attempted to prove the "*McCoy* Rule" is supported by legislative intent:

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206. *See id.* at 12.
207. *Id.* at 11.
208. *See In re McCoy*, 666 F.3d at 924.
209. *Id.*
210. King, *Discharging Taxes*, *supra* note 9, at 10.
211. *In re* Brown, 489 B.R. 1, 5 (*Bankr. D. Mass. 2013*).
212. King, *Discharging Taxes*, *supra* note 9, at 9-10.
213. *Id.* at 10.
214. *Id.*
215. *Id.* at 14.

> Presumably, Congress was made aware of the IRS's position during the eight years that bankruptcy reform legislation was pending prior to the 2005 enactment of BAPCPA. Yet, when Congress settled on a definition of "return," it did not adopt the long-sought-after rule advocated by the IRS in so many bankruptcy cases.[216]

The court simply "presumes" what Congress intended without citing to any authority.[217]

The court in *In re Martin* argued that there was no legislative intent to support the "*McCoy* Rule."[218]

> There is nothing in the legislative history to the BAPCPA Amendment that indicates it was intended to have such an effect on § 523(a)(1)(B)(ii). The legislative history says only that the amendment was intended to provide that a return prepared pursuant to section 6020(a) of the Internal Revenue Code, or similar State or local law, constitutes filing a return (and the debt can be discharged), but that a return filed on behalf of a taxpayer pursuant to section 6020(b) of the Internal Revenue Code, or similar State or local law, does not constitute filing a return (and the debt cannot be discharged).[219]

The *Wogoman* court also found no legislative support of the "*McCoy* Rule."[220] "Our own research has uncovered nothing to support the conclusion that the hanging paragraph was intended to create the rule that a late-filed federal income tax return can never lead to discharge."[221]

The Supreme Court in *Pennsylvania Public Welfare Dept. v. Davenport* stated: "We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[222] As the Supreme Court stated in *Dewsnup v. Timm*: "This Court has been reluctant to accept arguments that would interpret the Code, however vague

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216. Shinn v. IRS (*In re* Shinn), No. 10-83750, slip op. at 6 (Bankr. C.D. Ill. Mar. 22, 2012).

217. *See id.*

218. Martin v. United States (*In re* Martin), 482 B.R. 635, 639 (Bankr. D. Colo. 2012).

219. *Id.*

220. Wogoman v. IRS, 475 B.R. 239, 249 (B.A.P. 10th Cir. 2012).

221. *Id.*

222. Pennsylvania Public Welfare Dept. v. Davenport, 495 U.S. 552 (1990).

the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history."[223]

X. CONCLUSION

Contrary to the *McCoy* line of cases, the text of § 523 should be given its simple meaning, without grafting on unfounded assumptions. "A late-filed return becomes subject to penalties and interest. It does not, however, cease to be a return."[224] "The return may be frivolous. It may be false. It may be fraudulent. But it is a return nonetheless."[225] The failure to address the IRS' definition of "return" may be seen as disingenuous, since it is obvious that the IRS deems a late-filed return to be a "return." For example, even if the taxpayer misses the deadline for filing a return, he or she is still legally obligated to file a "return." Filing a return, even if late, assures that the taxpayer is not vulnerable to a criminal charge of failure to file a return.

It is legally irresponsible to change decades of law on the bases that "apparently" Congress intended to change it. The argument that an untimely tax return is by definition not a tax return is inconsistent with the words, plain language added to the Bankruptcy Code by BAPCPA.

The Fifth Circuit in *McCoy* has essentially judicially eliminated the two year filing rule. Prior to the January 2012 decision, the rules relating to the discharge of debts in bankruptcy were relatively straight forward. Bankruptcy Code §§ 507 (a)(8) and 523 (a)(1) provide that income tax debts can be discharged in bankruptcy if the tax in question meets the following requirements: 1) Three Year Age Rule-More than three years must elapse between the bankruptcy filing date and the date the income tax return was last due, including all extensions; 2) Two Year Filing Rule-The taxpayer must file the return for the tax year in question more than 2 years before he files or bankruptcy; and 3) 240 Day Assessment Rule-A taxpayer cannot discharge a tax in bankruptcy unless the taxing authority assesses the tax more than 240 days before the taxpayer files for bankruptcy.[226] A late-filed return did not create an impediment to discharging the tax so long the tax in question satisfied the 3

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223. Dewsnup v. Timm, 502 U.S. 410, 419 (1992).

224. Colsen v. United States (*In re* Colsen), 311 B.R. 765, 774 (Bankr. N.D. Iowa 2004).

225. Hess v. United States, 785 F. Supp. 137, 139 (E.D. Wash.1991).

226. *See* 11 U.S.C. §§ 507, 523 (2012).

year, 2 year, and 240 day rules.[227] The Fifth Circuit's controversial opinion eliminates a debtor's ability to discharge virtually all federal and state income tax debts in most cases.[228]

Unfortunately, the Fifth Circuit's interpretation of the change to § 523 (a) has greatly reduced the ability to discharge tax liabilities in bankruptcy and is extremely harsh to those honest, albeit delinquent, debtors who filed their tax returns days, weeks, or a few months late. None of the opinions in the *McCoy* line of cases clearly addresses the BAPCPA requirement that the definition of a return be based on "applicable nonbankruptcy law." It can be argued whether it is clear this is the result Congress intended. Absent legislative guidance, the courts will continue to struggle with the interpretation of the 2005 Amendment.

However, the advice to taxpayers should be quite clear: Never file an income tax return late, not even a day late, and file a timely extension if necessary. The effect of the *McCoy* ruling on bankruptcy tax practice is staggering. By misapplying a parenthetical of three words, "applicable filing requirements," the Fifth Circuit, which has jurisdiction over Louisiana, Mississippi, and Texas, has effectively ended bankruptcy discharge as it has been known for nearly five decades. Unfortunately, the tainted *McCoy* ruling has not been contained in the Fifth Circuit. Now the Supreme Court will have to decide this issue.

Kieone Cochran

227. *See* King, *supra* note 9.

228. *Id.*