Thoughts on Various
Tax Issues in Bankruptcy

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APPENDIX
I. INTRODUCTION

This material covers four basic topics, the nature of tax debt, the basic rules for dischargeability of income taxes, dischargeability of penalties, and post-petition interest in Chapter 13. Part of the dischargeability discussion is a brief history of the current confusion regarding the “two year filing rule” and some thoughts on how to resolve the confusion. The slides cover the discharge information in an alternative format. I practice in Colorado. I have attempted to provide a national outlook. In a few instances, I have provided Colorado specific information.

II. THE NATURE OF TAX DEBT (CONSUMER OR NON-CONSUMER)

When analyzing any Chapter 7 case, there is a critical question that is often overlooked. Is the case a consumer case or a non-consumer case? Non-consumer debts alter Bankruptcy in several respects. If business and other non-consumer debts are a majority of the debt (a non-consumer case), 11 U.S.C. 707(b) does not apply and there is no requirement to complete the means test. The threshold to recover a preference is higher in non-consumer cases. In addition, the co-debtor stay in 11 U.S.C. 1301 and the redemption rights in 11 U.S.C. 722 do not apply to non-consumer debts.

Taxes are not consumer debts. The Westberry case provides an excellent analysis of this issue. The Court laid out four basic reasons why taxes (even personal income taxes) are not consumer debts: 1) taxes are not incurred voluntarily, 2) taxes are incurred for a public purpose (as opposed to a consumer purpose), 3) taxes arise from the earning of money whereas consumer debts are the result of consumption, and 4) consumer debt involves the extension of credit.

The critical distinction is not whether the debt is consumer debt or business debt. The critical distinction is whether the debt is consumer debt or something else. The old voluntary petition form did not recognize this distinction. The new voluntary petition form remedies this mistake. On the new form, if most of the debt is neither consumer or business debt, the debtor enters the type of non-consumer debt in question 16.c.

1 11 U.S.C. 101(8) defines “consumer debt” as “a debt incurred by an individual primarily for a personal, family or household purpose.”

2 Preferences of $600 or more can be recovered in a consumer case. In a non-consumer case, only preferences of $6,425 or more can be recovered. See 11 U.S.C. 547(c)(8) and (9).

3 In re Westberry, 215 F.3d 589 (6th Cir. 2000), In re Harrison, 82 B.R. 557 (Bankr.D.Colo. 1987) and In re Stewart, 175 F.3d 796 (10th Cir. 1999).
III. DISCHARGING TAXES IN BANKRUPTCY

A. BASIC DISCHARGEABILITY RULES

Any discussion regarding the discharge of taxes in bankruptcy must start with the basic rules of dischargeability for taxes. The basic rules are:

An income tax debt cannot be discharged if:
1. The due date of the tax return is within three years of the date of the petition (“3-year rule”);
2. The assessment date is within 240 days of the date of the petition (“240-day rule”);
3. A tax is assessable, but not assessed;
4. The tax return was filed within two years of the date of the petition or not filed at all (“2-year rule”); or
5. The debt was incurred due to fraud.

These rules are for the dischargeability of income taxes. These rules are gleaned from 11 U.S.C. 523(a)(1). The fourth and fifth rules are in the body of that subsection. 11 U.S.C. 523(a)(1)(A) refers the reader to 11 U.S.C. 507(a)(8) for the first three rules. The first three rules address both dischargeability and priority status. The last two rules only address dischargeability. These rules are set out in a different format in the slides.

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4(a) 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--(1) for a tax or a customs duty--(A) 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; (B) with respect to which a return, or equivalent report or notice, if required--(i) was not filed or given; or (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

5(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition--(i) for 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 . . . (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;
B. TOLLING

The rules listed above are tolled for certain events.

1. BANKRUPTCY OR COLLECTION APPEAL REQUESTS

BAPCPA inserted a number of “hanging” paragraphs into the Bankruptcy Code. One of those hanging paragraphs is in 11 U.S.C. 507(a)(8).\(^6\) This provision provides two tolling events that apply to all periods in 507(a)(8). Therefore, for income taxes, these tolling events apply to the 3-year rule and the 240-day rule. The first tolling event is any request for a collection due process hearing or any other type of collection appeal that legally prevents the government from taking collection action. The second tolling event is the filing of a bankruptcy. Each of these tolling events tolls the 3-year rule and the 240-day rule for the duration of the event plus 90 days. These events are also events that toll the statute of limitations for collection of a Federal tax debt.\(^7\)

2. OFFERS IN COMPROMISE

The clause that provides the 240 day rule also provides two tolling events. The filing of an Offer in Compromise tolls the 240-day assessment rule, only. Tolling occurs for the time of the event plus 30 days. Offers in Compromise also toll the statute of limitations for collection of a tax debt. The second event is a duplication of the portion of the hanging paragraph relating to the tolling in the event of a bankruptcy filing. Later we will see that stating a concept a second time helps lead to the confusion regarding interpretation of the hanging paragraph in 523(a).

3. THE TWO YEAR RULE AND TOLLING

As mentioned above, the tolling provisions are in the hanging paragraph located in 11 U.S.C. 507(a)(8). The two year rule is located in 11 U.S.C. 523(a)(1)(B). Therefore, it is not possible for these tolling rules to apply to the two year rule. There are no tolling provisions in § 523. Prior to the passage of BAPCPA, there was a great deal of litigation regarding whether tolling applied to the discharge rules. This ended when the Supreme Court held that the principle of equitable

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\(^6\) An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.

\(^7\) 26 U.S.C. § 6503.
tolling applied to the 3-year rule. In Young, the Court held the discharge rules to be a form of statute of limitations. The Court then applied the statutory construction rule of equitable tolling. Equitable tolling assumes Congress did not express tolling provisions because they are implied as part of a statute of limitation. Congress has now expressly stated tolling provisions in § 507. However, is the lack of a tolling rule in § 523 by design or does the lack of any direction mean equitable tolling still applies? This question is unresolved. The answer is either that tolling does not apply or the two year rule is tolled for the time in any prior bankruptcy. At least one court has ruled that the latter is the case, applying the holding in Young. The IRS position is that, by analogy, the Young ruling applies to the two year filing rule.

C. OTHER UNIQUE ISSUES REGARDING THE 2-YEAR RULE

BAPCPA altered § 523(a) in two ways. First, “equivalent report or notice” was added to § 523(a)(1)(B). Second, a hanging paragraph was inserted into § 523(a) creating a unique definition of “return” for this subsection. The insertion of the “equivalent report or notice” language and the inclusion of the “including applicable filing requirements” parenthetical are designed to resolve a dispute regarding whether State law requirements to file documents after a Federal audit are tax returns. The hanging paragraph starts by making clear that non-bankruptcy law is the starting point regarding what constitutes a return. The concept seems simple. However, the tax code does not define what constitutes a tax return. We now have three Circuit Courts that have ruled that a tax return that is simply filed late is not a return for bankruptcy purposes. This is not consistent with nonbankruptcy law. How did we get here?

1. A LITTLE HISTORY

The question of what constitutes a tax return was litigated in several contexts during the early years of the income tax. Three Supreme Court cases are

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8 In re Young, 535 U.S. 43 (2002).


10 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 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.

11 In re McCoy, 666 F.3d 924 (5th Cir. 2012), In re Mallo, 774 F.3d 1313 (10th Cir. 2014), In re Fahey, 779 F.3d 1 (1st Cir. 2015).
commonly mentioned for the early guidance on what constitutes a tax return.\textsuperscript{12} These cases suggested that a tax return had to be on the proper form, be signed under penalty of perjury and be a genuine endeavor to file a return. Subsequent to these decisions, a number of situations arose regarding whether certain documents constituted tax returns.

One such situation was when a taxpayer failed to file a return and the Service commenced the process of creating an assessment without the filing of a tax return by the taxpayer.\textsuperscript{13} Sometimes during this process, the taxpayer signed the final report generated by the IRS. The final report is not a Form 1040, nor is it signed under penalty of perjury. However, in 1974 the IRS issued Revenue Ruling 74-203, which indicated signing these documents would constitute the filing of a return.

In 1984, the Tax Court addressed another problem situation. Taxpayer protestors were filing 1040 documents that were clearly never intended to be tax returns. In most instances, the sworn statement was crossed out. The documents normally contained little or no financial information. The taxpayer protestors were filing documents that were not intended to be tax returns for various purposes, including avoiding criminal prosecution for failure to file a tax return. Gleaning material from the Supreme Court cases mentioned above, the Tax Court created a four part test,\textsuperscript{14} which has become known as the Beard test, to determine what constitutes a tax return. The Court ruled that such documents were not tax returns. This ruling had a number of implications: the Service could pursue criminal failure to file, such documents did not have to be processed as returns and therefore did not start the audit statute of limitations, the Service could pursue the SFR process and assert the late filing penalty because a return had not previously been filed, the accuracy related penalty could not be asserted in the SFR process (because nothing had been reported).


\textsuperscript{13} This is known as a substitute for return (“SFR”). This process is authorized by 26 U.S.C. 6020(b). In re Bergstrom, 949 F.2d 341 (10th Cir. 1991) held that an SFR was not a tax return.

\textsuperscript{14} 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, Beard v. Commissioner of Internal Revenue, 82 T.C. 766, 777 (T.C. 1984), aff’d, 793 F.2d 139 (6th Cir. 1986).
The Beard courts choice of the “honest and reasonable” wording for the third prong of the test is unfortunate. Although the phrase was used by the Supreme Court, the more common and accurate terminology used by the Supreme Court is “a genuine endeavor to satisfy the law.” The Beard ruling analyzes the document, not the facts surrounding the filing to make the ultimate decision as to whether the documents in question were tax returns. This is known as an objective analysis. The phrase “honest and reasonable” leads those outside of the tax world to think in other terms.

Another question was whether a clearly fraudulent tax return constituted a tax return. In 1984, the Supreme Court indicated the answer was yes. The Supreme Court indicated the false returns in question “appeared on their faces to constitute endeavors to satisfy the tax law.” Similarly, the Tax Court addressed the question of whether a return containing clearly frivolous positions (clearly indicating there was no honest attempt to comply with the law) constituted the filing of a return. Using the Beard test, the Tax Court found such returns were tax returns. This was true despite the fact there was no reasonable or honest attempt to comply with the law, because there was a genuine endeavor to file a tax return.

Clearly, the bar for what constituted a tax return was a very low bar. Up to this point, any analysis always looked at the document itself and not the circumstances surrounding the document. Throughout this time, the IRS used RR 74-203 to determine whether a tax return was filed, including for bankruptcy purposes.

In the 90’s, the States were fighting another battle in bankruptcy courts. The issue creating the litigation revolved around State law requirements to file documents after a Federal audit. Many state tax codes require a taxpayer to file a notice, report or amended tax return within a certain period after the end of a Federal audit. The States took the position that these filing requirements (applicable filing requirements that are not tax returns) should be considered returns for purposes of § 523(a). There was a split, but the majority of courts agreed with the States. This result was problematic in the tax world, because this was the equivalent of ruling that there can be more than one return for any given tax year. The Supreme Court has clearly ruled that there is only one return for a given tax year.

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15 Zellerbach at 180.
17 Badaracco at 397.
19 In Colorado, this requirement is found at C.R.S. 39-22-601(6)(a).
The Supreme Court has stated that amended returns are a supplement to and part of the original return. This concept is basic and fundamental to the nature of our tax structure.

At the same time, Congress became frustrated with record bankruptcy filings during generally good economic times. The House passed the Bankruptcy Reform Act of 1999. The Senate passed the Bankruptcy Reform Act of 2000. The bills were reconciled and sent to President Clinton, who pocket vetoed the bill. The legislative history of that effort indicates the language at issue was intended to address State issues only. Much of the Bankruptcy Reform Act became BAPCPA. However, the legislative history regarding the changes to § 523(a) never made it into the legislative history of BAPCPA.

In the years between the initial drafting of the Bankruptcy Reform Act and the passage of BAPCPA another issue saw lot of litigation. These cases had fact patterns with variations of the facts in the Mallo case. The basic issue was whether a tax return filed after the completion of the SFR process was a tax return. Six appellate courts addressed this issue between 1998 and 2005. The circuits were split on the issue of how to implement the Beard test for this issue. However, BAPCPA was never redrafted or intended to address this issue.

After the passage of BAPCPA, the IRS immediately recognizes a problem. Revenue Ruling 74-203 is not consistent with the Supreme Court cases, Beard, or BAPCPA. In response, the IRS issues Revenue Ruling 2005-59 which revokes Revenue Ruling 74-203 as of September 12, 2005. Revenue Ruling 2005-59 adopts a test similar to Beard to define what constitutes a tax return. Still, Revenue Ruling 2005-59 does not specifically address the Mallo factual situation.

In September of 2010, the IRS Office of Chief Counsel issued a memo to the insolvency units around the nation. The memo addressed factual situations like Zellerbach at 181, 311, 269 and Badaracco at 393, 762, 557.


In re Savage, 218 B.R. 126 (10th Cir. B.A.P. 1998), In re Nunez, 232 B.R. 778 (9th Cir. B.A.P. 1999), In re Moroney, 352 F.3d 902 (4th Cir. 2003), In re Hindenlang, 164 F.3d 1029 (6th Cir. 1999), In re Payne, 431 F.3d 1055 (7th Cir. 2005), and In re Colsen, 446 F.3d 836 (8th Cir. 2006).

As a note, the IRS still considers documents signed pursuant to Revenue Ruling 74-203 prior to September 12, 2005 as tax returns for bankruptcy purposes.

Mallo. The stated IRS position is that the assessment based on the original SFR is never dischargeable. However, a later filed return will create a potentially dischargeable assessment in bankruptcy if the return creates a new assessment or liability. An example (similar to the facts in Mallo) can demonstrate the position:

- the IRS creates an assessment using the SFR process on husband of $8,000
- husband and wife subsequently file a joint tax return with total tax of $10,000
- more than two years after the filing of the joint tax return, husband and wife file for bankruptcy relief
- the IRS position is that the entire tax is dischargeable for wife and the additional $2,000 assessment is dischargeable for husband.

This had been the IRS position dating back to the Savage case. The IRS put forth the 2010 memo despite the fact there is no case law to support the position and there is no credible analysis of § 523(a)(1) that supports the interpretation. The position has been consistently rejected by the courts. Oddly enough, especially for those that reside in the First, Fifth or Tenth circuits, this position is very helpful.

2. THE INITIAL RETURN

Which brings us to today. As previously mentioned, three circuit courts have ruled that any late filed return is not a return for bankruptcy purposes. The rulings are nonsensical. The rulings effectively rewrite the statute to remove the two year filing rule, destroying the concept of the statute and failing to recognize the purpose of the language used by Congress. Despite the language in the statute indicating any return in nonbankruptcy law (which is tax law) is a return for bankruptcy, the courts use a non-tax law approach. The courts arrive at this decision by finding the due date of a return is an applicable filing requirement. To a lay person this might make sense. To anyone with an understanding of tax principles, the ruling makes no sense. Filing requirements have filing deadlines. However, the filing deadline is not part of the filing requirement. Filing requirements do not end when filing deadlines pass. In the tax code, filing requirements are addressed in one part of the code and the deadlines to comply with the filing requirements are set out in another part of the code. The “one day late” position mistakenly applies a “plain language” analysis to a term of art. Congress inserting two separate terms into the law to accomplish the same purpose certainly does not help. The rule of statutory construction to give meaning to all words creates the false conception that “equivalent report or notice” and “including applicable filing requirements” have different meanings.
Nevertheless, the First, Fifth and Tenth Circuits have ruled that a tax, where the return is filed late, is not dischargeable. However, that is not the end of the matter. The IRS tries to apply a uniform set of tax laws throughout the country. The IRS does not agree with the rulings of these Circuits and applies the law as set out in the memo originally issued in September of 2010. Therefore, at this time, the IRS will abate a dischargeable tax even when the return is filed late, as long as the other discharge rules have been met. In these circuits, it is important to note, that if there is a dispute as to dischargeability and the return was delinquent filed, there is no way to win an adversary proceeding. You must proceed administratively.

The Colorado Department of Revenue enforces the one day late rule. I assume the other State taxing authorities in these Circuits are doing the same.

For the balance of the circuits, a return filed more than two years prior to the bankruptcy filing is a return as long as the return was filed prior to a SFR assessment. In the Eighth circuit, even a return filed after a SFR assessment is a return. Although Colsen is a pre-BAPCPA case, the IRS acknowledges it is still good case law. In the Eighth Circuit, a return filed after more than two years prior to the filing of the bankruptcy is dischargeable, regardless of whether the return was filed before or after a SFR assessment.

The Colsen decision was rendered after three other circuits arrived at the opposite conclusion despite the fact all four cases used the Beard test to determine whether a return had been filed. The difference was that the Colsen decision used an objective analysis (a review of only the document) of the returns at issue. The Hindenlang, Maroney and Payne decisions used a subjective analysis (a review of the circumstances surrounding the filing). The courts in the Fourth, Sixth and Seventh circuits indicated returns filed after a SFR assessment were not “honest and reasonable attempts to comply with the law.” The courts did not create a per se rule that all such returns were not returns. However, personally, I am at a loss

There are two exceptions: returns prepared under 6020(a) and stipulated decision documents. A taxpayer has no right to ask for a tax return to be prepared under 6020(a). I have practiced in this area for over 25 years and have never seen one. The last step of the SFR process is for the IRS to issue a Notice of Deficiency to the taxpayer. The taxpayer can sign a stipulated decision document after timely filing a Tax Court petition. The signed decision document is defined as a return by the hanging paragraph.

The Chief Counsel memo recognizes that Colsen is still good law in the 8th Circuit and that the IRS will follow the Colsen ruling in that circuit.

In re Moroney, 352 F.3d 902 (4th Cir. 2003), In re Hindenlang, 164 F.3d 1029 (6th Cir. 1999), In re Payne, 431 F.3d 1055 (7th Cir. 2005).
as to what facts would constitute an “honest and reasonable attempt to comply with the law” given the rulings at hand.

Since the one day late decisions, three circuits have issued opinions that essentially follow the Hindenlang ruling.\textsuperscript{28} To my knowledge, the Second circuit has never ruled on this issue. Otherwise, whether pre or post-BAPCPA, every circuit has a ruling.

The bottom line is that at this moment, the IRS is following its own reasoning, not the one day late rule or the Hindenlang line of cases. The reasoning laid out in the IRS Chief Counsel Memo fits within both rules. Indeed the IRS reasoning at this point is more sympathetic than the case law, except in the Eighth circuit.

3. **THE SECOND RETURN**

BAPCPA, the legislative history of the Bankruptcy Reform Act, and the majority of cases prior to the passage of BAPCPA indicate there are filing requirements not normally considered tax returns which count as tax returns for bankruptcy purposes. The primary example, State law requirements to file some sort of document after the completion of a Federal audit are a second filing requirement for the same tax year. A second two year filing period must run before the assessment based on the second return can be discharged. Therefore, it is possible to have two assessments and each assessment will meet the two year rule on a different date. In circuits with the one day late rule, the second return must also be filed timely. This rule should not apply to amendments filed without a statutory filing requirement.

In theory, this can also apply to other statutory or regulatory requirements to file amended returns or other documents that would result in additional assessments. The easiest example to understand is the former 26 U.S.C. 121.\textsuperscript{29} Previously, this section allowed homeowners to defer the capital gain on the sale of a personal residence, as long as the proceeds were reinvested into a personal residence of greater or equal value within two years. If the reinvestment did not occur, there was a requirement to amend the tax return. On the Federal level, this would have been an example of an applicable filing requirement that is not a tax return.

4. **CAN THIS MESS BE FIXED?**

This mess is caused by a confluence of factors. Beard’s use of “reasonable and honest” instead of “genuine endeavor” is not the best summation of the Supreme

\begin{footnotes}
\item[28] In re Justice, 817 F.3d 738 (11th Cir., 2016), In re Giacchi, 856 F.3d 244 (3rd Cir., 2017) and In re Smith, 828 F.3d 1094 (9th Cir., 2016).

\item[29] This section was modified to its current state in 1998.
\end{footnotes}
Court cases. The circuit courts (except Colsen) fail to recognize this flaw, leading to a subjective approach to analyzing returns instead of an objective approach. In the 90's, the circuit courts were ruling that there can be two tax returns, when there was no statutory basis to do so. Congress recognizes the error, but wants to alter the statute so that the States are correct. This required a definition of “return” unique to § 523. Congress enacts legislation that contains redundant and superfluous language. There was no need to indicate a 6020(b) return was not a return. Such an assessment is not considered a return under nonbankruptcy law. Nor was there a need to indicate that a 6020(a) return was a return. The addition of “equivalent report or notice” to 523(a)(1)(B) and the parenthetical in the hanging paragraph accomplish the same purpose. Courts use the statutory canon of construction that all language is to be given meaning if possible. Stating the concept twice, can give the misconception that each item has a separate meaning. An excellent argument can be made that the entire hanging paragraph is superfluous. Finally, three courts have made the mistake of applying a plain language interpretation to a term of art.

Removing the hanging paragraph or the “applicable filing requirement” parenthetical would resolve the one day late problem, but not resolve the fact pattern in cases such as Mallo. Odds are that any legislative fix will resolve the Mallo fact pattern in favor of the IRS. I also believe Congress would be uncomfortable with removing the 6020(b) language, or the entire hanging paragraph. Simply removing such language might give the mistaken impression the law was changing on that issue.

Here is my crack at a fix: I would return 523(a)(1)(B) to its prior language. I would rewrite the hanging paragraph as follows:

For purposes of this subsection, the term “return” means a return that satisfies the requirements of applicable nonbankruptcy law. In addition, the following documents will also be considered a “return:”

A. a return prepared pursuant to section 6014 or 6020(a) of the Internal Revenue Code of 1986, or similar State or local law; or
B. a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal; or
C. any amended return, report, notice or other equivalent document required to be filed by Federal, State or local statutes which creates or leads to an additional assessment.

For purposes of clarity, the timing of the filing of a document has no relevance to whether the document is a return, and the following documents are not a “return:”

A. documents created pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law;
B. Any document consenting to an assessment other than a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.

This definition assures that all traditional forms of returns are considered returns. Congress intended stipulated decision documents (and State law equivalents) to be tax returns for this subsection, but not the type of documents referred to in Revenue Ruling 74-203. This language retains that intent. Congress also intended to resolve the issue of whether State law requirements to file documents after Federal audits are “returns” in favor of the States. This language retains that intent. In addition, the language is uniform so that any statutory requirement to file a document that leads to another assessment is another return. The last two items are superfluous, to make clear that nothing is added or subtracted to current law by the language.

This does not address the factual issues presented in Mallo. Perhaps that issue should be addressed in tax law rather than the bankruptcy code.

If one did want to resolve the Mallo issue in favor of the IRS position, then I would suggest adding the following language to the first (A):

except to the extent a return filed after the completion of the 6020(b) process of the Internal Revenue Code of 1986, or a similar State or local law, duplicates the assessment made in such process;

This language attempts to achieve the position of the IRS memo on this issue.

If one wanted to resolve the Mallo issue in favor of the taxpayer position (although one could argue this is superfluous language) I would add a (D) to the documents that constitute a return:

D. any return filed after the completion of the 6020(b) process of the Internal Revenue Code of 1986, or any similar State or local law.

This would make clear that there is no difference between a return filed prior to the SFR process and one filed after.

If you have suggestions, let me know. Better, inform your Congressional delegation.
D. PENALTIES

Generally, penalties are dischargeable if the three year rule is met. Although I have not seen any case law on the issue, it should be noted that the discussion regarding tolling of the two year rule must logically apply to this issue also.

11 U.S.C. 523(a)(7) indicates the event creating the penalty must have occurred at least three years prior to filing the petition. The most common penalties are: failure to pay, failure to file and failure to pay estimated taxes. Each of these penalties is an act of omission where the event occurs before or immediately after the tax return was due. However, the 10th Circuit BAP has held that the frivolous filing penalty occurs when the return is filed. Therefore, for the frivolous filing penalty, the three years runs from the filing of the return, not the due date. I believe the same logic would apply to the accuracy-related and fraud penalties. These events occur when the act occurs.

E. POST-PETITION INTEREST IN CHAPTER 13

BAPCPA added debts described in §§ 507(a)(8)(C) and 523(a)(1)(B) and (C) to the exceptions to discharge in § 1328(a). Since such debts are not dischargeable, post-petition interest continues to accrue. This is the case even if the liability is being paid 100% through the plan. Pursuant to § 1322(b)(10), post-petition interest can be paid through the plan if the plan is a 100% plan.

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30 11 U.S.C. 523(a)(7) and In re Roberts, 906 F.2d 1440 (10th Cir. 1990).
31 26 U.S.C. 6651(a)(2)
32 26 U.S.C. 6651(a)(1)
33 26 U.S.C. 6654
34 In re Wilson, 407 B.R. 405 (10th Cir. BAP 2009).
35 26 U.S.C. 6662A
36 26 U.S.C. 6663
APPENDIX - DISCHARGE RULES

I. Basic rules for dischargeability of income taxes (all three rules must be met)

A. Three year rule

This rule relates to the original due date of the return. The date the return was actually filed is not relevant. The date of the assessment is not relevant. No tax is dischargeable unless three years have passed since the original due date of the return. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(I).

1. Therefore, between January 1st and April 15th of each year, the last four years are never dischargeable periods. After April 15th of each year, the last three years are never dischargeable periods.

2. Be wary of April 15th falling on a weekend. April 15th falling on a weekend alters the due date of a tax return to the 16th or 17th. This is complicated by the fact the IRS has recognized Patriots Day as a holiday in several northeastern states. In these states, the deadline can be extended by another day. I am unaware of any cases ruling on this issue. However, I would not want to be the test case. Normally, I do not file cases before April 19th to avoid dealing with these issues.

3. Tax returns are normally due on April 15th. A taxpayer can file an extension to October 15th. If the extension is filed, the three year rule commences on the new due date, October 15th. As a note, Colorado provides an automatic extension to October 15th.

B. 240 day rule

This rule relates to the date the tax was actually assessed. The date the return was due is not relevant. The date the return was actually filed is not relevant. No tax is dischargeable if it was assessed within the 240 days preceding the Bankruptcy. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(ii). There can be multiple assessment dates. Each assessment is analyzed separately.

C. Two year rule - Federal

1. This rule relates to the date the return was actually filed. The date the return was due is not relevant. The date the tax was assessed is not relevant. No tax is dischargeable if the return was filed in the two years preceding the filing of the Bankruptcy or not filed at all. See 11 U.S.C. 523(a)(1)(B). If a return is filed late, the received date is the filing date, not the postmark date. In the First, Fifth and Tenth circuits one must advise clients of the theoretically possibility the IRS adopts the one day
late rule enunciated in McCoy, Mallo and Fahey at some point in the future. In these circuits, you cannot initiate an Adversary Proceeding to determine dischargeability in regard to a period with a late filed return.

2. A return filed after the completion of the SFR process will not count as a return except to the extent the return increases the tax. In addition, the return will count as a return for any non-SFR’d spouse.

D. Two year rule - State

1. Same as Federal, except in the First, Fifth and Tenth circuits. In these circuits any late filed return is not dischargeable. However, as mentioned above, in Colorado a late filing is a return filed after October 15th.

2. After a Federal audit, there is a “second” requirement to file a return. This is done by filing the document required by State statute. This later assessment is only dischargeable if the required document is filed and two years have passed since the filing of the required document. In the First, Fifth and Tenth circuits, the required document must also be filed timely.

E. Fraud

A tax is not dischargeable if the debt was incurred due to fraud. See 11 U.S.C. 523(a)(1)(C). However, the dischargeability of the fraud penalty is controlled by 11 U.S.C. 523(a)(7).

F. Assessable but not assessed

Any amount that could be assessed, but is not yet assessed, is not discharged. See 11 U.S.C. 523(a)(1)(A) and 11 U.S.C. 507(a)(8)(A)(iii).

1. The assessment must occur before a tax is dischargeable. It is foolish not to have full disclosure on any return that is going to be discharged. If the audit statute is still open, any amount that could be assessed is not discharged. The statute of limitations for assessment is three years from the date of the filing of the return or the original due date, whichever is later. The statute of limitations is increased to six years for substantial understatements and is unlimited in regard to fraud. See 11 U.S.C. 6501. If an audit is active, consider consenting to the assessment to start the 240 day rule. If there are significant inaccuracies on a return, consider filing an amendment.

2. The introductory clause relating to the two year filing requirement and the no fraud rule no longer effect dischargeability. The reference to § 523
simply limits the scope of priority debt. Without this clause, all unfiled and fraudulent returns would be priority debts.

II. Tolling

A. A prior Bankruptcy tolls the three year rule and the 240 day rule for the time in Bankruptcy, plus 90 days.

B. A collection due process request tolls the three year rule and the 240 day rule for the time in Bankruptcy, plus 90 days.

C. The 240 day rule is tolled for the time in an Offer in Compromise, plus 30 days.

D. It is unclear whether tolling applies to the two year filing rule or the three year rule for penalties. If tolling does apply, the tolling would be for the time in a prior bankruptcy pursuant to Young.