THE BANKRUPTCY DISCHARGE WAR, PART III:
WISER MINDS PREVAIL IN THE 9TH AND 11TH CIRCUITS

I've written two previous articles discussing this question:

*Can a bankruptcy debtor discharge income taxes in bankruptcy **after** the IRS or state taxing authority has assessed taxes on a substitute for return ("SFR") or similar state "no-file" assessment.*

Until the late 1990s, those of us who are familiar with the bankruptcy income tax discharge rules would answer this question with a resounding "yes!" Since the Bankruptcy Code contains a provision allowing discharge of taxes on a late-filed return, as long as the return is filed more than two years before the bankruptcy is filed (11 U.S.C. §523(a)(1)(B)(ii)), all the debtor had to do was file his/her own return, signed under penalty of perjury, wait two years and then file a bankruptcy.

In the late 1990s things began to change. IRS began challenging income tax discharge on returns filed ***after*** IRS had already assessed tax on an SFR. The IRS challenges were mostly successful (*Hindenlang, Moroney, Payne,* and several other cases), but the issue was settled (or so I thought) when Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). The BAPCPA provision affecting discharge is a hanging paragraph usually labeled 11 U.S.C. §523(*). This statute defines a "return" for bankruptcy purposes as follows:

> 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 [essentially an SFR prepared by IRS and signed by the debtor under penalty of perjury], 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 [the SFR statute], or a similar State or local law.

When the 523(*) BAPCPA language became law, I thought the answer to the question posed at the beginning of this article was a firm "No, debtor you cannot discharge SFR income tax assessments even if you file your own return signed under penalty of perjury more than 2 years before the bankruptcy is filed." I also thought that since BAPCPA did not modify the 2-year-late-filed-return-discharge-rule in 11 U.S.C. §523(a)(1)(B)(ii), income taxes on returns ***filed at least 2 years before the bankruptcy AND filed before*** the IRS makes an SFR assessment would remain dischargeable. After all, that would be a simple rule to apply, it doesn't lead to absurd results, and it leaves the meaning of both 523(*) and 523(a)(1)(B)(ii) intact. I became even more confident that this is how post-BAPCPA discharge should be interpreted when I read Chief Counsel Memo (CCM-2010-016) which states that ***only post-SFR-assessment returns*** are nondischargeable per BAPCPA. Pre-SFR-assessment returns filed more than 2 years before the bankruptcy remain dischargeable.

Unfortunately, my interpretation of the post-BAPCPA discharge rule hasn't been too persuasive. Beginning with *In re Creekmore*, 401 B.R. 748 (Bkr. N.D. MS 2008), bankruptcy courts and Appellate Courts began focusing on the parenthetical phrase in 523(*)—a return for bankruptcy purposes "means a return that satisfies the requirements of applicable nonbankruptcy law (***including applicable filing requirements***)"—and simply ignoring the unambiguous language of 523(a)(1)(B)(ii) that allows discharge of a late filed return that is filed before the SFR is assessed and filed more than 2 years before the bankruptcy is filed. These decisions reach the absurd conclusion that a tax return that is filed late—whether it's one-day late or 10 years late—is not a return for bankruptcy purposes.

This conclusion, dubbed by some practitioners and by the 11th Circuit Court of Appeals "the one-day-late rule", has now been adopted by three circuit courts. See, *McCoy v. Mississippi State Tax Comm'n*, 666 F.3d 924 (5th Cir., 2012), *Mallo v. Internal Revenue Serv. (In re Mallo)*, 774 F.3d 1313 (10th Cir., 2014) and *Fahey v. Mass. Dep't of Revenue (In re Fahey)*, 779 F.3d 1 (1st Cir., 2015). Although it's not much comfort, Circuit Judge Thompson who dissented in *Fahey* called the majority's conclusion in *Fahey* "absurd" five separate times.

After the three disastrous Circuit Court opinions, we practitioners may now have a couple of rays of hope. In *Justice v. United States (In re Justice)*, 817 F.3d 738, (11th Cir., 2016) the debtor filed his income tax returns for tax years 2000 through 2003 in October 2007. The debtor's income tax returns were filed more than 2 years before his bankruptcy was filed, but the returns were filed after IRS had assessed taxes on SFR returns. Although the Circuit Court in *Justice* could have focused exclusively on the parenthetical language in 523(*) and simply adopted the one-day-late rule, it didn't. Instead the Court used the definition of a return developed by the United States Tax Court in *Beard v. Commissioner*, 82 T.C. 766 (1984); *aff'd*, 793 F.2d 139 (6th Cir. 1986). The four-part "*Beard* Test", which has been accepted by nearly every federal court in the country, states that in order for a document to qualify as a return:

1. It must purport to be a return;
2. It must be signed under penalty of perjury;
3. It must contain sufficient information to allow the tax to be calculated; and
4. It must represent an honest and reasonable attempt to satisfy the requirements of the tax law.

Using the *Beard* test as its non-bankruptcy law definition of a return, the *Justice* Court followed the lead of many pre-BAPCPA bankruptcy and appellate courts and concluded that since the debtor's returns were filed after IRS had gone to the trouble of preparing SFRs, sending the debtor many notices, including a statutory notice of deficiency, and assessing the tax against the debtor, the debtor's returns did not "represent an honest and reasonable attempt to satisfy the requirements of the tax law." Therefore, the debtor's returns, even though they met the two-year rule of 523(a)(1)(B)(ii), were not returns for purposes of bankruptcy and the tax assessed on the returns was non-dischargeable.

It is interesting to note that in the *Justice* case, the Court clearly stated that it did not agree with the narrow interpretation of those courts that have adopted the one-day-late rule.

> We assume, without deciding, that Congress did not intend to include filing deadlines when it required, in the hanging paragraph, that tax returns comply with "applicable filing requirements." Even making that assumption, however, we hold that Justice's late-filed Forms 1040 do not qualify as tax returns under the *Beard* test".

I think I know where the 11th Circuit is going if faced with a pre-SFR assessment dischargeability case. But, unfortunately, it seems to me that there is still no split in the Circuits regarding the one-day-late rule, because the 11th Circuit decided the case solely on the basis of the *Beard* Test.

One other recent case, *Smith v. IRS (In re Smith)*, Case No. 14-15857 (9th Cir. July 13, 2016) is also worth mentioning. In *Smith* the 9th Circuit Court of Appeals had facts that were almost identical to *Justice.* The debtor in Smith filed his own returns after IRS had assessed income taxes on SFRs. In a very short opinion focused solely on the *Beard* Test, the Court held that the taxes were non-dischargeable because the debtor's returns did not "represent an honest and reasonable attempt to satisfy the requirements of the tax law." I would note that *Smith* doesn't mention the one-day-late rule or anything about the parenthetical provision in 523(*) regarding "applicable filing requirements."

So where does that leave us? Unfortunately, it leaves us still twisting in the wind waiting for a case that squarely presents the question: ***Can a debtor discharge taxes on a late-filed return filed before an SFR assessment AND filed more than 2 years before the bankruptcy***? As an attorney who has fought the bankruptcy discharge war for more than 20 years, I yearn for such a case to be presented to a thoughtful Circuit Court, a court other than the 1st, 5th or 10th Circuit. I want this to happen almost as much as I want the Cubs to win the World Series.