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Bankruptcy Law—Rethinking the Discharge of Late Filed Taxes in Consumer Bankruptcy

Justin H. Dion
Western New England University School of Law, justin.dion@law.wne.edu

Barbara Curatolo

BANKRUPTCY LAW—RETHINKING THE DISCHARGE OF LATE-FILED TAXES IN CONSUMER BANKRUPTCY

Justin H. Dion, Esq.[*] *& Barbara Curatolo*[**]

"[N]othing can be said to be certain except death and taxes."– Benjamin Franklin[1]

The 2005 amendments to the Bankruptcy Code, Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was enacted in

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* Justin Dion is a Professor of Legal Skills and the Director of Bar Admissions at Western New England University School of Law. He is responsible for designing, administering, and overseeing the Law School's bar examination preparation efforts and activities, including teaching classes, counseling bar applicants, and working with students on an individual and group basis. Professor Dion is a proud alumnus of Western New England University School of Law, where he served as Volume 22 Editor-in-Chief of the *Western New England Law Review* in 2000. He is a certified mediator and is admitted to practice before the Massachusetts and Connecticut State and Federal Courts, the United States Court of Appeals for the First Circuit, and the Supreme Court of the United States. He has of counsel status at Bacon Wilson, P.C., in Springfield, Massachusetts, as a general practitioner with a focus on bankruptcy and insolvency. Professor Dion is an experienced educator, who before becoming employed full time in this role, was a longstanding adjunct professor at Western New England University School of Law in which he was voted Adjunct Professor of the Year for three years. He was also a Professor and Department Chair for the Legal Studies, Forensic Studies, and Criminal Justice Departments at Bay Path University in Longmeadow, Massachusetts; he was voted to serve two terms as Chair of the Faculty Assembly while there. Professor Dion received the 2009 Adams Pro Bono Publico Award from the Massachusetts Supreme Judicial Court for his outstanding commitment to providing volunteer legal services for underserved populations in Massachusetts and was the founder of the Bay Path University Pro Bono Bankruptcy Clinic, for which he served as Director for eight years. He currently serves as a Hearing Officer for the Massachusetts Board of Bar Overseers and is a Member of the Massachusetts Supreme Judicial Court Bar Admissions Curriculum Committee. Professor Dion was also the recipient of the 2017 Distinguished Law Review Alumnus Award and would like to thank his wife and fellow *Western New England Law Review* Alumni, Attorney Kathleen E. Dion ('09), for her assistance, ideas, and unwavering support.

** Barbara "Barbie" Curatolo is a third-year law student at Western New England University School of Law, where she is member of the *Western New England Law Review* and co-president of Western New England University's chapter of the National Lawyers Guild. In addition, Barbara has been a teaching assistant for Business Organizations, Civil Procedure, and Constitutional Law.

1. Letter from Benjamin Franklin to Jean Baptiste Le Roy (Nov. 13, 1789), *in* 10 THE WRITINGS OF BENJAMIN FRANKLIN 68, 69 (Albert Henry Smyth, ed., 1907). The full quote states: "Our new Constitution is now established, and has an appearance that promises permanency; but in this world nothing can be said to be certain except death and taxes." *Id.*

order to improve bankruptcy law. However, BAPCPA has made the issue of whether late-filed taxes are dischargeable even murkier than before the amendments. After BAPCPA, some courts continued to analyze claims as they had before the amendment. Others used a "one-day-late rule" that prevented late-filed taxes from being dischargeable—even if the taxes were filed only one day late. This Article suggests a different approach. It argues that the legislature intended tax debt associated with late-filed income tax returns be dischargeable if the return is filed within two years of the due date.

INTRODUCTION

As a product of legislative statutes, bankruptcy rides the will of the political landscape. Thus, the legislature decides how the economy, personal freedom to discharge debt, creditor fairness, and tax liability intersect. These decisions comprise the bankruptcy rights we have and our ability to discharge debts in order to get a fresh start.

One issue the legislature has addressed is the dischargeability of income taxes. Unfortunately, the language used to describe income tax dischargeability has created confusion among practitioners and courts, as current decisions seem to contradict the spirit, intent, and language of the Bankruptcy Code. This Article argues that the legislature intended tax debt associated with late-filed income tax returns be dischargeable if the return is filed within two years of the due date, regardless of actions taken by the Internal Revenue Service (IRS).

I. PURPOSE OF BANKRUPTCY

The Bankruptcy Code was intended to give good, honest debtors a fresh financial start.[2] This concept recognizes two important factors: (1)

2. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

> One of the primary purposes of the Bankruptcy Act is to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.

Id. (quoting Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554–55 (1915)).

that debt default is not malicious and typically occurs without the fault of the debtor—often in conjunction with unanticipated medical issues, unemployment, and divorce;[3] and (2) having a large population of debtors saddled with overwhelming non-dischargeable debt not only financially paralyzes them, but ultimately harms the national economy by disallowing these individuals the ability to again contribute to the economy as responsible consumers.[4]

Harassment and debt collection tactics further propel the debtor into poverty, psychological despair, and even homelessness.[5] In turn, this puts an additional burden on taxpayers who become forced to support the debtor. Specifically, once a debtor begins missing debt payments, and debt amounts increase due to default interest rates, late fees, and penalties, default becomes increasingly difficult to cure. Ironically, creditors make it harder for the debtor to find a way to cure arrears because their collection tactics make it much more difficult for the debtor to remain employed and earn income.[6] Many states allow an unsecured creditor to repossess a vehicle—thus frustrating the debtor's ability to get to and from their place of employment—while also economically disincentivizing the debtor to work because their bank

3. Unanticipated medical bills, long term unemployment, and divorce are the three primary factors that propel people into filing consumer bankruptcy. Mamie Marcus, Fed. Reserve Bank of Bos., *A Look at Household Bankruptcies*, CMTYS & BANKING 15, 16–17 (Spring 2004), https://www.bostonfed.org/-/media/Documents/cb/PDF/Bankruptcies.pdf [https://perma.cc/2HWB-FG4S]. A 2007 study found that sixty-nine percent of bankruptcies were due to medical debt. David U. Himmelstein et al., *Medical Bankruptcy in the United States, 2007: Results of a National Study*, 122 AM. J. MED. 741, 744 (2009).

4. In addition to harassing phone calls and collection letters, debtors in arrears eventually face being sued and, in most states, having wages garnished by up to twenty-five percent. *See* 15 U.S.C. § 1673 (2016) (limiting wage garnishment to twenty-five percent of disposable earnings); *cf.* 15 U.S.C. § 1677 (2016) (allowing state laws prohibiting or otherwise limiting wage garnishment to stand); Ashley L. Rodgers, Case Note, In Re Pruss: *Protecting Accounts Receivable from Garnishment*, 54 ARK. L. REV. 435, 443–45 (2001) ("[T]he wages of all laborers and mechanics . . . shall be exempt from seizure by garnishment.") (quoting ARK. CODE ANN. § 16-66-208 (2017)).

5. *See, e.g.*, Paul Kiel & Annie Waldman, *The Color of Debt: How Collection Suits Squeeze Black Neighborhoods*, PROPUBLICA (Oct. 8, 2015), https://www.propublica.org/article/debt-collection-lawsuits-squeeze-black-neighborhoods [https://perma.cc/56PH-P3X2]; *see also* Aimee Constantineau, *Fair for Whom? Why Debt-Collection Lawsuits in St. Louis Violate the Procedural Due Process Rights of Low-Income Communities*, 66 AM. U. L. REV. 479, 486–87 (2016) ("The combination of predatory debt collection, garnishment practices, and an inability to repay debts has led to a cycle of poverty in Missouri that, for many, is unending, unalterable, and unforgiving.").

6. *See* ADP RESEARCH INST., GARNISHMENT: THE UNTOLD STORY 6 (2014), http://www.adp.com/tools-and-resources/adp-research-institute/insights/~/media/RI/pdf/Garnishment-whitepaper.ashx [https://perma.cc/3UEQ-K9R8].

account and paycheck may be subject to a lien.[7] Finally, many employers check credit reports before hiring employees, thus making it increasingly difficult for those with significant debt to find employment.[8]

II. BANKRUPTCY CODE HISTORY

Ratification of the United States Constitution in 1789 gave Congress the power to create "uniform Laws on the subject of Bankruptcies."[9] Although Congress's first attempts to create uniform bankruptcy laws failed to provide consistent debtor protection, the Bankruptcy Amendatory Act of 1938[10] and the Bankruptcy Reform Act of 1978[11] established the modern area of bankruptcy law. These acts created a process for debtors to voluntarily file for bankruptcy to resolve overwhelming debt.[12] Specifically, section 707(b) of the Bankruptcy Code used to state: "[t]here shall be a presumption in favor of granting the relief requested by the debtor."[13]

Although this presumption created a fresh start that was utilized by millions of Americans who were otherwise trapped and unable to pay their debt, lending institutions were becoming increasingly concerned about the growing numbers of bankruptcy filings that directly impacted the lending institutions' profitability.[14] Accordingly, lending institutions

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7. *See, e.g.*, ILL. ADMIN. CODE tit. 92, § 1010.160 (1999) ("[T]he Secretary of State established these procedures to be followed by a lienholder to allow the lienholder to obtain a certificate of title for a repossessed vehicle for which the lienholder does not have an assignment of title by the owner.").

8. *See* Gary Rivlin, *The Long Shadow of Bad Credit in a Job Search*, N.Y. TIMES (May 11, 2013), http://www.nytimes.com/2013/05/12/business/employers-pull-applicants-credit-reports.html. A 2012 survey by the Society for Human Resources Management (SHRM) found that forty-seven percent of employers run credit checks on job applicants. *Id.*; *Background Checking—The Use of Credit Background Checks in Hiring Decisions*, SOC'Y HUMAN RES. MGMT. (July 19, 2012) https://www.shrm.org/hr-today/trends-and-forecasting/research-and-surveys/Pages/creditbackgroundchecks.aspx [https://perma.cc/VB36-FC8U].

9. U.S. CONST. art. I, § 8, cl. 4.

10. *See* Bankruptcy Amendatory Act of 1938, ch. 567, 52 Stat. 840 (1938) (amended 1978). The Bankruptcy Amendatory Act of 1938 is also referred to as the "Chandler Act" in honor of its legislative sponsor, the Honorable Walter Chandler, a Tennessee Congressman. David S. Kennedy & Erno Lindner, *The Bankruptcy Amendatory Act of 1938/the Legacy of the Honorable Walter Chandler*, 41 U. MEM. L. REV. 769, 770, 776 (2011).

11. *See* Bankruptcy Reform Act of 1978, Pub. L. No 95-598, 92 Stat. 2549 (1978) (repealed).

12. *See id.* § 301.

13. H.R. REP. NO. 109-31, at 12 n.59 (2005) (Conf. Rep.), *as reprinted in* 2005 U.S.C.C.A.N. 88, 99 n.59 (citation omitted).

14. The number of non-business consumer bankruptcy filings steadily increased up through and including 2005. In 2005, a record number two million bankruptcies were filed.

worked to change the perception of bankruptcy as a necessary financial safety net used by good, honest people, to that of a legal loophole that lets irresponsible and fraudulent people escape their legitimate debt responsibilities.[15] Ultimately, the lenders were able to use significant resources to lobby Congress to draft legislation that would make filing for bankruptcy a more difficult and complex process.[16]

The 2005 amendments to the Bankruptcy Code, entitled the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"),[17] changed the aforementioned "presumption in favor of granting the relief requested by the debtor"[18] to a presumption of abuse that the debtor needed to overcome.[19]

BAPCPA was enacted "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors."[20] The reforms were meant to curb the increasing number of consumer bankruptcy filings that were viewed as abusing the system.[21] The steady increase in consumer bankruptcy filings was a large motivating factor in BAPCPA's enactment—especially as it was perceived that the increased

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See AM. BANKR. INST., ANNUAL BUSINESS AND NON-BUSINESS FILINGS BY YEAR (1980–2016), https://www.abi.org/newsroom/bankruptcy-statistics [https://perma.cc/RG6T-JD3C].

15. *See* A. Mechele Dickerson, *Bankruptcy Reform: Does the End Justify the Means?*, 75 AM. BANKR. L.J. 243, 262 (2001).

16. "The credit card industry as a whole spent an estimated $100 million or more from 1995 to 2005 in lobbying to influence the bankruptcy reform." Brendan A. Cappiello, The Price of Inequality *and the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act*, 17 N.C. BANKING INST. 401, 432 (2013).

17. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. (2005) (codified as amended at 11 U.S.C. § 101 (2016)). The Bankruptcy Abuse Prevention and Consumer Protection Act was passed by Congress on April 14, 2005, and signed into law by President George W. Bush on April 20, 2005 (to take effect on October 17, 2005). Jordan M. Kirby, *Unexpired Leases Under the New Bankruptcy Act: A Win-Win for Landlords and Lenders?*, 10 N.C. BANKING INST. 379, 379 & n.2 (2006). The law, among other things, created more obstacles and made it more cumbersome, difficult, and expensive for individuals to file Chapter 7 bankruptcy, which liquidates debts, and instead encouraged debtors to repay debts in a Chapter 13 reorganization bankruptcy. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

18. H.R. REP. NO. 109-31, at 12 n.59.

19. *Id.* at 12–13.

20. *Id.* at 2.

21. *Id.* at 70.

filings were having a negative effect on the nation's economy. This negative effect was viewed as being exacerbated by the prior law's failure to require debtors to repay their debts.[22] Also, the prior version of the bankruptcy system was seen to have "loopholes and incentives that allow[ed] and—sometimes—even encourage[d] opportunistic personal filings and abuse."[23] BAPCPA had the additional purpose of adding consumer protection reforms, such as strengthening disclosure requirements and heightening judicial oversight of the bankruptcy cases for small businesses.[24]

Below is a discussion of BAPCPA's impact in four primary areas.

A. *Presumption of Debtor's Abuse*

Instead of assuming that someone filing bankruptcy is acting in good faith when filing, the debtor now has the burden of proving good faith. This good faith burden was objectively implemented by requiring that Chapter 7[25] consumer debtors complete a "means test" to prove they were not abusing the bankruptcy process by attempting to discharge debts they otherwise could afford to repay in a Chapter 13 bankruptcy.[26] The test requires those with income above their state's average, which is adjusted for family size, to deduct presumed—not actual—monthly expenses.[27] If after deducting presumed expenses, the debtor has money remaining[28] (i.e., excess income), a presumption of abuse arises. Then the debtor either (1) must convert their Chapter 7 case to one that proceeds under Chapter 13, in which they propose a debt repayment

22. *Id.* at 5.

23. *Id.*

24. BAPCPA also labeled additional requirements for debtors to take financial management courses and receive credit counseling as "consumer protection reforms." *Id.* at 2–3.

25. A Chapter 7 bankruptcy is a liquidation bankruptcy, where assets are liquidated in order to pay creditors, designed for low-income debtors. *See generally* 11 U.S.C. §§ 701–84 (2016). On the other hand, Chapter 13 bankruptcy is a reorganization bankruptcy where a debtor repays the debt—or part of it—through a repayment plan. *See generally* 11 U.S.C. §§ 1301–30 (2016).

26. For a more complete discussion of the functionality of the means test, see generally Kathleen Murphy & Justin H. Dion, *"Means Test" or "Just A Mean Test": An Examination of the Requirement That Converted Chapter 7 Bankruptcy Debtors Comply with Amended Section 707(B)*, 16 AM. BANKR. INST. L. REV. 413 (2008).

27. 11 U.S.C. § 707(b)(2).

28. A "presumption of abuse" will arise if: (1) the debtor has at least $182.50 in current monthly income available after the allowed deductions (this equals $10,950 over five years) regardless of the amount of debt, or (2) the debtor has at least $109.59 of such income ($6,575 over five years) and this sum would be enough to pay general unsecured creditors more than twenty-five percent over five years. *See* 11 U.S.C. § 707(b)(2)(A)(i) (2016).

plan; or (2) the debtor's Chapter 7 case is dismissed, and their debts are not discharged.[29]

B. *Extended Time Between Filings*

An individual's eligibility for discharge is an important change brought about by BAPCPA. The time between a debtor's eligibility to receive a second Chapter 7 discharge was extended from six years to eight years.[30] "Under Chapter 13, prior to BAPCPA, debtors were entitled to proceed to discharge regardless of whether they had received discharge in a previous case. Under BAPCPA, however, individuals generally are entitled to discharge their debts only if they did not receive a discharge."[31]

C. *Required Credit Counseling and Debtor Education*

Section 109(h) of BAPCPA requires that consumers complete a credit counseling course from an approved third-party provider six months before filing, to ensure better non-bankruptcy options are not available.[32] Additionally, before becoming eligible for a discharge, the debtor must take a debtor education course to help the debtor understand basic personal finance concepts that may prevent the need to file bankruptcy again.[33]

D. *Automatic Stay Limitation*

Section 362(c)(3) provides that if the debtor files a Chapter 7, 11,[34] or 13 case within one year after the dismissal of an earlier bankruptcy case, the automatic stay in the new case terminates thirty days after the filing.[35] However, the debtor or some other party in interest may file a

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29. 11 U.S.C. § 707(b)(1) (2016).

30. 11 U.S.C. § 727(a)(8) (2016).

31. *See* Larry A. Pitman II & Jeffrey A. Deines, *A Hitchhiker's Guide to Consumer Bankruptcy Reform*, 75 J. KAN. B. ASS'N. 20, 21 (2006).

32. *See* 11 U.S.C. § 109(h) (2016).

33. *Id.*

34. A Chapter 11 Bankruptcy allows primarily corporate debtors to re-organize their debts in an attempt to keep their businesses operational. The benefits of filing Chapter 11 include obtaining the benefits of the automatic stay to protect the debtor from actions by lenders, including foreclosure. In addition, "[c]ompany executives are freed from pressure; instead of spending much of their time holding off creditors and lenders, they can concentrate on rehabilitating the company." Lawrence R. Reich, *Consider the Filing of a Chapter 11 Case*, 33 WESTCHESTER B.J. 31, 33 (2006).

35. *See* 11 U.S.C. § 362(c)(3) (2016).

motion and demonstrate that the present case was filed in good faith with respect to the creditor, or creditors, being stayed.[36]

Overall, the impact of BAPCPA has been to generally make the bankruptcy process less welcoming, more complex, more time consuming, and more expensive. Despite these consequences, bankruptcy still exists to provide most honest debtors a fresh financial start. The question then arises: how does bankruptcy deal with tax debt?

III. BANKRUPTCY TREATMENT OF TAX DEBTS

Although the scope of bankruptcy discharge is broad and eliminates the vast majority of debts owed by the filer, congressionally imposed exceptions exist. Specifically, student loan debts, family support obligations, and some tax obligations are the most prevalent non-dischargeable debts.[37]

Generally speaking, the IRS levies graduated taxes on "taxable income" that allows taxpayers to deduct certain exemptions from their "gross income" (which in turn is broadly defined to include virtually all accessions to wealth).[38] Our tax system relies on accurate self-reporting, with returns[39] generally being due April 15th each year. A six-month extension can be requested that permits the taxpayer additional time to file the return; however, the extension does not extend the tax payment deadline.[40] Failure to file a timely tax return empowers the IRS to then utilize various tools to assess and collect unfiled taxes.[41]

A. *Pre-BAPCPA: Majority Position*

Before BAPCPA, discharging taxes following a late-filed return was fairly straightforward. Essentially, a tax was dischargeable if the tax return was due more than three years ago and was filed more than two years before the debtor filed a Chapter 7 bankruptcy.[42]

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36. *Id.*

37. *See* 11 U.S.C § 523 (2016); *see also* Roger Roots, *The Student Loan Debt Crisis: A Lesson in Unintended Consequences*, 29 SW. U. L. REV. 501, 513 (2000) ("Student loans were thus categorized along with most tax debts, debts obtained by false pretenses or fraud, debts for embezzlement, larceny, or similar legal impropriety, debts for child support or alimony, debts for willful and malicious injury to another, and debts for criminal restitution.").

38. *See* Treas. Reg § 1.61-1 (1960).

39. "[A] return of tax is a return (including an amended or adjusted return) filed by or on behalf of a taxpayer reporting the liability of the taxpayer for tax under the Code, if the type of return is identified in published guidance in the Internal Revenue Bulletin." Treas. Reg. § 301.7701-15(b)(4) (2009).

40. *See* Treas. Reg. § 1.6081-4 (2008).

41. I.R.C. § 6020 (2016).

42. *Contra* 11 U.S.C. § 523 (2016).

A complication arose if the IRS prepared a substitute tax return before the taxpayer filed for bankruptcy relief. A substitute tax return is a return prepared by the IRS on behalf of the taxpayer who has otherwise failed to voluntarily file their tax returns on their own.[43] Before the IRS will prepare a substitute tax return,[44] the taxpayer is sent a Notice of Deficiency that notifies the taxpayer that they have ninety days to file a late return or, alternatively, file a claim in Tax Court.[45] If the taxpayer fails to do either, the IRS will attempt to determine the taxpayer's income based on available information in their possession and file a substitute return on the taxpayer's behalf.[46]

In that narrow situation, a split arose among the United States Circuit Courts of Appeals regarding tax dischargeability. The majority approach is represented by *In re Hindenlang*,[47] in which the IRS, pursuant to Internal Revenue Code (I.R.C.) § 6020(b),[48] prepared

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43. *See* IRM 4.12.1.8.4 (Oct. 5, 2010).

> When it has been determined that a taxpayer is liable for filing a return, and upon due notice from the Service fails to do so, an SFR [Substitute for Return] will be prepared by Examination.
>
> Examination uses this procedure to establish an account and examine the records of a taxpayer when the taxpayer refuses or is unable to file and information received indicates that a return should be filed.
>
> The examiner will follow the steps outlined *IRM 4.12.1.5.2 IDRS Research*, to confirm no return has been filed.
>
> An SFR, in and of itself, *DOES NOT* constitute a return under IRC 6020(b). For the purpose of asserting the Failure to Pay Penalty, additional steps should be taken before submitting the SFR package.

Id. (second emphasis added).

44. Substitute returns are discretionary. The IRS will not, and is not obligated to, file substitute returns in all cases where the debtor fails to file a voluntary return. United States v. Stafford, 983 F.2d 25, 27 (5th Cir. 1993); *see also Filing Past Due Tax Returns*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/filing-past-due-tax-returns [https://perma.cc/ET4K-JJRF] ("If you fail to file, we *may* file a substitute return for you.") (emphasis added).

45. *Filing Past Due Tax Returns*, *supra* note 44.

46. Treas. Reg. § 301.6020-1(b)(1) (2008).

> [T]he Commissioner or other authorized Internal Revenue Officer or employee shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. The Commissioner or other authorized Internal Revenue Officer or employee may make the return by gathering information and making computations through electronic, automated or other means to make a determination of the taxpayer's tax liability.

Id.

47. United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1032 (6th Cir. 1999).

48. I.R.C. § 6020(b) (2016):

> (1) Authority of Secretary to execute return.
>
> If any person fails to make any return required by any internal revenue law or

substitute returns and assessed taxes owed for the three years the debtor had failed to file.[49] The debtor later filed his tax returns for the missing years, and three years later filed a Chapter 7 bankruptcy seeking a determination that the taxes were dischargeable.[50] Although the Bankruptcy Court found in favor of the debtor,[51] the United States Court of Appeals for the Sixth Circuit ultimately agreed with the IRS. It found that, although the Bankruptcy Code does not define the term "return," "once a taxpayer has been assessed a deficiency, a Form 1040 submitted by the taxpayer to the IRS no longer qualifies as a return" and would thus be non-dischargeable.[52] In doing so, the court adopted the *Beard* test to determine what a "return" requires.[53] Specifically, the court held that four elements must be met: "(1) it must purport to be a return; (2) it must be executed under the penalty of perjury; (3) it must contain sufficient data to allow calculation of a tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law."[54]

Utilizing the *Beard* test, the court found no dispute that the first three elements were met; however, the debtor's significantly delayed filing did not "represent an honest and reasonable attempt to satisfy the requirements of the tax law," and the burden to show otherwise was on

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> regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise.
>
> (2) Status of returns.
>
> Any return so made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes.

Id.

49. *In re Hindenlang*, 164 F.3d at 1031.

50. *Id.*

51. *See generally In re* Hindenlang, 214 B.R. 847 (Bankr. S.D. Ohio 1997), *rev'd*, *In re* Hindenlang, 164 F.3d 1029 (6th Cir. 1999).

52. *In re Hindenlang*, 164 F.3d at 1032.

53. *Beard v. Commissioner*, 82 T.C. 766, 777–79 (1984). This test was compiled by the Tax Court by combining the principles from *Germantown Trust Co. v. Commissioner*, 309 U.S. 304 (1940) and *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934). *In re Hindenlang*, 164 F.3d at 1033.

54. *In re Hindenlang*, 164 F.3d at 1033 (quoting *In re Hindenlang*, 214 B.R. at 848).

the debtor, not the IRS.[55] As the court found that the debtor's filing of a 1040 return after the IRS has prepared a substitute return had no legal effect or impact on his tax obligation, the court concluded that the debtor's filing therefore did not qualify as a return under *Beard*, and therefore was non-dischargeable.[56] Other courts have followed this line of reasoning to similarly determine that after the IRS prepares a substitute return, the filing no longer qualifies as a return and the debt is non-dischargeable.[57]

B. *Pre-BAPCPA: Minority Position*

A minority of courts have found differently when applying the *Beard* test, such as the Eighth Circuit in *In re Colsen*.[58] The Eighth Circuit ultimately found that the fourth element of *Beard*, requiring the debtor make an "honest and reasonable attempt," or alternatively an "honest and genuine effort," was satisfied without needing to consider the filer's intent or timeliness of the returns, as those are not specific elements of the test.[59] In fact, the Eighth Circuit indicated that returns filed after substitute returns still have value to the IRS, who often use those returns to evaluate an offer to compromise.[60] The court stated:

> The government's essential position is that because Mr. Colsen's 1040 forms were filed after the IRS's assessment, they do not evince an honest, genuine attempt to satisfy the law and thus he has not satisfied the requirement that returns be filed in order for tax liabilities to be dischargeable. But we have no evidence to suggest that the forms appeared obviously inaccurate or fabricated; indeed, Mr. Colsen's 1040 forms contained data that allowed the IRS to calculate his tax obligation more accurately: The information contained in the forms was honest and genuine enough to result in thousands of dollars of abatements of tax and interest. . . .
>
> The IRS apparently has found post-assessment returns useful, as it has required taxpayers to file them before the agency would consider proposed offers to compromise tax liabilities. Filing the forms served an important purpose under the tax laws for Mr. Colsen.

55. *Id.* at 1034–35.

56. *Id* at 1034–35.

57. *See, e.g.*, *In re* Justice, 817 F.3d 738, 746 (11th Cir. 2016). As will be later discussed in Subpart V.C., this line of reasoning has continued in cases after BAPCPA's amendments.

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

59. *Id.* at 840.

60. *Id.* at 841.

> That the IRS did not also collect more tax as a result of Mr. Colsen's filings does not undermine their role in determining Mr. Colsen's ultimate liabilities. The theory of the case that the government espouses holds only if we consider the accurate calculation of a taxpayer's obligations not to be a valid purpose that satisfies the tax laws, which we decline to do. Our confidence in this result derives strength from the principle that "exceptions from discharge are to be strictly construed so as to give maximum effect to the policy of the bankruptcy code to provide debtors with a 'fresh start.'"[61]

With this reasoning, the Eighth Circuit relied on the purpose of the Bankruptcy Code in order to favor the debtor, which the majority position failed to do.[62]

C. *BAPCPA's Adjustment to 11 U.S.C. § 523*

BAPCPA amended the language in 11 U.S.C. § 523 by adding what is referred to as "the hanging paragraph," which states:

> 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.[63]

On its face, it would appear that the intent of this additional language is to make clear that a taxpayer-filed tax return (or section 6020(a) return) is dischargeable, whereas a return prepared by the IRS (or section 6020(b) return) is not.

The hanging paragraph was explained by the House Judiciary Committee as being 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

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61. *Id.* at 840–41 (quoting Geiger v. Kawaauhau (*In re* Geiger), 113 F.3d 484, 853 (8th Cir. 1997)).

62. *See supra* Subpart III.A.

63. 11 U.S.C. § 523(a) (2016). "Because it is not a numbered paragraph, courts routinely cite to it by using '§ 523(a)(*).'" Timothy M. Todd, *Discharge of Late Tax Return Debt in Bankruptcy: Fixing BAPCPA's Draconian Hanging Paragraph*, 24 AM. BANKR. INST. L. REV. 433, 446 n.126 (2016).

> Revenue Code, or similar State or local law, does not constitute filing a return (and the debt cannot be discharged).[64]

The intent of this addition was clearly to resolve a disagreement among the lower courts regarding the treatment of IRS prepared tax returns, with some courts holding them dischargeable and others holding them non-dischargeable.[65] Following this change, instead of limiting the hanging paragraph to IRS-prepared returns, some of the courts that have addressed the issue held the hanging paragraph adjustment reflected Congress's intent that all late-filed tax debt now be non-dischargeable.[66] By way of example, the Tenth Circuit in *In re Mallo* determined that late-filed tax returns filed after the IRS separately assessed the debtor's tax deficiencies was not dischargeable in a Chapter 7 bankruptcy because the returns failed to satisfy "the requirements of applicable nonbankruptcy law," requirements that included filing deadlines.[67]

D. *Distinction Between Federal Tax Obligations and State Tax Obligations*

All residents and citizens of the United States have the obligation to pay federal income taxes.[68] The IRS enforces federal tax laws and collects the taxes for the federal government.[69] State income taxes, however, are separate—these are governed by each individual state according to state law.[70] Although bankruptcy is federal law, the Bankruptcy Code often looks to state law to dictate many specific relationships of the parties.

For example, in *In re Fahey*,[71] the debtor filed seven years of his

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64. H.R. REP. NO. 109-31, at 103 (2005).

65. *Compare In re* Bergstrom, 949 F.2d 341, 343 (10th Cir. 1991) (holding that IRS prepared tax returns did not qualify as returns and thus were not dischargeable), *with In re* Ridgway, 322 B.R. 19, 37 (Bankr. D. Conn. 2005) (holding that Treasury Secretary's Substitute Returns qualify as returns for dischargeability purposes).

66. *See, e.g.*, Fahey v. Mass. Dep't of Revenue (*In re* Fahey), 779 F.3d 1, 2 (1st Cir. 2015).

67. *See* Mallo v. IRS (*In re* Mallo), 774 F.3d 1313, 1325–27 (10th Cir. 2014).

68. *State Income Tax vs. Federal Income Tax*, U.S. TAX CTR., https://www.irs.com/articles/state-income-tax-vs-federal-income-tax [https://perma.cc/VP6G-RCKC].

69. *Id.*

70. *Id.*

71. Fahey v. Mass. Dep't of Revenue (*In re* Fahey), Ch. 7 No. 10-21154-WCH, Ad. No. 12-1204 (Bankr. D. Mass. June 11, 2013), *aff'd sub nom.* Perkins v. Mass. Dep't of Revenue, 507 B.R. 45 (Bankr. D. Mass. 2014), *aff'd sub nom.* Fahey v. Mass. Dep't of Revenue (*In re* Fahey), 779 F.3d 1, 2 (1st Cir. 2015).

Massachusetts state income tax returns late, making partial payments on some years, and no payments on others.[72] The debtor later filed Chapter 13 bankruptcy, and listed the tax debt owed at $105,555.66.[73] After the case was converted to a Chapter 7 bankruptcy and the debtor received his discharge, Massachusetts Department of Revenue (hereinafter MDOR) issued a bill to the debtor and issued a Notice of Intent to Suspend the Driver's License.[74] The debtor then moved to reopen his case to determine tax debt dischargeability by way of filing an adversarial proceeding against MDOR.[75]

After evaluating the respective positions of the parties, the court held that because a late-filed Massachusetts tax return fails to satisfy the deadline pursuant to state law[76] it also fails to meet one of the "applicable nonbankruptcy law" filing requirements.[77]

IV. ONE-DAY-LATE RULE—LATE-FILED TAX RETURNS ARE NON-DISCHARGEABLE

After BAPCPA, a few circuit courts have held that the new language of applicable filing requirements in the hanging paragraph includes the filing deadline. As a result, these courts have adopted a one-day-late rule, where if a tax form was filed even one day late, that the debt is non-dischargeable. The circuit courts that have adopted this one-day-late-rule include the First, Fifth, and Tenth Circuits. The cases that have arisen in each circuit are discussed below.

A. *First Circuit*

When *In re Fahey* got to the First Circuit, the case involved four debtors who did not file Massachusetts tax returns on time for multiple years.[78] While the debtors eventually filed the late returns, they did not pay the taxes due, or the additional interest and late penalties. After at

72. *In re Fahey*, No. 10-21154-WCH, slip. op. at 1. Debtor filed late state tax returns from 1997 through 2002, and 2004 through 2005. He made partial payments on his outstanding 2000, 2001, 2002, 2004, and 2005 tax debt. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. According to MASS. GEN. LAWS ch. 62(c) § 6(c), a Massachusetts Income Tax Return requires that the return "be made on or before the fifteenth day of the fourth month following the close of the taxable year." *Id.*

77. *In re Fahey*, No. 10-21154-WCH, slip op. at 5–6.

78. *See generally* Fahey v. Mass. Dep't of Revenue (*In re Fahey*), 779 F.3d 1 (1st Cir. 2015).

least two years had passed, the debtors each filed for bankruptcy.[79]

In assessing the dischargeability of these debts, the court acknowledged that a straightforward reading of 11 U.S.C. § 523(a)(1)(B)(i)–(ii) would classify the debt as dischargeable:

> Looking solely at the foregoing language, and using a common notion of what a "return" is, one could easily conclude that any return filed after the due date but more than two years before a bankruptcy filing would place the tax due under that return outside the section 523(a)(1) exception, and thus within the broad category of dischargeable debts.[80]

However, the court then looked at the definition of the term "return" in the hanging paragraph and decided that timely filing is a "filing requirement" under Massachusetts law.[81] The court came to this determination by use of the word "shall" in MASS. GEN. LAWS ch. 62C, § 6(c) which states that returns

> shall be made on or before the fifteenth day of the fourth month following the close of each taxable year. . . . This command that returns "shall" be made by the due date certainly seems like a "filing requirement." . . . Accordingly, under this straightforward reading of Massachusetts law, a return filed after the due date is a return not filed as required, i.e., a return that does not satisfy "applicable filing requirements."[82]

This holding, although rooted in Massachusetts law, has been interpreted in a manner that has been extended to other state law in the circuit.[83]

B. *Fifth Circuit*

The Fifth Circuit reached the same one-day-late rule in *In re McCoy*.[84] In *In re McCoy*, the Fifth Circuit addressed the case of a debtor who filed her Mississippi income tax returns for 1998 and 1999 late, and she filed for bankruptcy in 2007.[85]

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79. *Id.* at 2.

80. *Id.* at 3.

81. *Id.* at 4.

82. *Id.* at 4–5 (citations omitted).

83. *See, e.g.*, Boudreau v. R.I. Div. of Taxation (*In re* Boudreau), 562 B.R. 853, 860–61 (Bankr. D. R.I. 2017).

84. *See generally* McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924 (5th Cir. 2012).

85. *Id.* at 925.

In its assessment, the court looked at the BAPCPA amendments. The debtor argued that the exceptions within section 523 were to be read narrowly, and that reading the amendment in a manner that would exclude returns filed after the deadline "render[ed] part of the statute superfluous." Therefore, the debtor advocated that the four-factor *Beard* test should still be applied.[86]

The Fifth Circuit rejected the debtor's argument by reading BAPCPA's amendment as "provid[ing] an unambiguous definition of 'return,'" one that includes filing deadlines, and one that was intended to replace the four-factor test.[87] Furthermore, the court did not find the language to be superfluous when read plainly as an "explanation of what kinds of tax filings qualify as 'returns'"—distinguishing § 6020(a) returns from that of § 6020(b).[88] This type of interpretation, the court found, is consistent with the policies in place before BAPCPA.[89]

C. *Tenth Circuit*

In *In re Mallo*,[90] the Tenth Circuit looked at the dischargeability of returns filed after the IRS issued statutory notices of deficiencies. The case arose when a married couple and another debtor—who made substantially the same arguments in bankruptcy court—were given different dischargeability results.[91] When addressing the issue, the Tenth Circuit interpreted the language of BAPCPA's hanging paragraph as including filing deadlines, thus excluding late-filed forms from qualifying as returns.[92] It explained that if this was not Congress's intent, then it should have used different language:

> If the statutory mandate contained in the Tax Code that a return "*shall be filed* on or before" a particular date is not an "applicable filing requirement," it is hard to imagine what would be. . . . If Congress intended § 523 to define a return through application of the *Beard* test or some other type of substantial compliance doctrine, rather than by a taxpayer's compliance with the applicable filing requirements contained in the Tax Code, Congress could simply have defined a return as one that "satisfies the requirements of applicable

86. *Id.* at 928–29.

87. *Id.* at 929.

88. *Id.* at 931.

89. *Id.* at 931–32.

90. *See* Mallo v. IRS (*In re* Mallo), 774 F.3d 1313 (10th Cir. 2014); *see also supra* Subpart IV.C.

91. *In re Mallo*, 774 F.3d at 1316–17.

92. *Id.* at 1327–28.

> nonbankruptcy law," without qualifying the statement with the phrase "including applicable filing requirements." Alternatively, Congress could have expressly stated a document is a return if it "satisfies the requirements of applicable nonbankruptcy law (including applicable *substantive* filing requirements)" or "(including applicable filing requirements, *except the date the filing is due*)." But Congress did not write the statute in any of these ways. It expressly incorporated compliance with applicable filing requirements as part of the definition of a return under the discharge provisions of § 523 of the Bankruptcy Code.[93]

Interestingly, the court concluded its analysis with an acknowledgement that such an interpretation is in dissonance with the purpose of bankruptcy and congressional intent:

> [T]he plain and unambiguous language of § 523(a) excludes from the definition of "return" all late-filed tax forms, except those prepared with the assistance of the IRS under § 6020(a). And we are bound to apply the statute according to its plain terms even if such an interpretation seems contrary to the broader purposes of the Bankruptcy Code or we are convinced that Congress intended a different result.[94]

Thus, despite acknowledging that the interpretation would go against the purpose of bankruptcy and congressional intent, the court held that BAPCPA created the one-day-late rule and rendered late filings non-dischargeable.[95]

V. CONTINUATION OF THE *BEARD* TEST

Even though a few circuits have adopted the one-day-late rule after BAPCPA, other circuit courts have refused and instead continue to use the *Beard* test in order to analyze whether tax debt is dischargeable.[96] In doing so, the circuit split regarding the dischargeability of tax debts after the IRS prepared a substitute return may continue even after the BAPCPA amendments—especially as the Eighth Circuit has not yet interpreted the BAPCPA amendments in regard to the dischargeability of late-filed tax forms.[97] If the Eighth Circuit decides in a similar manner

93. *Id.* at 1325.

94. *Id.* at 1327.

95. *Id.*

96. *See, e.g.*, Giacchi v. U.S. Dep't of Treasury (*In re* Giacchi), 856 F.3d 244, 247–49 (3d Cir. 2017).

97. Although the Eighth Circuit has looked at the BAPCPA amendments, and the hanging paragraph, in other contexts. *E.g.*, Capital One Auto Fin. v. Osborn, 515

as the cases described below, continues the use of the *Beard* test, and follows the precedent of *In re Colsen*,[98] late forms filed after the IRS prepared a substitute return would constitute a dischargeable return.[99] The circuit courts—including the Third, Ninth, and Eleventh Circuits—that have decided to take the *Beard* test approach instead of the one-day-late rule following the BAPCPA amendments have continued the pre-BAPCPA majority position that after the IRS filed substitute returns, late-filed tax forms are not returns.

A. *Third Circuit*

The Third Circuit took up the issue of the dischargeability of late-filed taxes and the BAPCPA amendments in *In re Giacchi*.[100] This case dealt with a debtor who did not file returns for 2000, 2001, and 2002 until after the IRS assessed tax liabilities for each of those years, and filed for bankruptcy four years after the last filing.[101]

The court started its analysis by looking at the definition of "return" that BAPCPA added to the Bankruptcy Code—specifically focusing on the "applicable filing requirement" language. After noting that other circuit courts have interpreted this language in a manner that would prevent late-filed forms from being considered returns, the Third Circuit decided not to weigh in on whether this interpretation was correct.[102] The court avoided deciding that issue and continued to make use of the *Beard* test in order to determine whether the debt was dischargeable:

> Several of our sister circuits have interpreted "applicable filing requirements" to include filing deadlines so that late-filed forms cannot be "returns." The government notes that this approach, called the "one-day-late rule," fails to harmonize provisions of § 523 that contemplate some late-filed forms are "returns." We need not reach the question of whether the "one-day-late rule" is correct. Instead, we join our sister circuits in applying *Beard v. Commissioner of Internal Revenue*, which sets forth "the requirements of applicable nonbankruptcy law[,]" and we conclude that Giacchi's tax debts are non-dischargeable.[103]

Despite not subscribing to the one-day-late rule, the court's use of

F.3d 817 (8th Cir. 2008).

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

99. *See supra* Subpart III.B.

100. *In re Giacchi*, 856 F.3d at 246–47.

101. *Id.* at 246.

102. *Id.* at 247–48.

103. *Id.* at 247–48 (footnotes omitted).

the *Beard* test still resulted in the court's finding that late-filed forms after the assessment did not qualify as returns. The court reasoned that after the IRS's assessment, the tax form failed to fulfill its purpose and thus could not be in compliance with tax law.

> Forms filed after their due dates and after an IRS assessment rarely, if ever, qualify as an honest or reasonable attempt to satisfy the tax law. This is because the purpose of a tax return is for the taxpayer to provide information to the government regarding the amount of tax due. If a taxpayer does not file a return, the IRS is required to independently assess the taxpayer's liability, as it did when Giacchi failed to timely file his 2000, 2001, or 2002 tax returns. Once the IRS assesses the taxpayer's liability, a subsequent filing can no longer serve the tax return's purpose, and thus could not be an honest and reasonable attempt to comply with the tax law. Here, there is no dispute that Giacchi failed to file timely returns, and that, as a result of Giacchi's failure, the IRS had to estimate his taxes without his assistance.[104]

In doing so, the court sided with the majority of courts before the BAPCPA amendments that found that filings made after the IRS prepared substitute returns are not dischargeable returns as exemplified by *In re Hindenlang*.[105]

B. *Ninth Circuit*

The Ninth Circuit looked at the BAPCPA amendments in *Smith v. IRS*, a case in which a debtor filed a tax return seven years late—three years after a deficiency was assessed.[106] Less than a year later, he declared bankruptcy.[107] Even though the Ninth Circuit had not interpreted the new definition of "return" in BAPCPA, following the decisions of other courts, the Ninth Circuit decided that the four-factor *Beard* test, as applied in a pre-BAPCPA decision, *In re Hatton*,[108] still

104. *Id.* at 248 (footnotes omitted).

105. *See* United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1032–33 (6th Cir. 1999); *see also supra* Subpart IV.A.

106. Smith v. IRS (*In re* Smith), 828 F.3d 1094, 1095 (9th Cir. 2016), *cert. denied*, 137 S. Ct. 1066 (2017).

107. *Id.* at 1095–96.

108. *See* United States v. Hatton (*In re* Hatton), 220 F.3d 1057, 1060–61 (9th Cir. 2000). *In re Hatton* is a Ninth Circuit case that followed *In re Hindenlang*'s use of the *Beard* test.

applied.[109] In doing so, the court decided that the fourth factor of the test would not be satisfied when a filing was made late.[110]

> [The debtor] argues that *Hatton's* "honest and reasonable" inquiry requires looking only at the face of the filing. . . . We disagree. *Hatton* focused the "honest and reasonable" inquiry on the honesty and reasonableness of the taxpayer's conduct, not on any deficiency in the documents' form or content. . . . We hold that *Hatton* applies to the bankruptcy code as amended, and that [the debtor]'s tax filing, made seven years late and three years after the IRS assessed a deficiency against him, was not an "honest and reasonable" attempt to comply with the tax code.[111]

This holding, like in the Third Circuit,[112] thus follows the pre-BAPCPA majority position, illustrated by *In re Hindenlang*,[113] that forms filed after the IRS prepares substitute returns are non-dischargeable because they fail the *Beard* test.[114]

C. *Eleventh Circuit*

In the Eleventh Circuit's *In re Justice*, the debtor filed returns after the IRS issued deficiency notices.[115] In determining whether or not the filings qualify as returns, the Eleventh Circuit looked at the language in the hanging paragraph and the interpretation of the three circuit courts that have construed "applicable filing requirements" to include filing deadlines.[116] The Eleventh Circuit, however, neither accepted nor rejected the "one-day-late rule" as even the use of the *Beard* test would result in non-dischargeability.[117]

> [W]e hold that, even under Justice's preferred interpretation of § 523(*), his tax debts are non-dischargeable. We can assume *arguendo*, although we expressly do not decide, that the one-day-late

109. *In re Smith*, 828 F.3d at 1096.

110. *Id*. at 1096–97; *see also In re Hatton*, 220 F.3d at 1061 ("[A] belated acceptance of responsibility, however, does not constitute an honest and reasonable attempt to comply with the requirements of the tax law.").

111. *In re Smith*, 828 F.3d at 1097 (footnote omitted) (internal citation omitted).

112. *See supra* Subpart V.A.

113. *See* United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1032–33 (6th Cir. 1999).

114. *See supra* Subpart III.A.

115. Justice v. United States (*In re* Justice), 817 F.3d 738, 740 (11th Cir. 2016), *cert. denied* 137 S. Ct. 1375 (2017).

116. *Id.* at 742–43.

117. *Id.* at 743–44.

> rule is incorrect. We can do this because, even under this assumption, Justice's tax debts are nevertheless non-dischargeable . . . .[118]

The Eleventh Circuit found that a debtor's failure to file until after the IRS contacts them "frustrates the requirements and objectives" of the tax system and its purpose.[119] "[The d]elinquency in filing, therefore, is evidence that the taxpayer failed to make a reasonable effort to comply with the law."[120] Because Justice filed late, the fourth factor of the *Beard* test could not be met.[121] In finding the debt non-dischargeable by analyzing it under the *Beard* test first, the Eleventh Circuit avoided interpreting the hanging paragraph, and joined the circuits discussed above that continue to hold the pre-BAPCPA majority position.

D. *Other Notable Cases*

It is perhaps interesting to note the cases that have come out of the Fourth and Seventh Circuits. Although these opinions, in their majorities, have not offered much guidance on the interpretation of BAPCPA's hanging paragraph, they each have been cited by other cases that look at this issue due to a unique use of the *Beard* test after the enactment of BAPCPA and commentary made within a dissent.

1. Fourth Circuit

The Fourth Circuit's *In re Ciotti*[122] is unique as it concerned a failure to report. The debtor filed returns, but later was issued a Letter of Determination by the IRS that made adjustments to her returns, increasing her income. The debtor failed to report the changes to the Maryland tax authorities. The IRS, however, forwarded its findings and the debtor's returns were adjusted to $500,000 of due taxes, penalties, and interest.[123]

The court had to determine whether the state form for reporting was similar enough to a return to be treated as an "equivalent report or notice."[124] To determine that the report was similar enough to a return, the court applied the factors of the *Beard* test.[125] As the *Beard* test was

118. *Id.* at 743 (footnote omitted).
119. *Id.* at 744.
120. *Id.*
121. *Id.*
122. *See generally* Maryland v. Ciotti (*In re* Ciotti), 638 F.3d 276 (4th Cir. 2011).
123. *Id.* at 278.
124. *Id.*
125. *Id.* at 280–81.

not used to determine dischargeability of tax debt, other opinions have cited *In re Ciotti* as distinguishable.[126]

In re Ciotti, while not providing a thorough analysis of the hanging paragraph, notes the debtor-unfriendly BAPCPA changes in other sections,[127] which other courts have used as support for a debtor-unfriendly interpretation of the hanging paragraph.[128] The Fourth Circuit, when looking at section 523(a)(1)(B) states:

> It is apparent from the changes that Congress determined that the same policy reasons that justify precluding the discharge of tax debt when the debtor failed to file a return also justify precluding the discharge of the tax debt when the debtor failed to file or give a required report or notice corresponding to that debt.[129]

The Fourth Circuit concluded that the failure to report, even if the IRS gave the required information, was a breach of the "taxpayer's statutory obligation to report the information herself" and thus caused the debt to be non-dischargeable.[130]

2. Seventh Circuit

Although the Seventh Circuit's *In re Payne* decision did not involve BAPCPA—since the debtor filed bankruptcy before the Act took effect—Judge Easterbrook's dissent mentioned BAPCPA and its effect: "After 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).'"[131] This statement has been used to support the "one-day-late" rule in other cases.[132] The rest of the dissent, however, argues that a post-assessment

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126. *E.g.*, McCoy v. Miss. Tax Comm'n (*In re* McCoy), 666 F.3d 924, 930 (5th Cir. 2012).

> Moreover, the issue in *Ciotti*—whether the attributes of a particular form make it similar to a return—is different from the issue in the case before us—whether a return that fails to comply with the applicable state filing requirements is a return. Accordingly, *Ciotti* provides little guidance for the case at hand and does not bolster McCoy's argument.

Id.

127. *See In re Ciotti*, 638 F.3d at 279–80.

128. *E.g.*, Fahey v. Mass. Dep't of Revenue (*In re* Fahey), 779 F.3d 1, 10 n.11 (1st Cir. 2015).

129. *In re Ciotti*, 638 F.3d at 279–80.

130. *Id.* at 281.

131. Payne v. United States (*In re* Payne), 431 F.3d 1055, 1060 (7th Cir. 2005) (Easterbrook, J., dissenting).

132. *See, e.g.*, *In re Fahey*, 779 F.3d at 5 ("And at least one other circuit court

return can be an honest and reasonable attempt to satisfy the law under the *Beard* test prior to the BAPCPA amendments.[133] These arguments have since appeared in numerous other cases that deal with that issue.[134]

VI. RETHINKING THE DISCHARGEABILITY ISSUE

A. *Ambiguous Text Should Be Read in Favor of the Debtor*

"In view of the well-known purposes of the Bankruptcy Law exceptions to the operation of a discharge thereunder should be confined to those plainly expressed."[135] By its plain language, the hanging paragraph was not intended to alter the landscape of tax dischargeability by preventing all late-filed taxes from being discharged, but rather to clarify dischargeability when the IRS prepares a substitute return. The primary confusion stems from the hanging paragraph language that defines a "return [as one] that satisfies the requirements of applicable nonbankruptcy law (*including applicable filing requirements*)."[136] Based on the emphasized language, and the courts' varying interpretations, the statute is ambiguous with two reasonably plausible interpretations: (1) the language could simply mean that late-filed returns that do not comply with substantive filing requirements are not dischargeable; or (2) that in fact late-filed returns must meet substantive and timing requirements.

In evaluating the ambiguity, it would appear that the context of the surrounding statutory language clearly supports the first interpretation. Specifically, reading the statute as a whole, in conjunction with the reparative philosophy on which the Bankruptcy Code is based, the first interpretation logically permits dischargeability. This interpretation permits the debtor a fresh start as opposed to creating a new discharge exception.

Reading the hanging paragraph of 11 U.S.C. § 523 in a manner that makes late-filed returns non-dischargeable ignores the surrounding express language. Specifically, 11 U.S.C. § 523 addresses the possibility

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judge, in dictum, predicted such a result.") (citing Payne v. United States (*In re* Payne), 431 F.3d 1055, 1060 (7th Cir. 2005) (Easterbrook, J., dissenting)).

133. *In re Payne*, 431 F.3d at 1060–61 (Easterbrook, J., dissenting).

134. *Compare* Colsen v. United States (*In re* Colsen), 446 F.3d 836, 840 (8th Cir. 2006) ("[W]e find Judge Easterbrook's arguments persuasive."), *with* Mallo v. IRS (*In re* Mallo), 774 F.3d 1313, 1320 (10th Cir. 2014) (disregarding Judge Easterbrook's arguments as not applicable after BAPCPA amendments).

135. Gleason v. Thaw, 236 U.S. 558, 562 (1915).

136. 11 U.S.C. § 523(a)(*) (emphasis added).

of a late-filed return being dischargeable if it was filed at least two years before the bankruptcy filing.[137] Accordingly, if Congress already made accommodations for the possibility of discharging late-filed returns, it would not make sense to view the hanging paragraph through a conservative, draconian lens that finds non-dischargeability. Thus, the ambiguity should be resolved in a manner that still allows for the possibility of late-filed returns.

B. *Resolving the Ambiguity*

There are two ways to resolve the ambiguity of the hanging paragraph. The first involves statutory revision which will make the language of 11 U.S.C. § 523 clearer. The second involves a compromise by setting a time limit for when debt would be dischargeable.

1. Statutory Revision

The easiest and most obvious resolution, but possibly the most difficult to implement, is amending the hanging paragraph to resolve the ambiguity in favor of tax dischargeability. The hanging paragraph of 11 U.S.C. § 523 could be amended as follows:

> For purposes of this subsection, the term "return" means a return that *is filed by the debtor and otherwise* satisfies the *substantive* 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

137. *See* 11 U.S.C. § 523 (a)(1)(A)–(C) (2016). Specifically, the statute exempts from discharge debts:

> (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.

Id.

> 1986, or a similar State or local law. (emphasis added to proposed additional text).

The proposed amendment attempts to clarify the intent that a procedural flaw (i.e., a tax return not being filed on time) should not prevent a filing that otherwise complies with tax filing requirements from being deemed a return.

In contrast, congressional clarification could in fact confirm the opposite position. Despite being contrary to the fresh start philosophy of bankruptcy, Congress could confirm the intent of non-dischargeability by revising the hanging paragraph of 11 U.S.C. § 523 as follows:

> For purposes of this subsection, the term "return" means a return that satisfies all the requirements of applicable nonbankruptcy law (including applicable filing and time deadline 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.

Although contrary to the position of this Article, this revision would make clear that Congress had intended to punish late tax filers and exempt them from obtaining a fresh start. While this initially may seem overly harsh, it could be argued that this policy is intended to incentivize compliance with all tax filing requirements (including timeliness).

2. Another Option: A Tax Dischargeability Solution Based on Compromise

Bankruptcy is a compromise. Specifically, the Bankruptcy Code strikes a balance between the rights of creditors who are entitled to payment of their debts and the rights of debtors to have an opportunity to start over and become financially productive citizens again. The law pre-BAPCPA was generally understood to be a good example of this balance. It gave the IRS at least three years to pursue and collect from a debtor who owed taxes, while also recognizing that eventually tax collection would be futile and the tax debt should be treated as other unsecured debts and be subject to discharge.

With limited exceptions, federal and state tax filings are uniformly due on April 15th.[138] Courts have been concerned that the failure to file

138. If April 15th falls on a weekend, or conflicts with a recognized holiday, the

a tax return on time fails to deem the filed document a "return," when it would otherwise comply with applicable nonbankruptcy law. Under this current interpretation, this implies that a tax filing filed—even one day late—would not have been filed pursuant to applicable nonbankruptcy law (i.e., tax law), and would not be deemed a return and therefore would be non-dischargeable.

Based on the compromising nature of bankruptcy law, this silly and extreme result could not have been Congress's intent when drafting the hanging paragraph of 11 U.S.C. § 523. A better compromise may be available that would take into account the needs of the taxpayer-debtors and taxing authority creditors. This compromise would differ from the current extreme position taken by some courts that tax debt associated with late-filed returns is never dischargeable or a converse position that tax debt associated with late-filed tax returns is always dischargeable. Instead of operating within two extremes, a better policy would be to set an extended time in which late-filed returns can be dischargeable, coinciding with the six-year statute of limitations used to assess a tax deficiency.[139] Accordingly, if a taxpayer files a late return for a tax that was due within the six years prior to filing (and otherwise meets the other requirements of 11 U.S.C. § 523), the tax would be dischargeable.

From a policy perspective, this would balance the interests of the

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date on which tax filings are due can be delayed.

> When the last day prescribed under authority of the internal revenue laws for performing any act falls on Saturday, Sunday, or a legal holiday, the performance of such act shall be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. . . . [T]he term 'legal holiday' also means a Statewide legal holiday in the State where such office is located.

26 U.S.C. § 7503 (2016); Treas. Reg. § 301.7503-1 (1996). For example, in states such as Connecticut, Maine, Massachusetts, and Wisconsin, Patriot's Day (or the alternate spelling, Patriots' Day), which commemorates the first battles of the Revolutionary War, sometimes conflicts with the day on which tax filings are due, thus giving filers an additional day. *See* CONN. GEN. STAT. § 10-29a(78) (2018); ME. STAT. tit. 4, § 1051 (2017); MASS. GEN. LAWS. ch. 6 § 12J (2017); WIS. STAT. § 118.02 (2018); *see also Why the 2017 Tax Deadline Was Moved to April 18*, FOX BUS. (Feb. 16, 2017), http://www.foxbusiness.com/features/2017/02/16/why-2017-tax-deadline-was-moved-to-april-18.html [https://perma.cc/CR25-X4LV].

139. "The IRS normally must assess a tax deficiency within three years of the date a tax return is filed. However, if a taxpayer omits a substantial amount of gross income from a filed return, § 6501(e) extends the statute of limitations on assessment to six years." Joan L. Rood, *Congress Expands the Six-Year Statute of Limitations on Assessment*, BLOOMBERG NEWS (Oct. 15, 2015), https://www.bna.com/congress-expands-sixyear-n57982059483/# [https://perma.cc/67PV-68QF]; *see also* 26 U.S.C. § 6501(e) (2016).

IRS and the debtor. The IRS would have ample time to assess and pursue the taxpayer for all amounts owed, while also recognizing the debtor's need for a fresh start and the improbability of collecting on such a stale tax debt. This compromise would work to ensure fairness on both sides.

Again, this fix would require another amendment to the Bankruptcy Code, however the effects would be beneficial for the debtor and the IRS.

CONCLUSION

U.S. bankruptcy laws have consistently provided a safe haven to millions of honest and hardworking debtors who have fallen on hard times. In fact, the bankruptcy safety net has helped power our economy as it both encourages consumer spending and entrepreneurship, while also balancing fairness to creditors. This, in turn, allows debtors who have fallen on hard times to shed paralyzing debt obligations in order to once again become financially productive members of our society. As such, it is contrary to the debtor rehabilitation philosophy of the Bankruptcy Code that appellate courts have interpreted the hanging paragraph tax language in such a harsh and restrictive manner.

Congress mandates that debtors be provided a "fresh start," and there is a presumption of debt dischargeability. Denying relief for late-filed tax returns is antithetical to this instruction since it leaves the debtor paralyzed in a lifetime of financial constraint. Although the changes promoted by BAPCPA modified certain debtor eligibility, when considering the overall purpose of the Bankruptcy Code, the hanging paragraph language was clearly intended to apply only to substitute returns, not to all late-filed returns. This overly broad interpretation is contrary and harmful to the efforts of honest debtors seeking a fresh financial start. Since the courts have failed to apply the language in a correct and fair manner, Congressional action is necessary to most effectively remedy the judicial misunderstanding.

Further, adjustments to the Bankruptcy Code should either clarify Congress's intent to create an extreme (either late-filed returns are never dischargeable or are always dischargeable), or better yet, should impose a new rule that permits dischargeability after six years of the due date as a compromise that best works for all.

Although death and taxes will always be a certainty, congressional clarification of the 11 U.S.C. § 523 hanging paragraph will at least let us know if late-filed returns mean that we must in fact take our taxes to the grave.