DISCHARGEABILITY OF TAXES IN BANKRUPTCY [1]

I. General overview - Chapter 7.

A. The principal purpose of the filing of a liquidation proceeding under Chapter 7 of the Bankruptcy Reform Act of 1978, as amended ("Code"), is to obtain a discharge of all dischargeable debts under Section 727(a).

B. A Chapter 13 proceeding is an alternative to a Chapter 7 liquidation. In a Chapter 13 case, an individual wage earner retains his assets and makes periodic payments for a period of between 36 and 60 months. The present value of those payments must be at least as much as the creditor body would have received in a Chapter 7 liquidation case.

C. A Chapter 11 reorganization proceeding is available to both individuals and corporations. As in Chapter 13, the Debtor retains his assets and must propose and obtain approval of a Plan which must meet many standards, including the standard that the present value of distributions under the Plan are at least as great as the value of the Debtor's assets in a hypothetical liquidation.

D. Thus, as outlined above, one reason a Debtor may opt to file a Chapter 11 or a Chapter 13 case, is the ability to keep non-exempt assets, and to restructure debt over time. An illustration of this would be to save a home in foreclosure. A second reason, would be to use the reorganization proceeding to pay otherwise non-dischargeable debt.

E. Section 523 of the Bankruptcy Code sets forth a series of categories of debts which survive the debtor's discharge (which are not dischargeable).

---

[1] Prepared by Robert L. Pryor a partner in the Westbury law firm of Pryor & Mandelup, LLP, concentrating in bankruptcy, reorganization and insolvency-related litigation. Pryor & Mandelup, LLP is located at 675 Old Country Road, Westbury, New York 11590 (516) 997-0999.

II. Nondischargeable Debt.

A. The dischargeability of debt in either Chapter 7, 11 or 13 is governed by 11 U.S.C. § 523. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BRA") fully effective as of October 17th, 2005, the super discharge, previously available under Chapter 13, which provided a major impetus to debtors to file Chapter 13, as opposed to filing under the alternative chapters, has been virtually eliminated.

B. As a general proposition, non-dischargeable debts are debts that Congress has determined should survive bankruptcy for various policy reasons.

C. The following constitute a list of the basic categories of nondischargeable debt:

a. Certain tax debt which will be discussed in substantially more detail herein.

b. Debts incurred by fraud or false representation, except that debt based upon a false representation concerning the debtor's financial condition must be based upon a writing. This category also includes certain consumer debts for luxury goods or services and certain cash advances, incurred on the eve of bankruptcy.

c. Domestic support obligations which include, alimony, maintenance or support of a spouse or child.

d. Debts incurred through larceny, embezzlement or defalcation while acting in a fiduciary capacity.

e. Debts not timely listed in the debtor's schedules, where the creditor lacked knowledge of the bankruptcy case in time to protect its interests therein.

f. Debts incurred through wilful and malicious injury.

g. Debts for fines, penalties or forfeitures.

h. Student loans, unless accepting such debt would impose an undue hardship on the debtor and the debtor's dependants.

i. Debts arising from death or personal injury caused by the debtor's operation of a motor vehicle, vessel or aircraft while intoxicated.

j. Debts arising from the failure to pay a federal criminal restitution award.

k. Property settlements to a spouse or child of the debtor.

l. Loans to tax qualified pensions, profit sharing, stock, bonus or similar plan.

m. Debts arising under certain of Federal and State Securities Laws.

III. Dischargeability of Tax Obligations.

A. The dischargeability of tax obligations is governed by Section 523(a)(1). Only those taxes enumerated in 523(a)(1) are nondischargeable. All other taxes are dischargeable.

B. Section 523(a)(1) provides:

> (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 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;

C. Thus, under Section 523(a)(1) four categories of non-dischargeable tax obligations are established: (a) those tax obligations set forth at Code Sections 507(a)(3) (which applies only in the limited context of involuntary bankruptcy petition and will not be discussed further herein); (b) those tax obligations set forth in Section 507(a)(8), (c) tax obligations in respect to which a required return was not filed or was filed late and after two years before the date of the filing of the bankruptcy petition; and (d) tax obligations arising from fraudulent returns or arising from willful attempts to evade or defeat such a tax.

D. Section 507(a)(3) provides:

(2) Third, unsecured claims allowed under section 502(f) of this title.

E. (2) 507(a)(8) Priority Taxes – There are several implications to a tax being included in 507(a)(8). First, as discussed the tax is nondischargeable. Secondly, it is paid on a priority basis, i.e. prior to general unsecured claims. This manifests an

intention by Congress, a) to raise money for public coffers, and b) more importantly from a debtor's perspective, to authorize a bankruptcy estate to use potentially limited dollars to pay a nondischargeable debt. Section 507(a)(8) taxes are:

> allowed unsecured claims of governmental units, only to the extent that such claims are for –
>
> (A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition —
>
> (i) for 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.

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.

(iii) other than a tax of 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) a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (4) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on –

(i) a transaction occurring before the dated of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise –

(i) entered for consumption within one year before the date of the filing of the petition; or

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certified that failure to liquidate such entry was due to an investigation pending on such date into assessment of anti-dumping or countervailing duties or fraud, or in information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

IV. Dischargeability of Tax Claims Set Forth in 11 U.S.C. Section 507(a)(8).

The taxes covered by 507(a)(8) cover taxes owed to all governmental units, federal, state and local. (See 11 U.S.C. §101(27) and 101(40). However, not all debt owed to a governmental unit is a tax. See U.S. v. CF&I Fabricators of Utah, Inc., 116 S.Ct. 2106 (1996) (a payment to IRS of 10% of accumulated funding deficiency for certain

pension plans is a penalty not a tax).

The following categories of taxes are non-dischargeable under 507(a)(8):

(A) A tax on or measured by income or gross receipts.

(1) Respecting a year for which a return was last due (including extensions) within three years of the bankruptcy filing.

(a) See, Smith v. United States, 114 B.R. 473 (W.D.Ky. 1989) In re Gerulis, 56 B.R. 283 (Bankr. D.Minn. 1985).

(b) However, the 3 year look back period is tolled by prior intervening bankruptcies, The Supreme Court case of Young v. U.S., 122 S. Ct. 1036 (2002), has been codified under the Bankruptcy Reform Act at Section 507(a)(8)(A)(II).

(period tolled during period of pendency of stay plus 90 days)

(2) Assessed within two hundred forty days (of the bankruptcy filing) plus the period in which an offer and compromise was pending plus thirty days.

(a) What is effect of offer in compromise which predates the date of assessment. In re Aberl, 78 F.3d 241 (6th Cir. 1966), the Sixth Circuit Court of Appeals concluded that offers in compromise made in advance of assessment, even if rejected by IRS after assessment do not toll 240 period.

(3) A tax not assessed but assessable after the filing of the petition in bankruptcy. An example of a tax, not assessed but assessable after filing would be a tax liability under audit. In re Fein, 22 F.3d, 631 (5th Cir. 1994). Another is a

tax claim for a tax year that has not ended as of the time of the commencement of the case. In an individual Chapter 7 or Chapter 11 case (but not a Chapter 13 case), IRC § 1398 (d)(2)(A) authorizes a debtor to elect a short tax year, ending his tax year the day prior to a bankruptcy filing.

(a) Definition of "Assessment" - Courts have assumed with little dispute, that the assessment date as utilized in Bankruptcy Code §507(a)(8)(A)(ii) is the same date as that set forth in the Internal Revenue Code. In re Hardie, 204 B.R. 944 (S.D. Texas 1996); In re Lilly, 194 B.R. 885 (Bankr. D. Idaho 1996); In re Hartman, 110 B.R. 951 (Bankr. D.Kan. 1990); In re Youngcoult, 86 B.R. 715 (Bankr. M.D.Fla. 1988), In re Carter, 74 B.R. 613 (Bankr. E.D.Pa. 1987).

(b) The assessment date for a state or local tax, has generally been held to be the date established under the state or locality's tax law. In re King, 961 F.2d 1423 (9th Cir. 1992). Nevertheless, the

determination of when assessment occurs remains a question of federal not state law. In re Garfinckel's, Inc., 203 B.R. 814 (Bankr. D. Col. 1996). The key consideration is when formal liability is fixed.

(c) Generally, where the taxpayer has filed a tax return, no assessment may be made for a tax that is owing UNLESS THE ASSESSMENT IS MADE WITHIN THREE YEARS OF THE FILING OF THE RETURN. 26 U.S.C. §6501(a); In re Wines, 122 B.R. 804 (Bankr. S.D.Fla. 1991).

(d) Where taxpayer underestimates his income by greater than 25% on the return, the IRS may assess within six years following the date the return is filed. Id.

(e) An assessment is made by the IRS only after the taxpayer is sent a Notice of Deficiency. There is a period of 90

days from the mailing of the Notice of Deficiency where the IRS is barred from assessment. 26 U.S.C. §6503(a)(1). Within 60 days of the assessment being entered, the IRS sends a Notice of Assessment and therein demands payment. See, 26 U.S.C. §6303.

(f) The assessment shall be made by the assessment officer signing the summary record of assessment . . . The date of the assessment is the date the summary record is signed by an assessment officer. 26 C.F.R. §301–6203-1; see 26 U.S.C. §6203. In re King, 961 F.2d 1423 (9th Cir. 1992).

(g) Assessment of tax by the IRS creates a valid tax lien, albeit unrecorded [and] unenforceable against third parties until notice of the lien is given. Daniel R. Cowans, Cowans Bankruptcy Law and Practice §13.6, In

re King, supra.

(h) The IRS has ten (10) years from the date of a tax assessment to collect a tax due and owing. 26 U.S.C. §6502(a), which statute of limitations is tolled by certain events including an intervening bankruptcy or the pendency of an offer in compromise.

(B) A property tax assessed before the commencement of the case and last payable without penalty within one year of the filing of the bankruptcy petition. If the tax is last payable without penalty outside of one year before bankruptcy, it is not a priority tax. While this category most often concerns real estate taxes, it can apply to taxes assessed against personal property. Taxes imposed against real estate generally are secured claims, and therefore are not priority claims.

(C) A tax which the debtor is required by law to withhold or collect from others and for which he is liable in any capacity, regardless of the age of the tax returns. This covers the so called "trust fund" taxes, i.e., income taxes which an employer is required to withhold from the pay of employees, the employee's share of social security taxes and taxes imposed upon a responsible officer under the Internal Revenue Code Section 6672. It also includes sales taxes collected from third parties. See, DeChiaro v. New York State Tax Commission, 760 F.2d 432 (2d. Cir. 1985) .

(1) See Rosenow v. State of Illinois, Department of Revenue, 715 F.2d 277, 9 C.B.C.2d 196, 200 (7th Cir. 1983); 3 Collier on Bankruptcy paragraph 523 .06 (1989 Supp.).

(2) It should be noted that in contrast to the other categories of priority taxes, there is no time limit applicable to trust fund taxes.

(D) Employment taxes on wages, salaries or commissions, including vacation, severance and sick leave pay for which a return is last due within three years before the filing of the bankruptcy petition. This category covers the employer's share of employment taxes to the extent the employer is a debtor in bankruptcy.

(E) Excise taxes on -

(1) pre-petition transactions for which a return was due within three years of the bankruptcy filing; or

(2) if no return is required a transaction occurring within three years before the bankruptcy filing;

(3) all federal, state of local taxes generally considered or expressly treated as excises are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes; (124 Conq. Rec. 32416 (1978) remarks of Senator DeConcini, senate subcommittee chairman; see 68 Am. Jur.2d. sales and U.S.C. Taxes §4 (1973) (All Federal Sales Taxes Not Collected from Third Parties). (4) An Excise tax is a tax, "which is any form of taxation that is not a burden laid directly upon persons or property." See, Generally, 3 Collier on Bankruptcy 523.06, N. 9a (1989 Supp.), citing In re Beaman, 4 C.B.C.2d 157 (Bankr. D.Or. 1980).

(5) Distinguish between sales taxes collected from third persons and those due and owing from debtor-taxpayer. See 11 U.S.C. §507(a)(8)(c).

(F) Certain duties arising out of importation of merchandise.

(G) A penalty relating to any other 507(a)(8) tax and in compensation for actual pecuniary loss. See, In re Barbier, 77 B.R. 799 (Bankr. Nev. 1987).

V. Dischargeability of Tax Claims Relating to Late Returns.

(A) The fact that a debtor does not timely file a tax return does not automatically bar the discharge of the underlying obligation. If the tax return is filed prior to two years before the filing date, then the fact that the tax return was a late filed return is not an impediment to the discharge of the obligation.

(1) For example, debtor files a bankruptcy petition on June 30, 2007. The debtor seeks to discharge an income tax obligation for the tax year ending December 31, 2003. Insofar as the tax return for said 2003 tax year would have timely been filed on April 15, 2004, more than three years prior to the bankruptcy filing, the tax obligation for 2003 can be discharged. If the debtor files the tax return for said 2003 tax period on June 29, 2005, i.e., just outside of two years prior to the bankruptcy filing, the tax obligation is dischargeable notwithstanding that the return was a late-filed return.

(B) Alternatively, if the debtor fails to file the tax return, the tax obligation cannot be discharged in bankruptcy.

(C) Under prior settled precedent, a "Substitute for Return" filed by the Internal Revenue Service pursuant to 26 U.S.C. Section 6020(b) upon the failure of the debtor to file a required tax return does not constitute a filed return for purposes of Section 523(a)(1)(b)(i) In re Chastang, 20 B.C.D. 1360 (Bankr. M.D.Fla. 1990). See also In re Haywood, 62 B.R. 482 (Bankr. N.D.Ill. 1986) (pro forma State Tax Return).

(D) Section 714 of the BRA now provides that if a return was prepared by an employee of the taxing authority, and the Debtor cooperated fully and actually signed the return, this is an "acceptable" tax return. Thus, returns prepared by the IRS under § 6020(a) of the I.R.C. satisfy the filing requirements of § 523(a)(1). Alternatively, if the taxpayer makes a false return and the IRS independently "makes" the return this situation governed by § 6020(b) of the IRS is insufficient to meet the "filed or made" standard of 523(a)(1).

VI. Debts With Respect to Which the Debtor Made a Fraudulent Return or Willfully Attempted in Any Manner to Evade or Defeat Such Tax.

(A) The term fraudulent return in Section 523(a)(1)(c) should be construed consistently with Section 6653(b) of the Internal Revenue Code. The I.R.S. must prove that debtor's actions were deliberate, not accidental, and done with fraudulent intent. Debtor must have engaged in a deliberate act calculated to defraud. In re Gathwright, 102 B.R. 211 (Bankr. D.Or. 1989), Citing, In re Harris, 49 B.R. 223 (Bankr. W.D.Va. 1985), modified on reconsideration 49 B.R. 545 (Bankr. W.D.Va. 1986); Matter of Fox, 609 F.2d 178 (5th Cir.), cert. denied, 449 U.S. 821, 101 S.Ct. 78, 66 L.Ed.2d 23 (1980). If it is a fraudulent return, any tax arising out of return similarly non-dischargeable. In re Harris, 59 B.R. 545 (Bankr. W.D.Va. 1986).

(B) The phrase "willfully attempted in any manner to evade or defeat such tax"

in Section 523(a)(1)(c) resembles four similarly worded sections of the Internal Revenue Code, §§ 6531(2), 6653, 6672 and 7201. Each includes the additional language "or the payment thereof". This has caused a majority of courts to conclude that the avoidance of the payment of the tax creates a nondischargeable debt as well. See In re Tudisco, 183 F.3d 133 (2d Cir. 1999), Wright v. U.S., 191 B.R. 291 (SDNY 1995), In re Brunner, 55F.3d 195 (5th Cir. 1995); but see In re Haas, 48F.3d 1153 (11th Cir. 1995).

(1) Under Section 17(a)(1)(c), of the Bankruptcy Act of 1898, the predecessor to Section 523(a)(1) of the Bankruptcy Code, a debtor did not discharge debts "which were not reported on a return by the bankrupt." Courts have interpreted this language to mean that a tax return must have reported the proper amount of taxes due and not merely the information given rise to those taxes. See Scholz v. U.S. Internal Revenue Service, 773 F.2d 709 (6th Cir. 1985); In re Donnell, 639 F.2d 535 (9th Cir. 1980); Wukelic v. U.S., 544 F.2d 285 (6th Cir. 1976); In re Michaud, 458 F.2d 953 (3d Cir. 1972); In re Indian Lake Estates, Inc., 428 F.2d 319 (5th Cir. 1970).

(2) The case of In re Lynch, 299 B.R. 62 (Bankr. S.D.N.Y. 2003), is quite informative in illustrating the current trend developing under the law in analyzing whether a debt should be rendered non-dischargeable because the debtor wilfully attempted in any manner to evade or defeat the payment of the tax. The debtor Christine Carter Lynch was a well compensated bond salesperson during the period of 1993 through 1999 in which she incurred her tax debt. Her income ranged from $182,568.00 in 1993 to $478,001.00 in 1996 and down to $281,699.00 in 1999. In none of the foregoing years except 1993 did she make less than

$218,000.00 per year. There was regular withholding from Ms. Lynch's salary in meaningful amounts, however, still leaving very substantial sums due and owing to the taxing authorities. Various of Ms. Lynch's taxes were filed one year late or two years late, and she never made estimated payments to augment the insufficient withholding. During the subject period, the debtor also submitted an offer in compromise proposing to pay only a portion of the outstanding tax debt.

The court cited Wright, 191 B.R. at 291 held

> It is not necessary to prove that the debtor was inspired by "bad purpose or evil motive" in failing to pay his taxes. It is enough if the debtor "had the wherewithal to file his return and pay his obligation", but "voluntarily, conscientiously, and intentionally" decided to pay other creditors instead.

Based upon this standard, the court looked to the manner in which Ms. Wright utilized her income and held that the debtor's expenditures went well beyond her basic needs for food, shelter, utilities, medical services and other costs of living. The court noted the following facts. First, the debtor did not have children and maintained a three bedroom apartment in a doorman building on Central Park West at a cost of more than $6,000.00 per month. Additionally, the court found that the debtor frequented expensive restaurants, frequently traveled abroad and made large contributions to her church. These facts gave rise to the court's conclusion that the debtor voluntarily, conscientiously, and intentionally decided to pay other creditors instead of the taxing authorities. Accordingly, it found that the entirety of her tax debt was nondischargeable. See also In re Volpe, 377 B.R. 579 (Bankr. N.D.Ohio 2007) (the fact that debtor took several vacations with his girlfriend, paid for his children to attend private school, filed late tax returns, failed to pay taxes due thereon

was grounds to deny the dischargeability of the taxes); In re Haesloop, 2000 Bankr. LEXIS 1104 (Bankr. E.D.N.Y. 2000) (the debtor, an attorney applied available funds to discretionary expenses including payment of tuition for a daughter at Brown University, paying spouses back tax obligations, maintaining payments on a country home, leasing a luxury automobile, and undocumented unspecified personal expenses, justifies a determination of nondischargeability).

(C) Query: If a taxpayers claimed deductions are disallowed, is the tax imposed as a result of said disallowance dischargeable?

(1) Spies v. U.S., 63 S.Ct. 364 (1943), under Spies, the Supreme Court set forth certain types of conduct from which a willful attempt to defeat or evade a tax could be inferred including keeping a double set of books, making false entries or alterations or false invoices or documents, destruction of books and records, concealment of assets or covering up sources of income, handling of ones affairs to avoid making the records usual in transactions of the kind, and any conduct the likely effect of which would be to mislead or to conceal.

(2) However, the report by the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973), utilized in formulating the Bankruptcy Code, deletes this language from its proposed non-dischargeability section 4-506. William T. Plumb, Jr., consultant to the Commission, provided some explanation for the changes made in Section 4-506 of the Commission Report, the predecessor to Section 523(a)(1) of the Code. Mr. Plumb states that the Commission's objective was "predicated upon a much more liberal discharge to debtors in bankruptcy. Id.

(3) In light of this explanation, it would appear that the deletion was an intentional liberal departure from the predecessor statute.

(D) The transfer of assets subsequent to a tax assessment has been held to be evidence of an "attempt to evade or defeat payment of the tax." In re Jones, 20 B.C.D. 1208 (Bankr. D.Kan. 1990). Significantly, in Jones the Court found no irregularity in the debtor's filed returns. The Court focused solely on the debtor's transfer of its assets in placing them beyond the reach of the Internal Revenue Service.

(E) The measure of proof to establish fraud in connection with a cause of action under 523(a)(1) is by "clear and convincing evidence." To prove fraud, "the government must show that the taxpayer acted with specific intent to evade a tax believed to be owing." In re Carapella, 105 B.R. 86 (Bankr. M.D.Fla. 1989).

(F) The mere assessment pursuant to 26 U.S.C. Section 6653(b) for a fraudulent underpayment of tax does not bind the Bankruptcy Court in its determination of the dischargeability of the tax obligation. In re Graham, 94 B.R, 386 (Bankr. E.D.Pa. 1988).

VII. Treatment of Interest and Penalties Due to the Taxing Authorities.

(A) Section 523(a)(7) of the Bankruptcy Code governs the dischargeability of "non-pecuniary loss" tax penalties.

(B) Section 523(a)(7) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this tile does not discharge an individual debtor from any debt –
>
> > (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental

> unit, and is not compensation for actual pecuniary loss, other than a tax penalty –
>
> (A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or
>
> (B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition.

(C) Courts have reached differing interpretations of §523(a)(7). Certain cases follow the Committee Report to Section 523 which indicates that Section 523(a)(7) renders non-dischargeable tax penalties "which are basically punitive in nature," "computed by reference to a related tax liability which is non-dischargeable" or "if the amount of the penalty is not computed by reference to a tax liability, which is nondischargeable, the transaction or event giving rise to the penalty occurred during the three-year period ending on the date of the petition." 124 Cong. Rec. H. 11 113-14 (Sept. 28, 1978); S. 17, 430-1 (Oct. 6, 1978). See Matter of Longlev, 66 B.R. 237 (Bankr. N.D.Ohio 1986); In re Carlton, 19 B.R. 73 (B.N.M. 1982); In re Gerulis, 56 B.R. at 283. In re Ferrara, 103 B.R. 870, (Bankr. N.D.Ohio 1989) (Mutual Exclusivity of (7)(A)(7)(B)). In other words, if the penalty relates to an otherwise nondischargeable tax, it does not matter if it is over 3 years old, it is nondischargeable. Other cases hold that under the clear language of the statute, if the "punitive" penalty relates to any tax, whether covered by 523(a)(i) or not, over 3 years old, it may be discharged. In re Bums, 887 F.2d 1541, 1544 (11th Cir. 1989); In re Byrum, 139 B.R. 498 (C.D. Cal. 1992).

(D) Interest. Pre-petition interest on a tax afforded priority under Section 507(a)(7) is granted the same priority as the underlying tax. Matter of Larson, 862 F.2d 112 (7th Cir.

1988); In re Palmer, 88 B.R. 101 (Bankr. N.D.Tex. 1986); In re Treister, 52 B.R. 735 (Bankr. S.D.N.Y. 1985).

(1) Insofar as Section 507(a)(8) priority tax claims are non-dischargeable under Chapter 7 as discussed above, it has been held that the interest accorded priority status under the foregoing case authority is similarly non-dischargeable when the underlying priority claim is deemed to be non-dischargeable. Matter of Larson, 862 F.2d at 112; In re Brinegar, 76 B.R. 176 (Bankr. Colo. 1987); In re Young, 70 B.R. 43 (Bankr. S.D.Ind. 1987).

VIII. Tax Liens.

(A) A federal tax lien arises once the Internal Revenue Service makes demand for payment and the taxpayer fails to pay. The lien attaches to all property of the taxpayer both real and personal. See, 26 U.S.C. Section 6321; See also In re Nevada Environmental Land Fill, 81 B.R. 55 (Bankr. D.Nev. 1987).

(B) The lien refers back to the date of assessment and continues until paid or until it becomes stale, usually ten years. See, 26 U.S.C. Sections 6342 and 6502.

(C) The lien may continue to attach to property abandoned by the trustee and to exempt property, even if the tax claim is determined to be discharged. 11 U.S.C. §522(c); In re Smiley, 26 B.R. 680 (Bankr. D.Kan. 1982)

(D) Section 544 of the Bankruptcy Code operates to subordinate the tax lien by cloaking the trustee or debtor-in-possession with the rights of a bona fide purchaser or judgment lien creditor. Consequently, a tax claim will be unsecured unless a tax lien is recorded under 26 U.S.C. Section 6233(f) and applicable state law.

(E) A tax lien is specifically excluded from the trustee's preference avoidance

powers under 11 U.S.C. §547. It is treated as a secured claim in the bankruptcy case entitled to the special rights and treatment that secured claimant status confers.

(F) Post-petition interest on tax liens. The Supreme Court of the United States has determined in United States v. Ron Pair Enterprises, Inc., 109 S.Ct. 1026, 103 L.Ed.2d 290, 20 C.B.C.2d 267 (1989), that under 11 U.S.C. §506(b) the government is entitled to collect post-petition interest on an oversecured tax lien.

IX. Dischargeability of Taxes In Chapter 11.

(A) Under Chapter 11, the confirmation of a plan of reorganization does not discharge an individual debtor from any debt excepted from discharge under Section 523. 11 U.S.C. §1141(d)(2). Thus, the foregoing analysis of the non-dischargeability of taxes under Chapter 7 may be imported fully into any Chapter 11 analysis.

(B) However, in respect to the priority taxes described in 11 U.S.C. §507(a)(8), rendered non-dischargeable under 11 U.S.C. §523(a)(1), Section 1129 of the Bankruptcy Code, as amended by the BRA, requires that the present value of the tax claims be paid over a period not exceeding five (5) years from the order for relief (as opposed to the prior provision requiring payment within six (6) years from the date of assessment. Thus, a Chapter 11 plan of reorganization cannot be confirmed unless it makes proper provisions for the payment in full of Section 507(a)(8) non-dischargeable tax claims.

(C) Section 1141(d) is modified so that the confirmation of a corporation's plan does not discharge the debtor from taxes or custom duties related to false statements or fraudulent returns or willful attempts in any manner to evade or defeat such tax.

(D) The BRA resolves the conflict in prior law utilizing different interest rates applicable to the repayment of 507(a)(8) tax claims. Under the BRA the applicable interest rate on a tax claim,

including the rate to be used in determining the present value of a tax claim, is the rate that would be applicable under nonbankruptcy law. 11 U.S.C. §511(a). The rate is to be determined in the context of confirmation as of the calendar month of confirmation 11 U.S.C. §511(b).

(E) To the extent that a tax claim has acquired lien status then it must be treated as a secured claim in the Chapter 11 case.

X. Dischargeability of Taxes In Chapter 13.

(A) Prior provision 1328(a) granted to a Chapter 13 debtor a "super discharge" enabling such debtor the ability to discharge 523(a)(1)(B) and 523(a)(1)(C) taxes, i.e. income taxes for which no returns was filed, tax returns late filed within two (2) years of the bankruptcy filing, taxes related to fraudulent returns or taxes the debtor willfully attempted in any manner to evade or defeat.

(B) The foregoing taxes are no longer dischargeable in Chapter 13.

Query: If one of the pivotal policy considerations underlying the BRA is to channel consumer debtors into Chapter 13 repayment plans, is not the repeal of the statutory "super discharge" inconsistent with this goal?

XI. Nondischargeability of Loans Used to Pay Nondischargeable Taxes.

(A) Under new 11 U.S.C. §§523(a)(14) and 523(a)(14A), if a debtor pays an otherwise nondischargeable state or federal tax with borrowed funds, the debt to the lender is similarly nondischargeable.

XII. Offers in Compromise and the Bankruptcy Process.

(A) The IRS, based upon internal policy guidelines has declined to consider offers in compromise from persons involved in pending bankruptcy cases.

(B) In IRS v. Holmes, 309 B.R. 824 (M.D.Ga. 2004), the district court affirmed a bankruptcy court decision compelling the IRS to enter into offer in compromise negotiations,

notwithstanding the pendency of a Chapter 11 case. Accord, In re Macher, 303 B.R. (W.D.Va. 2003); contra In re 1900 M Restaurant Associates, Inc., 319 B.R. 302 (Bankr. D.D.C. 2005).