American Bankruptcy Institute Law Review

Volume 3 Number 2 Winter 1995

CONGRESS'S ROLE IN BANKRUPTCY TAX POLICY: A ROUNDTABLE DISCUSSION

Introduction

MR. WILLIAMS: Welcome. Let me begin this Roundtable discussion by introducing our distinguished participants. Steve Csontos is from the Tax Division of the Department of Justice and has extensive experience in the litigation of bankruptcy and tax issues; Carmen Eggleston is from Price Waterhouse and specializes in insolvency taxation; the Honorable Polly Higdon of the District of Oregon Bankruptcy Court and chair of the ABI Taxation Committee; Robin Phelan, ABI President and attorney with Haynes and Boone in Dallas, Texas; and, James Shepard a bankruptcy tax consultant in Fresno, California, member of the Bankruptcy Review Commission, and a frequent lecturer on bankruptcy and tax issues.

I want to begin today's discussion by first providing a brief contextual overview. Our topic is "Congress's Role in Bankruptcy Tax Policy," a formidable topic, indeed.

I. Overview

What we plan to do is address this topic through specific recurring law and policy issues. Bankruptcy and tax issues are rising with increasing frequency. [1] One need only peruse the advance sheets to witness the increase in reported bankruptcy tax cases. Part of the interest in this subject of bankruptcy taxation is generated by the juxtaposition of bankruptcy and its policies against tax law and its policies. [2] Oftentimes, these bodies of law and policy dramatically conflict. [3]

The Bankruptcy Code contains explicit references to taxes; for example, sections 346, [4] 728, [5] 1146 [6] and 1231 [7] speak to tax issues. However, these provisions are limited to state and local taxes. [8] For federal tax purposes, one must consider the Internal Revenue Code ("IRC"), specifically sections 108, [9] 1398 [10] and 1399. [11] As we will soon discuss, the treatment of the two regimes regarding federal taxes on the one hand, and state and local taxes on the other, is inconsistent and imposes its own problems. [12]

Amendments to the Bankruptcy Code in the 1994 Act [13] also have had a dramatic effect on tax collection and the tax collector. [14] We will discuss those issues as well. Moreover, within the last couple of years, Congress repealed the stock−for−debt exception to the recognition of cancellation of indebtedness income. [15] That issue will also be addressed. [16] This Roundtable discussion is intended to elaborate on these issues and more particularly to probe the deficiencies of bankruptcy and tax law and the policy behind insolvency taxation as presently framed. To start the discussion, let me pose my first question to the panelists.

II. Emerging Importance of Bankruptcy Taxation Issues

MR. WILLIAMS: How important is the treatment of taxes and the tax collector to any bankruptcy system?

MR. PHELAN: It didn't use to be. But, I think the tax collector has now come to the realization that there are significant (a) taxes to be collected in connection with bankruptcy cases, (b) tax policies that they feel need to be made through aggressive action in bankruptcy cases, and (c) tax benefits which can be eliminated in bankruptcy cases which will allow for future collections for the tax collector.

MS. EGGLESTON: In line with that, you also have more aggressive stances being taken on behalf of pension liabilities. There have been claims that have been filed, in some cases, that have been very significant where the plans have not yet been terminated. Those issues need to be dealt with and they become significant in terms of confirming a plan.

MR. WILLIAMS: So, for the private bankruptcy practitioner, bankruptcy and tax become important because it's becoming more important to the tax collectors. The more aggressive the tax collector is, the more important it becomes to respond to that aggressiveness.

MR. PHELAN: Tax ramifications can't be ignored, because the government doesn't ignore it. A number of years ago, both the government and the practitioners ignored the tax ramifications to a large degree. [17] It just slid through the cracks. It doesn't fall through the cracks anymore.

MR. SHEPARD: Under the Bankruptcy Code, there has been a significant change in the amount of relief that is provided for debtors. As a result, debtors' counsel have become far more aggressive. I think that the taxing authorities have had to respond to that, at least, to protect revenue. That has created a massive change between the Bankruptcy Act of 1898, and the Bankruptcy Code.

JUDGE HIGDON: As a judge, I've seen tax knowledge take the same learning curve that I've seen other knowledge take in practicing under the new Bankruptcy Code. That is, in the beginning, we were all learning. The practitioners were learning. The tax authorities were learning. Judges were learning. Everyone's knowledge has increased in all aspects of bankruptcy. And, this is true of tax matters. I would say now, after fourteen or fifteen years, the IRS and, to a lesser extent, but more and more every day, the state taxing authorities are really becoming aggressive players in the system.

MR. CSONTOS: Before the Bankruptcy Code taxing authorities would sit back, in many respects, and wait because many of the taxes were not subject to discharge. [18] After the bankruptcy was over, if there was anything left to collect, the authority would come in and its rights would be protected. [19] That's not the case any longer. [20] It seems to me that to the extent that the Bankruptcy Code was intended to force the government to act more like a private creditor to protect its rights, [21] it has done so. I think that there are still areas where the government cannot protect its rights in the same way that a private creditor can, but that's another issue that maybe we will get to later.

III. Tax Compliance Issues in Bankruptcy: Administrative Tax Claims

MR. SHEPARD: The other thing that has developed is not as much a result of the Bankruptcy Code as the Bankruptcy Tax Act of 1980, [22] and that is the treatment of administrative claims. [23] I think the learning curve on that is even slower for the debtors, trustees, and government tax enforcers. This has brought a big change in what's happening. You see that more from the standpoint of accountants, possibly, doing returns. But, there is growing litigation in that field.

MR. WILLIAMS: Could you be more specific about the administrative claims issues?

MR. SHEPARD: There is a lot of litigation as to priority [24] and a lot of tax cases coming up as to *ad valorem* property taxes because of the nature of the assessment or lack of assessment. [25] A lot of states do not even define their procedures, including procedures for assessment.

The trustees' returns in Chapter 7 cases [26] are causing problems because of the section 505(b) discharge. [27] What does it really mean? Does a trustee get a discharge? Or, is it the estate that gets the discharge? In spite of the language of the Bankruptcy Code, there's a significant question. [28] And, a lot of things like that are coming up that would not have come up under the Bankruptcy Act or prior to the Bankruptcy Tax Act of 1980.

JUDGE HIGDON: Jim drew my attention the other day to a new case out of Illinois that is right on point with that, *In re Markos Gurnee Partnership*, [29] where the taxing authorities were attempting to hold the trustee personally liable for post petition administrative taxes arising out of failure to send the withholding taxes into the government. [30] They had

a trust issue first which they had addressed in a companion case. [31] Then before the court was a question of potential personal liability versus official immunity. [32] That all arose within the context of an administrative claim. [33]

MR. SHEPARD: The section 505(b) issue was not even raised in that case.

IV. The 1994 Amendments to the Bankruptcy Code

MR. WILLIAMS: The 1994 amendments to the Bankruptcy Code attempted to address some of the pressing, recurring tax issues posed in bankruptcy. [34] Steve, did the government get what it wanted in the 1994 Act?

A. Assessment of Taxes in Bankruptcy

MR. CSONTOS: The automatic stay relief for assessment of taxes [35] was at the top of the list that the IRS and the Tax Division had put together. It was one that we thought did not necessarily involve the most money of the issues that were on our list. But, from the standpoint of administrative importance, it was certainly the top issue. The IRS computer is a key to the assessment of a tax liability. [36] With the prohibition on assessment, it meant that the IRS had to manually track all of these accounts. They had trouble with posting payments to the accounts. They had trouble with determining when the stay was lifted so that the time for assessment was no longer suspended. The statute of limitations [37] was no longer suspended. It created all sorts of headaches for the IRS and, I'm sure, for other taxing authorities. Back in 1983, the General Accounting Office ("GAO") identified this as an amendment that should be made. It took us a while, but eventually we got it. It includes some strange language about the secret lien that is created whenever a tax assessment is made and attempts to negate the secret lien except as it might be applied to a non dischargeable tax *vis−a−vis* that debtor. [38] But, we were very happy to see that Congress took our advice on that issue and adopted the amendment.

MR. SHEPARD: Could you explain to this group, then, how that amendment affects the priority of taxes under section 507(a)(8)(A)(iii), [39] the not assessed but assessable rule, and the dischargeability of those taxes? I am concerned about the serial bankruptcy filing because the assessment is no longer prohibited.

MR. CSONTOS: I think that it works with section 507(a)(8)(A)(iii) because I think you look at that as of the date of the bankruptcy. I think that was the measure of tax assessable on the petition date. So I don't think that the amendment changes the result with respect to that tax priority or the dischargeability. I'm not sure I worked through all of the ramifications of it.

JUDGE HIGDON: Have you worked through the impact on the statute of limitations under section 6503 [40] of the IRC and section 108 [41] of the Bankruptcy Code, of the fact that you can now go forward and assess?

MR. CSONTOS: I don't think it has any impact, because I think that the suspension of the statute of limitations in section 6503, had two parts to it. One was suspension of assessment and the other was suspension of collection, [42] I think you could probably read them together if you were trying to aggressively read these provisions. But, I think there were two separate parts. I think that the legislation took care of the assessment part of it, so that's off the table. I think that it negated the fact or the reason for having a suspension of the statute of limitations on assessment of tax. You still have the suspension on collection. That's going to protect the IRS during the pendency of the case.

JUDGE HIGDON: Well, that's kind of the way I had looked at it. But, I didn't want to issue any rulings on it until I talked to you, Steve.

(Laughter.)

MR. CSONTOS: Well, that's not to say that there won't be some aggressive Tax Division trial attorneys who take a different position when the case gets in litigation. But, I think the fair reading of it is that it was intended in the fashion that I have described.

MR. SHEPARD: Does this give debtors' counsel the opportunity to argue that they should be able to compel a taxing authority to assess a tax post petition; for instance, in a Chapter 11 setting to be able to buy a six−year stretch [43] out of the taxes under the plan? If they are not assessed, can they do it or not?

MR. CSONTOS: I think that we've always resisted the thought that the IRS could be forced to do anything.

(Laughter.)

MR. CSONTOS: I think that most of the courts that have looked at the six−year stretch out have determined that if the tax was not assessed at the time that the plan was confirmed that it would be six years from the confirmation of the plan. [44] That hasn't been a major problem. We've talked about a stretch out, there are some problems with the stretch out, but I don't think that's a major one.

JUDGE HIGDON: I've looked at that. And, my conclusion is that there is no alternative other than the six year treatment.

MR. PHELAN: Sure there is. It's six years, and I start my payments whenever you get around to assessing.

MR. CSONTOS: You couldn't be forced to make payments prior to assessment.

MR. PHELAN: That's right. It's six years. But, by God, you get your first check, Mr. Taxing Authority, when you get around to assessing.

JUDGE HIGDON: You make the assessment as to confirmation, whether or not section 1129(a)(9)(C) [45] applies, as of the date of confirmation. If it has not yet been assessed, you still, as the judge, have to put that debt in some slot within the Bankruptcy Code provisions. What other slot is there? It's not a secured claim. [46] It's not a general, nonpriority claim. It has to go in the priority slot. [47]

MR. PHELAN: It does, because it falls within section 507(a). [48]

JUDGE HIGDON: And the only treatment under section 1129 for priority claims is section 1129(a)(9)(C). [49]

MR. PHELAN: Right. I can pay it over six years after the date of assessment. When the taxing authority gets around to assessing, that's when I will start paying it.

MR. WILLIAMS: You are looking at the timing of the payment.

MR. PHELAN: Right.

JUDGE HIGDON: My question wasn't timing. My question was whether or not the six year period applied. I think it must. As from when that period starts to run, that's another issue.

MR. WILLIAMS: Steve, have the amendments to section 362(b)(9) [50] rendered superfluous or redundant the provision in section 505(c) [51] that permits immediate assessment in certain circumstances. Section 505(c) allows the immediate assessment by the governmental unit of a tax where the court has made a determination of that tax under section 505.

MR. CSONTOS: I think it may be mostly superfluous as a result of this.

MR. SHEPARD: Section 505(c) was specifically intended to allow them to assess administrative taxes primarily, [52] although it may also apply under section 505(a) to the debtors' taxes. But, I think the section 362(b)(9) amendment [53] was to cover the debtors' taxes. So, the purpose may have been slightly different. But, maybe they do address the same issue.

JUDGE HIGDON: Before we move on to that, could I address one other thing or have Jim address one other thing? He made a point to me the other day that I think we need to put on record here because we don't have a representative from the state taxing authorities before us today around the table. That was the particular problems that the language of section 362(b)(9) [54] creates or doesn't address, more appropriately, for certain state taxing authorities. Many states don't have dates of assessment in their statutes.

MR. SHEPARD: State income tax provisions, particularly after a federal audit where states piggyback [55] on federal tax collection but may also require a return, frequently do not have language couched in terms of an assessment. They have some other way to fix the liability. States are having a great deal of trouble now, and I don't think that the section 362(b)(9) amendment is going to help them. They are struggling to come up with a solution to this problem. Decisions are coming down against the states on the dischargeability issues that are tied to the new return requirement and, in many cases, the decisions are saying that there's only one return required for dischargeability. I think states are still going to be struggling with this problem of dealing with a lack in their state law terminology specifying assessments.

JUDGE HIGDON: And, whether or not under the particular terms of their state law, they can go forward and do what they need to do.

MR. CSONTOS: Except the problems have been that section 362 said the taxing authority couldn't assess. [56] In fact, the 1994 amendment went a little bit beyond that, because it also talked about permitting an audit to go forward. [57] I don't think there was any big problem with that. But, I think there have been some debtors or their counsel who may have threatened to hold the taxing authority in contempt if they did an audit. Similarly, I think, that there were, at least occasionally, some threats that demands for tax returns were violations of the stay. Except that although it's not mandatory, it's required by statute. [58] So, a couple of other things were taken care of. I certainly would argue vigorously that if a state didn't have an assessment provision it seems to me that they are entitled to go forward and fix their liability under old law.

MR. SHEPARD: Regardless of the terminology.

MR. CSONTOS: Right.

MR. SHEPARD: I think one of the problems is timing. It certainly has been litigated many times. [59] There is no bright line in these cases, and it may foster further litigation.

B. Late−Filed Claims in Bankruptcy

MR. WILLIAMS: Those are very good points. I'd like to turn now to the issue of late−filed claims. We have two lines of authority on how the late−filed claim is to be treated in bankruptcy. The *Tomlan* [60] */Zimmerman* [61] line of authority and the *Hausladen* [62] line of authority. In the *Tomlan/Zimmerman* line of analysis, an untimely filed proof of claim is a ground for disallowance. [63] Contrast that with *Hausladen*, which exemplifies the contrary line of authority, that would hold that tardiness is not a ground for disallowance listed under section 502. [64] It is, in effect, a subordination under section 726, [65] if we are talking about a Chapter 7 case; or, a nondischargeable claim in Chapter 13, which ties as one of two types of debts that are discharged, those that are disallowed under section 502. [66] In 1994, Congress amended section 502(b). [67] If you read the legislative history, it specifically states it was designed to overrule *Hausladen*. [68] I have a twofold question: Is that a good idea? And did they do it?

MR. SHEPARD: I think a preliminary question, at least in my mind, has been what is the effect of the rules. Are they given force of law or are they merely advisory? There seems to be a split of opinion, certainly in this case, as to whether the rule is jurisdictional [69] or whether it's merely a bankruptcy rule [70] which can be avoided or not followed in all cases. You've seen the discussion of other rules where it seems that they are saying they are advisory or very loosely applied. [71]

MR. WILLIAMS: You are talking about Bankruptcy Rule 3002 [72] and how it plays into the debate on late−filed claims.

JUDGE HIGDON: Whether it's substantive or procedural?

MR. SHEPARD: Yes.

MR. PHELAN: I thought, at least in some of the cases, especially the newer one, the *Chavis* [73] case out of the Sixth Circuit, that they came to the conclusion that the rule conflicted with the statute. [74] As a result, when you have the rule and the statute and they conflict, then the statute prevails. [75] Then you have to go with the statutory language. [76] The amendment to section 502 is designed to eliminate that issue so that an untimely filed tax claim is now going to be disallowed. [77] There's some different time periods to accommodate the taxing authority's antiquated computer. [78]

JUDGE HIGDON: The *Zimmerman* court pointed out that rules have always been used to create procedural processes to implement the substantive law. [79] The court did not feel that a statute of limitations procedure was different from any other type of procedure for implementing the substantive law and allowance of claims. [80] Whether or not they are correct I think is now a moot issue in light of the 1994 amendment. [81] The amendment reflects the position that, whether or not the rule was substantive or procedural, for clarification, treatment of late claims should be put in the Bankruptcy Code itself.

MR. SHEPARD: My question is: Is it a fix or is it just a temporary patch? Did it resolve the problem? Will we avoid litigation? Are needs met?

JUDGE HIGDON: I think you have to ask whose needs. It addressed the administrative needs of the bankruptcy system, certainly with some of the courts' problems with administrative delay, particularly in Chapter 13, which needs to get off the ground quickly and start moving through the court process. But, it didn't address the needs of the taxing authorities who still have a lot of problems.

MR. SHEPARD: The state taxing authorities, particularly, because of this piggyback on the federal audits, don't even know they have a claim until the federal audit is complete.

MR. PHELAN: You get a countervailing policy here, particularly in Chapter 11. If the taxing authority can come winging in long after the bankruptcy plan is confirmed, even with a subordinated claim, it makes the stock that the debtor issued in connection with that Chapter 11 plan not worth very much if they then come in with a gazillion dollar claim two years after the case is confirmed. You have to have some finality. The rationale is this: If you don't reorganize under Chapter 11, then you are going to liquidate under Chapter 7. [82] At some point, that trustee is going to write checks, and when the taxing authority comes in two years after the trustee writes the checks there is not going to be any money there. And, since a Chapter 11 is really an alternative to a Chapter 7, it's not really unfair to say, "You wouldn't get any money in a Chapter 7, therefore, we are going to require some type of finality so people can get on with their economic lives."

JUDGE HIGDON: Well, that's true of all chapters. In Chapter 13, the problem is that priority claims have to be paid in full. [83]

MR. CSONTOS: But, the numbers aren't in the Chapter 11s. The numbers are in the Chapter 7s and Chapter 13s.

MR. CSONTOS: The number of cases?

MR. PHELAN: Right. But in terms of the numbers of dollars, if I've got a 200 million dollar Chapter 11 floating around out here and I'm issuing stock to these creditors, then they are going to want to know that the government isn't going to show up and say, "Hi, you owe half a billion dollars for a reverse convertible sheep tax or something that we thought you didn't have."

MS. EGGLESTON: It goes also to that whole issue of whether you are going to confirm a plan that is ultimately not feasible. [84] A lot of companies are now going to be coming out with a lot more debt, especially since the repeal of the stock−for−debt exception, and there are going to be incentives to put more debt on companies. So even if you have a taxing authority that can come in after the fact and have their assessment allowed, you may not have a debtor that is

going to be able to pay that assessment.

JUDGE HIGDON: Well, feasibility is a finding the court has to make in Chapter 13, [85] too. How can you do it if claims are allowed no matter how late they are filed?

MR. WILLIAMS: Back to the language of the amendment of section 502(b)(9), which was section 213 of the 1994 Act. [86] Couldn't the death of the *Hausladen* rule be greatly exaggerated here? You have the 1994 Act, which adds this language that a substantive ground for disallowance is that the proof of claim was not timely filed. [87] I think that language alone eliminates the *Hausladen* problem. But, the amendment continues. It states that, "except to the extent tardily filed as permitted under paragraph (1), (2) or (3) of section 726(a)." [88] Doesn't that resurrect the *Hausladen* issue?

JUDGE HIGDON: I think it resurrects the problem in Chapter 7. I think that there is a way of eliminating it in Chapter 13, thank goodness, because I do a lot of Chapter 13s. I say this selfishly, strictly from a bankruptcy administrative point of view. I am generally terribly sympathetic to the taxing authorities' problems.

MR. PHELAN: But, you've got a specific provision in Chapter 7 that says if you file a tardy claim with your taxing authority or, you know, Leroy Brown, you can have your claim and get your money before the debtor gets any money back.

MR. WILLIAMS: Right. But, there is no disallowance. It's a subordination. [89] Although, in effect, it may be the same thing in many cases.

MR. CSONTOS: But, it's not even a subordination if it's a priority claim.

JUDGE HIGDON: That's right. And, that has been recognized in the Ninth Circuit, too. [90]

MR. WILLIAMS: I think as to the priority issue, we have the clearest resolution. But, as to the other issue, the unsecured claims that are not timely filed, it's an amendment to section 502(b)(9) and not just section 726.

MR. PHELAN: I think its relatively clear that they are not trying to amend section 726.

MR. CSONTOS: It actually fits them together in a way that they didn't fit before.

MR. PHELAN: It's not a problem.

MR. WILLIAMS: It is a ground for disallowance, although the ultimate effect is subordination.

MR. PHELAN: No. It's a carve out from the disallowance. You disallow it except to the extent that you can get it before the debtor gets some money back under section 726. [91] That, I think, was the intent of Congress. I think it's relatively clear from the amendment.

JUDGE HIGDON: As long as we are talking in this area, I wanted to raise an issue which I was looking at yesterday. When we do a Chapter 13 and we come to the confirmation hearing, a court has to determine whether or not in this case, the potential distribution meets the best interest of the creditor's test, [92] which immediately then focuses back into Chapter 7.

What do we do with the treatment of late claims under those circumstances, given the "excepted" language we've been discussing under section 502(b)(9)? Fortunately, I think the language of section 1325(a)(4) can be interpreted to require the court to take into consideration for purposes of that test, only claims which would be allowed in the Chapter 13 process. Therefore, if late claims are automatically disallowed through that process we need not worry about the "excepted" language of section 502(a) which recognizes the allowance of late claims in Chapter 7. But, you need to have a system in place whereby late claims automatically are disallowed in Chapter 13. Otherwise, you are going to have to take late claims into consideration for both your feasibility analysis under section 1325(a)(6) [93] and

your best interest analysis under section 1325(a)(4). [94] This creates almost an impossible situation because you do not know where you are with the claims at confirmation.

MR. PHELAN: Don't you make your feasibility analysis based upon the information that is available at that time? You can't predict the future. Feasibility is a guess based on the information available to the court at the time it makes a feasibility analysis. [95] You never know what's going to happen in the future.

MR. SHEPARD: Then what's the effect of an allowed late claim?

MR. PHELAN: The effect of an allowed late claim is an allowed late claim. Just like in Chapter 11, you make a feasibility determination. If three months later the market crashes for, for example, purple widgets, and the debtor can't make its payments, that's the way it goes.

MR. SHEPARD: What is the solution, then, with regard to the Chapter 13 that is in place and a late claim comes in? Many Chapter 13s are filed intending to be fast track. Debtors list the taxing authorities' claims at a minimal amount and hope to get the plan confirmed. Under the procedure now, there is a question as to the effect of the late claim?

MR. PHELAN: You have to modify the plan. [96] You have to file a motion for a rehearing. There are procedural avenues. [97]

JUDGE HIGDON: Essentially what you are saying is that if late claims are allowed in Chapter 13, ignore both the best interest test and the feasibility question at the time of the confirmation hearing. We assume that these requirements of section 1325 are met. Then down the road if a late claim is filed that messes the plan up, then we look at it again. That seems to me contrary to the Bankruptcy Code language.

MR. PHELAN: You can't assume there is going to be a late claim. That's not before you at the time you make a determination.

JUDGE HIGDON: We can't assume anything, including feasibility and best interest, unless we somehow cut off those claims. My partial solution is to have a provision in the form plan and order which the District of Oregon uses. The provision will be simply to disallow all late claims that are filed in the case.

MR. CSONTOS: Of course, the tax claim won't be late anymore if it's filed within 180 days. [98]

JUDGE HIGDON: I understand. I am talking about beyond that. One has problems beyond six months, although the 180 days is going to cause some problems, too.

C. Retroactive Waiver of Sovereign Immunity

MR. WILLIAMS: If we can move on to a very intriguing part of the 1994 Act that involves not only the waiver of sovereign immunity under section 106 [99] but its retroactive application as a model of legislation. [100] With the Bankruptcy Review Commission coming on line and a movement in Congress to maybe revisit some of the fundamental aspects of the Bankruptcy Code and bankruptcy policy in this country, I think it would be interesting for the panelists to consider retroactive application of the new legislation, in particular, to the waiver of sovereign immunity.

MR. CSONTOS: It seems to me that Congress has certain powers when the United States government is on the receiving end of its legislation that Congress would not have with respect to the rights of the debtor and private creditors. And, I think that this particular piece of legislation, the sovereign immunity waiver, had a history to it. The history was that some felt that the courts had incorrectly defined the original will of Congress in the 1978 Bankruptcy Code. In order to correct what the courts had done, it was necessary to do this. To do it most efficiently, it was necessary to do it on a retroactive basis. It was, what I will call, pure politics. This is something that a member of Congress wanted. He was on the Judiciary Committee. It was the one thing in the bill that he was interested in. And, he was able to work his will with respect to it despite forceful opposition from some folks in the Administration.

JUDGE HIGDON: We aren't going to get any names to spice up this story?

MR. CSONTOS: No, I don't think so.

(Laughter.)

MR. CSONTOS: You know, this is, of course, much broader than the tax collector. The tax collector is on the receiving end of many sanction awards as a result of violations of the automatic stay and is a prime target of this. [101] But, it cuts across the board; it's not just the IRS, it's all agencies of government. So, I'm not sure how good an idea it is to spend a lot of time on this because it really is not tax specific. Obviously, the IRS was hit by it. Congress did give some allowances to the United States and other government agencies by capping the amount of attorneys fees that can be awarded and by putting a limitation on, or preventing, punitive damage awards which some courts had imposed on the government. [102]

JUDGE HIGDON: I assume the reason it's on the agenda today is because, as a bankruptcy judge, I have seen, probably nine times out of ten, that it has been the taxing authorities that have been involved in the most egregious instances of keeping more than their fair preferential share of the debtors' limited assets, with the Supreme Court's blessing. [103] They got something and they were darn well going to hang on to it. It was very, very frustrating, particularly in light of the fact that oftentimes these were significant amounts of money for the estate. I assume that's why this is on the agenda today.

MR. SHEPARD: What I hear you describing is a power struggle in which the taxing authority lost; is that correct?

MR. PHELAN: Well, what happened was the guys with the sharp fangs and the hobnailed boots would come out and take whatever they wanted, and there wasn't anything the courts could do about it under *Nordic Village*. [104] I've got to say that I agree with the dissent in *Nordic Village*. [105] The whole concept of sovereign immunity was derived from the old English common law. [106] And, we ain't got no kings no more.

MR. SHEPARD: Of course, there are different views on the source of sovereign immunity. [107] My question really goes to the heart of the thing. Should this have been a power struggle, if that's what it was?

MR. WILLIAMS: I would weigh in with Steve. The way I read it−and I was not directly involved in it−it was a power struggle not between committees of the House and the Senate but a power struggle between the legislative and judicial branches. The legislative branch was reacting quickly to the issue of what, at least a group of them, perceived to be a misinterpretation of section 106 when they thought they were pretty darn clear about the waiver in section 106. [108] I bring it up for two reasons: One, the retroactivity issue because it's one thing to apply a new rule prospectively only. And, at least, according to the Supreme Court, the new section 106, in the 1994 Act, would be perceived as a new rule. It's a waiver of sovereign immunity that's unequivocal and includes a waiver as to money damages. [109]

Two, the problem that the 1994 Amendments pose is what does retroactivity mean exactly? We know what kind of cases we are talking about but, for example, there are now stances being taken by practitioners within the Eleventh Circuit that the statute of limitation periods for avoidable preferences which had originally run against the IRS, because they weren't brought under the *Nordic Village* standard, are somehow resurrected. In other words, when you have a retroactive waiver of sovereign immunity, it resurrects the cause of action. [110] Is a model of legislation that includes retroactive application of new rules a smart idea?

JUDGE HIGDON: You have addressed several different issues there.

MR. WILLIAMS: My question was primarily whether this is a good model of legislation?

MR. CSONTOS: Absolutely not.

JUDGE HIGDON: I'm thrilled with it myself.

MR. PHELAN: As a model legislation, I've got to agree with Steve. They should have just put down, "Ain't no more sovereign immunity," instead of fourteen provisions. Justice Scalia will come in there and decide they are contradictory again. With respect to retroactivity, you certainly could delineate it a little better than they have if you deem it so important that it has to be retroactive.

JUDGE HIGDON: The first thing that we needed to do, and they did it, was make it quite clear that Congress is abrogating sovereign immunity for both the federal and state entities. [111]

MR. WILLIAMS: All right, to the extent Congress may have that power to waive sovereign immunity on behalf of the states.

JUDGE HIGDON: To the extent that they can, Congress is doing it. And, they use that word. I love the clarity of that. Maybe they made an error, but they attempted to include every section of the Bankruptcy Code that might at all be−

MR. PHELAN: Yeah, then they go muddy it up by adding sections. Whenever you add something that should be simple you create complexity for which clever lawyers can find inconsistencies.

JUDGE HIGDON: That could be. But, the intent couldn't be clearer, [112] which I like. There are still some issues that remain outstanding under the new language. But, certainly the question of abrogation and whether Congress intended to do that has been put to rest. Whether Congress has the authority to abrogate the states' immunity is the big issue that still remains. [113]

MR. CSONTOS: You know, now we are actually going to have to try those preference cases.

JUDGE HIGDON: Did you know that there was a case that came down just the other day out of North Carolina by Judge Tom Small? Are you familiar with this case, *Sparkman*? [114] This was a fraudulent conveyance action against Florida in which Judge Small directly addressed−and he couldn't avoid it because it was the only issue before him−whether or not the federal government had the constitutional authority to abrogate sovereign immunity as to the state. [115] His response was yes. [116] He adopted the rationale in another case called *McVey* [117] out of the Seventh Circuit in 1987, wherein the court analyzed this constitutional area of law very, very carefully and reached the conclusion that Congress could, in fact, do this by statute. [118] The court concluded that under the Constitution, Congress has plenary authority over federal law questions and the Eleventh Amendment was never intended to eliminate or impose upon that authority. [119] So we now have, already under the Bankruptcy Reform Act, the first case which raises this issue under the federal plenary bankruptcy power. The issue in the *McVey* case came up under the Commerce Clause. [120] But, the Bankruptcy Clause [121] is right there along with the Commerce Clause, as a federal power.

MR. WILLIAMS: But, recall Justice Scalia's concurrence in *Hoffman*, [122] that you don't have to reach the section 106 issue because a state authority was involved. [123] His conclusion is that the Eleventh Amendment prohibits Congress from waiving sovereignty. [124]

JUDGE HIGDON: I know that.

MR. WILLIAMS: So there is one vote against Judge Small.

JUDGE HIGDON: Yes. I think that this issue is going to be resolved, not by bankruptcy practitioners, but by constitutional lawyers.

D. State/Local Taxes and Abandonment

MR. WILLIAMS: With that, let's leave the issue of sovereign immunity and address the issue of what I call the normalization of federal and state and local taxes. In particular, we will be looking at several provisions in the Bankruptcy Code that attempt to address state and local tax issues and practice. [125] We will also consider the issue of the tax consequences of abandonment. [126] One of the things that I would like you to focus on in your discussion is the tension in the House and Senate regarding the tax provisions of the Bankruptcy Reform Act of 1978.

MR. CSONTOS: I guess I still have a question about the authority of Congress to tell the state tax collectors what their tax systems *vis−a−vis* debtors in bankruptcy ought to look like. The taxing provisions of Title 11, sections 346, [127] 728, [128] 1146 [129] and so forth, are among the most curious statutes that I've ever seen, because the legislative history says something to the effect that the Congress intends to pass these pieces of legislation applying only to state taxing authorities for study purposes because the Ways and Means and Senate Finance Committees are going to be taking up the federal side of it and all of this will be straightened out shortly. [130] Of course, that was in 1978 when the Bankruptcy Code was enacted. Here we are a few years hence and the Congress has never taken up the challenge of trying to straighten out the two systems. I think that sections 346 and 728, 1146, in some respects, weren't a bad first cut or first draft, if you will. I think that Congress did a little bit better when they put section 1398 [131] together, which is not without its own problems. But, it is something that Congress ought to go back and fix. As long as Congress doesn't give broad, declaratory judgment authority so that the bankruptcy courts can drag the IRS and the Tax Division in trying to project future tax consequences, it will be−

MR. WILLIAMS: Or reaffirm that authority based upon one's point of view.

MR. CSONTOS: Well, based on your point of view.

(Laughter.)

MR. CSONTOS: That's my one caveat, which is currently in section 1146 limited to state and local taxes. [132] I would definitely not like to see that broadened. I know there are some in the bankruptcy community who might disagree with my viewpoint on that issue. [133]

MR. SHEPARD: The legislative history to the special tax provisions of the Bankruptcy Code clearly state they are nothing more than policy to be studied by bench and bar in anticipation of the Bankruptcy Tax Act. [134] Unfortunately, as you say, nothing has ever been done with those provisions since the adoption of the Bankruptcy Code. The number of places where they are inconsistent with the Internal Revenue Code is significant. I don't know how many specific inconsistencies have been identified, maybe fifteen to eighteen. My real question is, how in the world can you impose any system on somebody else's system and make it work, whether they have the authority or not?

MR. PHELAN: Simple. The Constitution says you can have uniform laws regarding bankruptcy. [135] It seems to me it's a natural corollary that you can issue a discharge and you can say, "This debtor is discharged from everything, including taxes," period, end of sentence. And, if you want to play in the bankruptcy game, State Taxing Authority, here are the rules you have to play by. If you don't, fine. Then, the guy just gets a discharge. I think *Ketchen v. Landy* [136] is consistent with that.

MR. SHEPARD: But, that doesn't make the system work.

MR. PHELAN: It works. The debtor gets a discharge, the creditors get their money and the taxing authority gets screwed. That works, doesn't it?

(Laughter.)

MR. CSONTOS: There are some who have thought that has been the game. I'm glad you have affirmed it.

(Laughter.)

MR. PHELAN: It sounds fair to me.

(Laughter.)

JUDGE HIGDON: Obviously, Robin is not the one that has to fill out and file these tax returns, analyzing and agonizing over each and every provision of the Bankruptcy Code where it conflicts with section 1398 of the Internal Revenue Code. That is the problem. I sympathize with these people that actually have the responsibility of taking care

of that.

MR. PHELAN: I live in a non−communist state that doesn't have a state income tax.

(Laughter.)

JUDGE HIGDON: I wanted to ask you, Jim, what you thought about this: section 346(a) indicates it is subject to the Internal Revenue Code. [137] This says to me that the Internal Revenue Code provisions take priority over the Bankruptcy Code provisions where there is a conflict. [138] Couldn't you interpret this language of section 346(a) to simply authorize you to file your returns in uniformity with provisions in the Internal Revenue Code?

MR. SHEPARD: There's two ways to read section 346(a): One is as you are reading it which, quite frankly, is the way I have read it for quite some time, that section 346(a) says these rules apply subject to the Internal Revenue Code of 1986 and, therefore, it would appear that where anything in section 346 contradicts with the Internal Revenue Code, the rules in the Internal Revenue Code apply. Ken Klee [139] straightened me out, though. He said, "No, that wasn't the intent of this," and Colliers, I believe, backed him up, [140] that what they really meant in section 346(a) is that for state income tax purposes all of the special tax provisions apply but for federal tax purposes the Internal Revenue Code applies. [141]

JUDGE HIGDON: If we are wrong, then Congress absolutely must address this issue.

MR. SHEPARD: Unquestionably.

JUDGE HIGDON: It's a total disaster.

MR. SHEPARD: Yeah, they do not work at all. Section 1398, unfortunately, does not work well. And, to try and make the two work is terrible.

JUDGE HIGDON: You didn't mention section 1231 [142] which is an additional problem.

MR. WILLIAMS: Right, yes. We have Bankruptcy Code sections 346, 728, 1146 and 1231 that all have their specific quirks along with Internal Revenue Code section 1398, for that matter.

MR. PHELAN: Section 1398 has got a real quirk that I run into all the time. And, that's the situation where you have some Joe Gold Chain that walks into your office and he has $100 million in debts to his creditors on his real estate developments, he has got a low basis and lots of debt. If he files a case and the trustee abandons the property and the property gets foreclosed upon, he's got a gazillion dollars in nondischargeable tax debts. [143]

MR. SHEPARD: Isn't that the intent of Congress, the intent of the Code?

MR. PHELAN: It depends. You have got a split in the cases now. You've got *A.J. Layne* [144] and *Rubin* [145] cases going in one direction, saying that, number one, it impedes the fresh start and number two, it's a taxable event to abandon it because of the language of section 1398 which says there is no taxable event going in but only says there is a taxable event on termination of the case going out. [146] There is also an inherent inequitable situation because the poor slob that now has this nondischargeable postpetition tax debt doesn't get to keep the NOLs because the trustee gets to use them for the benefit of creditors until the end of the case.

MR. SHEPARD: Do we have a couple of hours? I've got a pretty well prepared answer to every point of that discussion.

(Laughter.)

MR. PHELAN: There is a new Ninth Circuit decision, *Johnston* [147] that goes the other way and says, "Man, you read the statute like it says. If section 554 says you can abandon it, abandon it." [148]

JUDGE HIGDON: Abandonment under section 554 does not affect the transfer of any property. [149] All it does is simply release the estate's interest. [150] What happens to the property after that is up to the parties outside the bankruptcy estate. [151] It may or may not create a tax problem.

MR. PHELAN: I think the question should be addressed by Congress.

MR. SHEPARD: The point that you brought up must begin by examining what happened before the man walked into your office with his tax problem because, in all likelihood, it was a tax shelter investor who stripped off large amounts of tax revenue by sheltering other income it in whatever asset he has, a partnership interest or some real estate investment, and he's now trying to say, "I get to keep the benefits of the tax free income stream" and now you are going to stick the government on the tax liability.

MR. PHELAN: That's true in many instances. In a lot of instances, some dumb real estate developer that's in a rising market thinks he's smart because he's making money but the point is that this is an issue−

MR. SHEPARD: So, he borrowed money, spent the money, and enjoyed the use of that money.

MR. PHELAN: The point I'm trying to make is that this is an issue that Congress needs to address to weigh the various arguments as to who should bear that obligation. At the minimum−and I'm not necessarily even disagreeing with you, Jim, as to where it ought to come out−I think there is an inequity in requiring the individual human being debtor to bear the tax obligation of the taxable event but not be able to use whatever legitimate net operating loss carry forwards or other tax benefits that he has to offset that obligation. To bifurcate that creates a problem. [152]

MR. SHEPARD: I disagree, because you have the ability as a debtor to make the transfer prepetition and use those tax benefits. Section 1398 was designed specifically for that purpose. [153]

MR. PHELAN: But, then you put the debtor in a Catch 22. He can either allow the foreclosure to take place prepetition and definitely go down the tubes or he can file his Chapter 11, try to refinance, reorganize, hope that Fizel Allah Fahd shows up from Saudi Arabia with a sack full of riyals to bail him out and all the other things debtors think in the Chapter 11 cases.

(Laughter.)

MR. SHEPARD: The feasibility of that Chapter 11 was in doubt at its initiation.

(Laughter.)

MR. PHELAN: Feasibilities of all Chapter 11s are in doubt at the initiation.

(Laughter.)

MR. SHEPARD: All right. Then, we need an early determination of feasibility to avoid the whole issue.

MR. PHELAN: That, I don't disagree with you on.

MR. SHEPARD: *Rubin* and *Lane* represent the perfectly executed Chapter 11 tax avoidance. [154] I think the larger issue is a question of whether or not we are going to extend tax relief for debtors in bankruptcy. Clearly, policy, Code and anything you look at says that the taxes incurred within three years of bankruptcy are not dischargeable. [155] Why then, should the taxes incurred on a postpetition liability that represent deferred tax liability be discharged; or, should they be discharged?

MR. WILLIAMS: That's the ultimate question.

MR. PHELAN: Because you wait three years to get rid of them.

MR. WILLIAMS: That's the ultimate answer.

(Laughter.)

V. Concluding Remarks

MR. WILLIAMS: With that, we are going to have to finish up right here. I ask you to come out with−borrowing from another distinguished group of panelists−your own personal outrage from the bankruptcy tax interface. Identify what you think Congress and the Commission need to move on right now, sooner than later, the problem or problems that you perceive need to be addressed in the bankruptcy tax area.

JUDGE HIGDON: Let us get out our lists.

MR. WILLIAMS: We have time for one each.

JUDGE HIGDON: One each? Mine is Chapter 13. As we all know, Chapter 13 treats tax authorities very badly. [156] I think it should be corrected so that no longer happens. More specifically, we need to address something I thought we were going to talk about this morning but we didn't get to, and that is how to treat late claims filed under section 6672 [157] of the Internal Revenue Code in light of the fact that the taxing authorities often don't even know that there is a section 6672 or trust fund tax obligation out there when the bankruptcy is filed.

The second problem is that prepetition tax penalties are discharged without full payment because most of those prepetition penalties are not priority as they are not compensation for actual pecuniary loss under section 507(a)(8)(G). [158] However, unlike in Chapter 7 they are nondischargeable under section 523(a)(7). [159]

Third, there is no discount factor provided for priority taxes paid over time in Chapter 13, [160] unlike Chapter 11. [161] There is no explanation in the legislative history for this. This is inequitable.

And fourth, something else I thought we were going to talk about today but we need to emphasize, and this is the most egregious omission which requires change: discharge of 523(a)(1)(B) and (C) [162] taxes without payment in full under section 1328(a). [163] Section 1328(a) does not except 523(a)(1) taxes from discharge because priority taxes must be paid in full through the plan prior to discharge. However, section 523(a)(1)(B) and (C), arising under the most egregious of circumstances, are not treated as priority under section 507(a)(8). The statutory structure works well in Chapter 7 but fails miserably in Chapter 13.

MR. WILLIAMS: Do you expect such taxes to be treated through the plan, as opposed to outside the plan?

JUDGE HIGDON: You bet. They have to be treated just like all other priority claims are treated.

MR. WILLIAMS: And not allow the Service, outside of the plan, to go against the debtor.

JUDGE HIGDON: They can't.

MR. WILLIAMS: We could modify that provision, in one of two ways: One, to require that it be treated like the priority tax claims; [164] or, two, to modify and just treat it like in the Chapter 7 context.

JUDGE HIGDON: I see. I don't care which way.

MR. PHELAN: You are taking a tortee and a defraudee in a nontax context and he gets screwed in the Chapter 13, too. That's the Chapter 13 policy, is screw everybody, to allow the debtor to pay maybe a little more to all the unsecured creditors across the board. Why do you single out the taxing authority? The tortee has the same problem. And, the defraudee has the same problem.

MR. SHEPARD: Robin, you speak like you are a debtor's lawyer. Is that true?

(Laughter.)

MR. PHELAN: Sometimes.

MR. WILLIAMS: Carmen, what is your outrage.

MS. EGGLESTON: My outrage is the shifting that has taken place back from the enactment of the most recent Bankruptcy Code where we really were looking to a fresh start for the debtor, [165] we were looking to help the debtor to reorganize. What we've seen really in the '90s is a movement away from helping the debtor to reorganize from a tax perspective and, instead, trying to collect more taxes from the debtor. [166]

MR. SHEPARD: Is that a result of over−aggressive debtors' counsel in attempting to achieve what really was not intended?

MS. EGGLESTON: I'm not sure that that's, in fact, the result of it. I think it's a result of Congress looking for ways to raise revenue; and that bankrupt debtors are not well represented; and, people don't know that in three to five years they are going to be in bankruptcy and so they are not up there lobbying to help keep provisions in that are beneficial to them. So that when you have the repeal of section 1275(a)(4), [167] when you have the repeal of the stock−for−debt exception, [168] what you are doing is now creating more debt forgiveness income [169] and making it a more difficult process for a debtor to come out. The critical years for a debtor−and I'm talking about most corporate debtors−coming out are the first three to five years after bankruptcy. To have an enhanced cash flow because they are not having to pay tax liabilities really helps to increase the viability of that debtor. Not only that, but because you had the stock−for−debt exception you had a real negotiating tool from the debtor's perspective to get creditors to accept stock, that they needed to come out not with 100 percent of their payment in the form of cash or debt but that they would take some of that now in the form of stock. [170] You had a healthier debtor upon emergence. Now, you don't have that incentive from the creditors' perspective to accept the stock. I mean, a lot of times when they end up with stock it's because that's all that's left and that's the only type of payment that they can take. You are going to end up seeing debtors that have a more leveraged balanced sheet, because there is now a disincentive to have equity as compared to debt. So, I really see this as a shift. We had a long period where there were no regulations that were issued. When regulations came out, the first regulations under the nominal or token test, for example, under the stock−for−debt, [171] I thought they were, very difficult to apply. In most situations, they were not applicable. You just couldn't do it. The Service came out again with a new set in response to practitioners. [172] But, even in those regulations there were problems with the assumptions that were made. So, I see that there is now a shift to collecting taxes from the debtors instead of looking to helping the debtor reorganize and go forward.

MR. WILLIAMS: So, the new laws are revenue−generating?

MS. EGGLESTON: The new laws are revenue−generating.

MR. WILLIAMS: Not policy−driven?

MR. SHEPARD: Revenue−generating or revenue−protection?

MS. EGGLESTON: I think that they are revenue−generating.

MR. WILLIAMS: It depends on your point of view.

MS. EGGLESTON: Yes.

MR. WILLIAMS: Robin, you have 12.3 seconds.

MR. PHELAN: That's easy. There seems to be more concern about the ineptitude of the taxing authorities' computers than there is about the taxpayer and the crushing tax debt that sometimes occurs that people just can't get out from under, because the statutes seem to be more and more restrictive with respect to discharge and the dischargeability of

these taxes. [173]

You have the *Haas* [174] case, for example, in the Eleventh Circuit where the taxing authority said just because the poor slob that owed $726,000 in taxes didn't pay his taxing authority debt, he couldn't get a discharge. Instead of paying his taxes he paid for the bread and milk and his other obligations, his credit card debt or whatever. [175] Number one, they weren't satisfied with convicting him of a federal crime. [176] He had not filed fraudulent tax returns; his tax returns were all perfectly okay and everything; he didn't do anything fraudulent; he just didn't pay the tax. [177] They tried to bar his discharge in the case. Fortunately the Eleventh Circuit said that didn't bar the discharge. [178] But, it's one thing that Congress needs to address. It's either bad to just not pay your debts and you don't get your taxes discharged or you do. [179] The other thing that really bothers me is that when we deal with tax problems in bankruptcy and policy and legislation, instead of making the law clear, one way or the other, on whatever issue it is, there is some type of a compromise that's worked out that requires fifty−seven steps and forty−three procedures. No one can figure out what it means. You end up spending all the money on lawyers trying to interpret the statute rather than just making it clear one way or the other. You either get it or you don't get it.

MR. WILLIAMS: Steve.

MR. CSONTOS: Okay. First of all, I want to say on the record that I agree with Robin Phelan on the Chapter 13 super discharge [180] and also with Judge Higdon's comments on the problems that Chapter 13 creates for the taxing authority. [181] I guess out of all of the outrages, I will take one that maybe Congress could do something about. I think that a big problem for the IRS is the balloon payment in the six year payout in a Chapter 11 case, [182] because some courts will find that the plan is feasible even though there are to be nominal payments on a tax liability in the early years of the plan and a balloon payment at the end of the six year period after assessment. [183] The end result is that the IRS and the United States government bear the risk of loss on the plan and the risk of failure of the plan. I'm not sure what the latest statistics are, but I know that less than 50 percent, maybe less than two−thirds, of the confirmed Chapter 11 plans actually wind up as successful. The result is that the federal government is out the money. I guess I will use that one as my outrage of the day.

MR. WILLIAMS: Okay. Jim.

MR. SHEPARD: I think that the bigger picture of everything that has been said is a question of how much tax relief should there be for debtors in bankruptcy, individual or corporate or whatever. Within that context, you've got to ask the question of whether or not the taxing authority governments, state, local, and federal, should be just another creditor or do they have some larger position in the way things function and, therefore, should be treated as a unique creditor.

JUDGE HIGDON: Could I say one last thing?

MR. WILLIAMS: You certainly may.

JUDGE HIGDON: If this is going to be addressed by Congress, it has been clear to all of us for some time that the committees are going to have to start talking to each other. The committee that is responsible for bankruptcy law is going to have to start communicating with the committee that's responsible for tax law. This has been, I would guess, one of the primary reasons why we have these problems that we have been discussing today. The bankruptcy people think in terms of bankruptcy. The tax people think in terms of tax. And, they do not cross paths. There has got to be some communication starting to take place in order to address and resolve these problems. Hopefully, the Bankruptcy Commission, with Jim as a member who is so sensitive to tax issues, will be a vehicle to do this.

MR. SHEPARD: Yes, I agree. I think one of the problems in that regard is that there has been a lack of understanding of the two disciplines. And, I would hope that that can be avoided.

MR. WILLIAMS: Thank you.

Conclusion

MR. WILLIAMS: I want to thank all of the panelists. I also want to thank the American Bankruptcy Institute and the *American Bankruptcy Institute Law Review* for co−hosting this Roundtable and providing this forum for us so that we may discuss these issues and start to move toward a more coherent policy of bankruptcy taxation.

Thank you all very much.

FOOTNOTES:

[1] *See* Jack F. Williams, Rethinking Bankruptcy and Tax Policy, 3 Am. Bankr. Inst. L. Rev. 153, 154 (1995) (suggesting that tremendous number of real estate bankruptcies result from desire to avoid adverse tax consequences).Back To Text

[2] Tax law frequently allows the taxing authority greater latitude in the collection of revenues than is allowed to other nongovernmental creditors, while bankruptcy laws are designed to provide a "fresh start," aimed at the financial rehabilitation of the debtor. 3 Cowans Bankruptcy Law and Practice § 13.1 (6th ed. 1994). *But see* 1A Collier on Bankruptcy ¶ 8.01, at 8−3 (Lawrence P. King ed., 15th ed. 1995). "Although there are many points of divergence in the operation of the two legislative schemes, it is possible that the overall objectives of the Bankruptcy Code and the Internal Revenue Code do not conflict because `successful reorganization satisfies the goals of bankruptcy and tax.'" Id. (citation omitted).Back To Text

[3] *See generally* Williams, supra note 1 (discussing various conflicts between bankruptcy and tax law). For example, the policy of giving the debtor a fresh start is overridden by making certain taxes nondischargeable. *See* 11 U.S.C. § 523(a) (1994).Back To Text

[4] 11 U.S.C. § 346(b)(1) (providing that with respect to individual debtors under Chapter 7 or 11, income of estate is only taxable to estate, not to debtor).Back To Text

[5] Id. § 728 (1994) (providing "special tax provisions" in Chapter 7).Back To Text

[6] Id. § 1146 (1994) (providing "special tax provisions" in Chapter 11).Back To Text

[7] Id. § 1231 (1994) (providing "special tax provisions" in Chapter 12). This section will be effectively repealed as of October 1, 1998. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99−554, § 302(f), 100 Stat. 3088, 3124, *as amended by* Pub. L. No. 103−65, § 1, 107 Stat. 311, 311 (1993).Back To Text

[8] *See* 11 U.S.C. §§ 346, 728, 1146, 1231. All four sections are "[f]or the purposes of state and local law imposing a tax." *See also* infra note 141 and accompanying text.Back To Text

[9] I.R.C. § 108 (1988 & Supp. V 1993) (excluding discharge of indebtedness from gross income and discussing resulting tax consequences).Back To Text

[10] I.R.C. § 1398 (1988) (providing tax rules relating to individual's title 11 cases).Back To Text

[11] I.R.C. § 1399 (1988) (stating that except where § 1398 applies, "no separate taxable entity shall result from the commencement of a case under title 11").Back To Text

[12] *See* discussion infra part IV.D.Back To Text

[13] *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, 108 Stat. 4106.Back To Text

[14] *See* discussion infra part IV.Back To Text

[15] The stock−for−debt exception was repealed by the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103−66, § 13226(a), 107 Stat. 312, 487−88. Under this exception, if a corporate debtor issued stock in exchange for debt, no COD income arose even when the stock was worth less than the debt satisfied. I.R.C. § 108(e)(8)(A) (1988) (repealed 1993); *see* 1A Collier on Bankruptcy, supra note 2, ¶ 15.02[1] (discussing stock−for−debt exception).Back To Text

[16] *See* supra notes 167−172 and accompanying text.Back To Text

[17] *See* 3 Cowans Bankruptcy Law and Practice, supra note 2, § 13.1, at 197 (suggesting that tax issues were sometimes ignored by both tax and bankruptcy attorneys because of inconsistent IRS action).Back To Text

[18] Bankruptcy Act of 1898, ch. 541, § 17, 30 Stat. 544, 550 (providing for general nondischargeability of taxes "[l]evied by the United States, the State, county, district, or municipality in which [the debtor] resides") (codified as amended at 11 U.S.C. § 523 (1994)).Back To Text

[19] *See* id.Back To Text

[20] *See* 11 U.S.C. § 523(a) (1994). Section 523(a) of the Bankruptcy Code limits the exceptions to discharge with respect to taxes. Id.Back To Text

[21] *See* United States v. Whiting Pools, Inc., 462 U.S. 198, 209 (1983) ("We see no reason why a different result should obtain when the IRS is the creditor . . . . Nothing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector"); Quality Tooling, Inc. v. United States, 47 F.3d 1569, 1573 (Fed. Cir. 1995) (noting that "[i]n exercising their power over bankrupt estates," courts often treat the Federal Government as if they were private parties). Back To Text

[22] Pub. L. No. 96−589, 94 Stat. 3389.Back To Text

[23] *See* I.R.C. § 1398(h) (1988) (providing that administrative expenses allowed under Bankruptcy Code § 503 are allowed as a deduction, to extent not disallowed under any other provision in IRC); 11 U.S.C. § 503(b) (1994) (listing claims allowed as administrative expenses).Back To Text

[24] *See, e.g.*, Official Creditors Comm. v. Tuchinsky (In re Major Dynamics, Inc.), 897 F.2d 433, 435−36 (9th Cir. 1990) (holding claim by taxing authority for post petition taxes withheld by debtor−in−possession receives priority status); United States v. Friendship College, Inc. (In re Friendship College, Inc.), 737 F.2d 430, 432 (4th Cir. 1984) (same); In re General Polymetrics Corp., 54 B.R. 523, 525 (Bankr. D. Conn. 1985) (finding taxes based upon post petition withholding taxes are given priority).Back To Text

[25] *See, e.g.*, Hartman v. United States (In re Hartman), 110 B.R. 951, 955−56 (D. Kan. 1990) (finding tax "assessed" only when taxing authority has taken some additional step beyond mere determination of tax deficiency); In re Broadway 704−706 Assocs., 154 B.R. 44, 45 (Bankr. S.D.N.Y. 1993) ("[T]axes start to run with the land as of the tax due dates and not on the tax status date."); In re T & T Roofing and Sheet Metal, Inc., 156 B.R. 780, 782 (Bankr. N.D. Tex. 1993) (finding term "assessed" as used in Bankruptcy Code refers not to act of assessment but to effective date of assessment); Forell v. Kent County Treasurer (In re Kamstra), 51 B.R. 826, 833 (Bankr. W.D. Mich. 1985) (concluding taxes assessed two months before filing were not incurred by estate thus not administrative expense and were therefore not given first priority).Back To Text

[26] 11 U.S.C. § 728(b) (1994) (stating that "the trustee shall make tax returns of income for the estate). Back To Text

[27] Section 505(b) provides for the discharge of liabilities for taxes incurred during the administration of the estate where the trustee submits a tax return for such tax and a request for determination to a governmental unit where either:

> (A) such governmental unit does not notify the trustee, within 60 days after such request, that such return has been selected for examination; or

(B) such governmental unit does not complete such an examination and notify the trustee of any tax due, within 180 days after such request or within such additional time as the court, for cause, permits . . . .

Id. § 505(b)(1)(A)−(B) (1994). For a thorough treatment of the issues posed by § 505(b), see C. Richard McQueen & Jack F. Williams, Tax Aspects of Bankruptcy Law and Practice, § 3.21, at 3−27 to −32 (2d ed. 1995).Back To Text

[28] Two courts have held that although the trustee and the debtor are protected from personal liability for § 505(b)(1)(A) discharges, the estate is not. *See* In re Fondiller, 125 B.R. 805, 807 (N.D. Cal. 1991); In re Rode, 119 B.R. 697, 700 (Bankr. E.D. Mo. 1990). "The courts reasoned that, because the bankruptcy estate is not a `trustee, debtor or successor to the debtor,' it is not discharged under § 505(b)(1)(A) and must pay the tax claims so long as the estate remains open." Paul B. Geilich, Essentials of Bankruptcy Tax Law, 66 Am. Bankr. L.J. 323, 329 (1992).Back To Text

[29] Schechter v. Illinois (In re Markos Gurnee Partnership), 182 B.R. 211 (Bankr. N.D. Ill. 1995).Back To Text

[30] Id. at 213−14.Back To Text

[31] State of Illinois v. Steege (In re Markos Gurnee Partnership), 163 B.R. 124 (Bankr. N.D. Ill. 1993).Back To Text

[32] Schecter, 182 B.R. at 215−16.Back To Text

[33] Id.Back To Text

[34] For example, the Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, 108 Stat. 4106, clarifies the types of state and federal "tax collection activities permitted under the automatic stay, and provides a waiver of sovereign immunity for law suits based on IRS violations of the automatic stay." A. Breault et al., Bankruptcy Act Covers Tax Collection, 54 Tax'n For Acct. 125 (1995).Back To Text

[35] *See* 11 U.S.C. § 362(b)(9) (1994). Section 362(b)(9) lifts the automatic stay as it applies to tax audits, a demand for tax returns, assessment of uncontested tax liability, or the making of certain assessments of tax and issuance of a notice and demand for payments of such assessments. Id. The automatic stay in § 362 prevents litigation, enforcement of judgements, acts to obtain property of the estate, any acts to create a lien and other such actions to collect property or to enforce a debt. Id. § 362(a). Back To Text

[36] *See* Robert Garcia, *"Garbage In, Gospel Out":* Criminal Discovery, Computer Reliability, and the Constitution, 38 U.C.L.A. L. Rev. 1043, 1057 (1991) (noting that "[t]he IRS is the largest and most computerized law enforcement agency in the country, and perhaps the world"). The IRS has the largest concentration of computer power outside of the Pentagon. Id. at 1057 n.40 (citing Hershey, *I.R.S. Chief Faces Task of Rebuilding*, N.Y. Times, Mar. 4, 1990, at F23).Back To Text

[37] *See* I.R.C. § 6501(a) (1988) (stating that tax shall be assessed within three years after return filed).Back To Text

[38] The federal tax lien which arises upon assessment is a secret lien. While the lien is good against the taxpayer, it is not good against certain other parties, such as judicial lien creditors. Williams, supra note 1, at 191. Because Bankruptcy Code § 544(a)(1) vests the trustee with the status of a hypothetical lien creditor as of the date of the bankruptcy position such secret lien may be voided by the trustee. *See* id. at 192.Back To Text

[39] 11 U.S.C. § 507(a)(8)(A)(iii) (1994). Eighth in the list of priorities are certain income taxes "not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case." Id. *See generally* McQueen & Williams, supra note 27, § 8.12, at 8−25 to −27 n.93.Back To Text

[40] I.R.C. § 6503(a) (1988 & Supp. V 1993) (providing for suspension of statute of limitations for period during which Secretary is prohibited from assessing or collecting by levy or proceeding in court, and for sixty days thereafter); *see* McQueen & Williams, supra note 27, §§ 5.24−.25.Back To Text

[41] 11 U.S.C. § 108 (1994) (extending time periods for commencing or continuing civil actions that are stayed). Back To Text

[42] *See* I.R.C. § 6503(a).Back To Text

[43] *See* 11 U.S.C. § 1129(a)(9)(C) (1994) (allowing confirmation of a plan which provides for deferred cash payments of taxes over six year period). Back To Text

[44] *See* James H.M. Sprayregen, Dischargeability of Personal Income Taxes In Bankruptcy, 64 Am. Bankr. L.J. 209, 227 n.5 (1990) (stating that "§ 1129(a)(9)(C) provides that payment of tax obligations

. . . may be made over a period of six years from the date of assessment . . . or confirmation of the plan, whichever is shorter."); John C. Anderson, *Classification of Claims and Interests in* Reorganization Cases Under the New Bankruptcy Code, 58 Am. Bankr. L.J. 99, 117 (1984) (noting that prior claims may be paid over six years after confirmation) (citing 11 U.S.C. § 1129(a)(9)(C)).Back To Text

[45] 11 U.S.C. § 1129(a)(9)(C) (1994) (applying only to taxes enumerated in § 507(a)(8)). Back To Text

[46] 11 U.S.C. § 506 (1994) (determining secured status of claim).Back To Text

[47] 11 U.S.C. § 507(a)(8) (1994) (granting priority to various unsecured governmental claims).Back To Text

[48] Id.Back To Text

[49] Id. (allowing payment of priority tax claims in deferred cash payments over six years).Back To Text

[50] 11 U.S.C. § 362(b)(9) (1994). Section 362(b) provides for certain exceptions to the automatic stay provisions in § 362(a). "[T]he Bankruptcy Reform Act of 1994 amended § 362(b)(9) to permit audits to determine tax liability, a demand for tax returns, and the making or [sic] an assessment and issuance of notice and a demand for payments of any tax." 2 Collier on Bankruptcy, supra note 2, ¶ 362.05[9], at 362−55 (citation omitted).Back To Text

[51] 11 U.S.C. § 505(c) (1994) (allowing immediate assessment of tax by governmental unit after court's determination of tax under other provisions of § 505).Back To Text

[52] The legislative history of § 505(c) of the Bankruptcy Code states that it was intended to codify Statmaster v. United States (In re Statmaster Corp.), 465 F.2d 978 (5th Cir. 1972).

> Its purpose is to protect the trustee from personal liability for a tax falling on the estate that is not assessed until after the case is closed.
>
> . . . .
>
> The final order of the court and the payment of the tax determined in that order discharges the trustee, the debtor, and any successor to the debtor from any further liability for the tax.

H.R. Rep. No. 595, 95th Cong., 2d Sess. 356 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6312.Back To Text

[53] *See* supra note 50.Back To Text

[54] 11 U.S.C. § 362(b)(9) (1994).Back To Text

[55] *See, e.g.*, Tax Section of the Florida Bar, *One State's Reaction and Reaganomics: The 1982 Amendments to the* Florida Income Tax Code, 36 U. Miami L. Rev. 661, 662−63 (1982).

> In the interest of simplicity and administrative convenience, the Florida Income Tax Code incorporated . . . a procedure commonly known as "piggybacking." Piggybacking enabled the state and taxpayers to ascertain easily the Florida income tax due by starting with federal taxable income and then making adjustments to arrive at Florida taxable income. State administrative costs are reduced under this piggybacking system because the Department of Revenue can rely on a federal audit, limiting both the number of state revenue agents and the scope of state audits.

Id. (citations omitted).Back To Text

[56] *See* 11 U.S.C. § 362(a)(5) (1994). Section 362(a)(5) imposes a stay on "any act to create, perfect, or enforce against property of the debtor any lien to the extent" that this prevents "a taxing authority from collecting, assessing, or recovering a tax claim of the debtor that arose prior to filing the petition." Grant W. Newton & Gilbert D. Bloom, Bankruptcy & Insolvency Taxation 359 (2d ed. 1993).Back To Text

[57] 11 U.S.C. § 362(b)(9)(A) (1994) (lifting automatic stay for tax audit); *see* supra notes 55−56 (noting that 1994 amendments permit auditors to determine tax liability).Back To Text

[58] *See* 11 U.S.C. § 362(b)(9)(C) (lifting automatic stay for a demand for tax returns). *See generally* McQueen & Williams, supra note 27, § 5.11, at 5−14 to −16.Back To Text

[59] *See, e.g.*, In re Price, 103 B.R. 989, 996 (Bankr. N.D. Ill. 1989) (holding that IRS willfully violated automatic stay when it sent notice of intention to levy), aff'd, 130 B.R. 259 (N.D. Ill. 1991); In re Warden, 36 B.R. 968, 974 (Bankr. D. Utah 1984) (holding that IRS violated automatic stay when it froze debtors' account); Mealey v. Department of Treasury (In re Mealey), 16 B.R. 800, 802 (Bankr. E.D. Pa. 1982) (holding that retention by IRS of debtors' tax refund was violation of automatic stay).Back To Text

[60] Ledlin v. United States (In re Tomlan), 102 B.R. 790 (E.D. Wash. 1989), aff'd, 907 F.2d 114 (9th Cir. 1990).Back To Text

[61] In re Zimmerman, 156 B.R. 192 (Bankr. W.D. Mich. 1993).Back To Text

[62] In re Hausladen, 146 B.R. 557 (Bankr. D. Minn. 1992).Back To Text

[63] Zimmerman, 156 B.R. at 198 (stating allowance dependent upon timely filing); Tomlan, 102 B.R. at 796 (holding claim discharged since not timely−filed); *accord* In re Jones, 164 B.R. 543, 546 (Bankr. N.D. Tex. 1994) (following *Zimmerman* in holding IRS's claim to be disallowed due to untimely filing); In re Bailey, 151 B.R. 28, 33 (Bankr. N.D.N.Y. 1993) (expunging claim due to untimely filing).Back To Text

[64] Hausladen, 146 B.R. at 559 (stating late−filing not ground for disallowance under § 502).Back To Text

[65] Id. at 560. *Hausladen* states that while § 726 is not directly on point, it does support the conclusion that late filed claims are allowable. Id. Section 726 provides for payment of late−filed claims as long as the holder of that claim "did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim." 11 U.S.C. § 726(a)(2)(c) (1994). Although lateness is not dispositive as to payment, it may cause the claim to be subordinated. *See* id. (paying late−filed claims after those which are timely−filed). *See generally* McQueen & Williams, supra note 27, § 10.14, at 10−25 to −26.Back To Text

[66] *See* 11 U.S.C. § 502 (1994).Back To Text

[67] *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, § 213(a), 108 Stat. 4106, 4125−26. Back To Text

[68] H.R. Rep. No. 835, 103rd Cong., 2d. Sess. 48 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3357 (stating that amendment designed to overrule *Hausladen* and its progeny by disallowing claims that are not timely filed). Back To Text

[69] *See* In re Zimmerman, 156 B.R. 192, 196−97 (Bankr. W.D. Mich. 1993) (suggesting that rules should not be given as much weight as laws). For cases impliedly treating Bankruptcy Rules as law, see In re Turner, 157 B.R. 904, 911 (Bankr. N.D. Ala. 1993) (referring to Bankruptcy Rule 3002(a) as applicable law making claim unenforceable if deadline for filing proof of claim is not met); In re Harper, 138 B.R. 229, 242 (Bankr. N.D. Ind. 1991) (noting that Bankruptcy Rule 3002(c) absolutely bars late claims).Back To Text

[70] *See* Wilkens v. Simon Bros., 731 F.2d 462, 464 (7th Cir. 1984) (noting that some courts have left open possibility of exercising equitable powers to "enlarge" bankruptcy rule setting deadline for filing claim); In re Furrer, 67 B.R. 654, 657 (Bankr. E.D. Wis. 1986) (stating that "most courts have held that proofs of claims must be filed in the time allotted [by the rules], or they will not be allowed").Back To Text

[71] *See* Wilkens, 731 F.2d at 464 (discussing when rules might not need to be followed).Back To Text

[72] Fed. R. Bankr. P. 3002(c). Subsection (c) provides that "a proof of claim shall be filed within 90 days" of the first meeting of creditors. Id. There is debate regarding whether the bankruptcy court has the power to grant extra time after the filing period has expired absent a timely filed motion for extension. *Compare* Zimmerman, 156 B.R. at 196−97 (finding bankruptcy court lacked power to grant extra time) *with* In re Hausladen, 146 B.R. 557, 560−62 (Bankr. D. Minn. 1992) (finding court had power to grant extension).Back To Text

[73] United States v. Chavis (In re Chavis), 47 F.3d 818 (6th Cir. 1995).Back To Text

[74] Id. at 822 (citing In re Vecchio, 20 F.3d 555 (2d Cir. 1994), which found that Bankruptcy Code and Bankruptcy Rule 3002 conflict).Back To Text

[75] Id. at 822−23 (finding that Bankruptcy Code and Rules can be harmonized notwithstanding finding that where the two conflict, code must win out).Back To Text

[76] This seems to be the required result in light of the language in 28 U.S.C. § 2075, which states, in pertinent part, that "[bankruptcy] rules shall not abridge, enlarge, or modify any substantive right." 28 U.S.C. § 2075 (1988); Chavis, 47 F.3d at 822 (quoting *In re* Vecchio, 20 F.3d 555 (2d Cir. 1994)).Back To Text

[77] Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, § 213, 108 Stat. 4106, 4125−26 (1994). The amendment added subsection (b)(9) which disallows claims which are not timely filed. *See* 11 U.S.C. § 502(b)(9) (1994).Back To Text

[78] Section 502(b) allows governmental units 180−days within which to timely file a claim. 11 U.S.C. § 502(b)(9) (1994).Back To Text

[79] In re Zimmerman, 156 B.R. 192, 196−97 (Bankr. W.D. Mich. 1993) (noting also that often procedural rules change substantive outcomes).Back To Text

[80] Id. at 199 ("The debtor and all timely filing creditors benefit from the claims bar date because the case can be administered much more efficiently.")Back To Text

[81] Bankruptcy Reform Act of 1994, § 213, 108 Stat. at 4125−26. By placing paragraph (b)(9) into § 502, the Bankruptcy Code itself now deals with the issue of when a claim must be filed.Back To Text

[82] *See* 11 U.S.C. § 1112(b) (1994). If it is in the best interest of the creditors, then the Chapter 11 case can be converted to a liquidation case under Chapter 7. Id.; *see, e.g.*, In re Melp, LTD., 143 B.R. 890, 892 (Bankr. E.D. Mo. 1992) (finding that it would not be in best interest for Chapter 11 creditors to convert to Chapter 7 since debtor paid all prepetition obligations and was current on all postpetition obligations); In re Southern Int'l Co., 126 B.R. 223, 226−27 (Bankr. E.D. Va. 1991) (granting conversion to Chapter 7 under § 1112(b) because of "lack of a reasonable likelihood of reorganization within a reasonable time").Back To Text

[83] 11 U.S.C. § 1322(a)(2) (1994). The Chapter 13 plan must "provide for the full payment . . . of all claims entitled to priority under section 507." Id.Back To Text

[84] The feasibility requirement of plan confirmation is that the "plan is not likely to be followed by the liquidation, or the need for further financial reorganization." 11 U.S.C. § 1129(a)(11) (1994). Back To Text

[85] *See* 11 U.S.C. § 1325(a)(6) (1994). *Compare* 11 U.S.C. § 1325(a)(6) (1994) (requiring that debtor be able to make all payments) *with* 11 U.S.C. § 1129(a)(11) (1994) (requiring merely likelihood of success). For an example of a court disapproving of a plan under Chapter 13 because it was not feasible; see In re Baxter, 155 B.R. 285, 288−89 (Bankr. D. Mass. 1993) (finding debtor's income insufficient to complete plan).Back To Text

[86] Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, § 213(a), 108 Stat. 4106, 4125−26.Back To Text

[87] Id. (stating that government shall allow such a claim except to the extent that proof of such claim is not timely filed).Back To Text

[88] Id.Back To Text

[89] *See* 11 U.S.C. § 726(a) (1994). For example § 726(a)(3) gives third priority to unsecured claims that were tardily filed and gives first priority to unsecured priority claims which were timely filed. *See* id.

§ 726(a)(1), (3); IRS v. Roberts (In re Larry Merritt Co.), 169 B.R. 141, 142 (E.D. Tenn. 1994) (holding IRS's tardily filed priority claim to be paid only after paying of all other timely filed unsecured claims); Crawford v. Green (In re Crawford), 135 B.R. 128, 133 (D. Kan. 1991) (subordinating IRS claim to those of unsecured creditors who filed claims on time).Back To Text

[90] *See* United States v. Towers (In re Pacific Atlantic Trading Co.), 33 F.3d 1064, 1067 (9th Cir. 1994) (holding that IRS's failure to timely file did not deny it first priority under § 726(a)(1) because § 726(a) does not distinguish between late and timely filed priority claims).Back To Text

[91] Section 502(b)(9) disallows proofs of claims which are not timely filed "*except* to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a)." 11 U.S.C. § 502(b)(9) (1994) (emphasis added).Back To Text

[92] *See* 11 U.S.C. § 1325(a) (1994) (listing requirements for confirmation of Chapter 13 plan). Section 1325(a)(4) in particular requires that "the value . . . of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate . . . were liquidated under chapter 7." Id. § 1325(a)(4). Back To Text

[93] 11 U.S.C. § 1325(a)(6) (1994) (requiring Chapter 13 debtor to be able to make all payments under plan and will be able to comply with plan). For a more comprehensive discussion of the Chapter 13 "feasibility" requirement, see 5 Collier on Bankruptcy, supra note 2, ¶ 1325.07.Back To Text

[94] *See* supra note 92.Back To Text

[95] *See, e.g.*, In re Anderson, 18 B.R. 763, 765 (Bankr. S.D. Ohio) (stating feasibility is determined based upon factors as they appear at time of confirmation), aff'd, 28 B.R. 628 (S.D. Ohio 1982).Back To Text

[96] 11 U.S.C. § 1329 (1994) (allowing modification of plan after confirmation). Back To Text

[97] *See* Fed. R. Bankr. P. 3015(g) (providing guidelines for modification of plan after confirmation).Back To Text

[98] *See* 11 U.S.C. § 502(b)(9) (1994) (allowing governmental claims filed within 180 days from date of order of relief).Back To Text

[99] 11 U.S.C. § 106 (1994). Section 106, as amended by the Bankruptcy Reform Act of 1994, waives sovereign immunity of the federal and state governments in limited circumstances. Id. The amendment of § 106, "made clear Congress's unmistakable intent to provide expressly for a waiver of sovereign immunity. . . with respect to monetary recoveries as well as declaratory and injunctive relief." 2 Collier on Bankruptcy, supra note 2, ¶ 106.01, at 106−3.Back To Text

[100] Section 106, as amended, became effective retroactively by stating that it applies to cases brought under title 11 of the Code "`before, on and after the date of the enactment of this Act.'" 2 Collier on Bankruptcy, supra note 2, ¶ 106.01A, at 106−8 (citing Bankruptcy Reform Act of 1994, Pub. L. No. 103−394). Back To Text

[101] *See* 11 U.S.C. § 362(h) (1994) (providing actual damages for persons injured by violation of automatic stay); *see also* United States v. Fingers (In re Fingers), 170 B.R. 419, 427 (S.D. Cal. 1994) (holding IRS waived its sovereign immunity with regard to debtor's claim for damages for violation of automatic stay).Back To Text

[102] *See generally* McQueen & Williams, supra note 27, § 4.08, at 4−10 to −12.Back To Text

[103] *See, e.g.,* United States v. Nordic Village, Inc., 503 U.S. 30 (1992). In *Nordic Village*, an officer of the corporation withdrew funds from the corporation, part of which was sent to the IRS to pay off his individual tax liability. Id. at 31. Nordic Village's trustee subsequently sued the IRS to recover the funds. Id. On appeal, the Supreme Court held that the suit against the IRS was barred by the doctrine of sovereign immunity, and that § 106 of the Bankruptcy Code did not render the IRS amenable to suit for monetary relief. Id. at 34. Back To Text

[104] *See* Nordic Village, 503 U.S. at 39 ("Neither § 106(c) nor any other provision of law establishes an unequivocal textual waiver of the Government's immunity from a bankruptcy trustee's claims for monetary relief.").Back To Text

[105] Id. at 42 (Stevens, J., dissenting) (noting doctrine of sovereign immunity, which has been completely relies on idea that "king can do no wrong" which has been completely discredited).Back To Text

[106] John F. Duffy, Sovereign Immunity, the Officer Suit Fiction, and Entitlement Benefits, 56 U. Chi. L. Rev. 295, 297 (1989). English law provides that the sovereign could not be sued without his consent. Id. (citing 1 William Blackstone, Commentaries on the Laws of England 238 (Chicago, 1979)).Back To Text

[107] *See* id. at 297 n.16 ("There is some doubt as to the source of sovereign immunity for both the states and the United States."). Some believe that the Constitution is the source for Federal Sovereign Immunity. See Kennecott Copper Corp. v. State Tax Comm., 327 U.S. 573, 580 (1946) (Frankfurter, J., dissenting) (stating sovereign immunity embodied in the Constitution); Nancy E. Milsten, Note, *How Well Can States Enforce Their Environmental Laws When the Polluter is the United States Government?*, 18 Rutgers L.J. 123, 129 (1986) (citing supremacy clause as a source of sovereign immunity). Some simply believe that it is a common law principle borrowed from England. *See* Erwin Chemerinsky, Federal Jurisdiction § 9.2.1, at 545 (2d ed. 1994). Similarly, there may be alternate sources responsible for sovereign immunity. *See* Thomas M. Clark, Note, More Plenary Than Thou: A Post−Welch Compromise Theory of Congressional Power to Abrogate State Sovereign Immunity, 88 Colum. L. Rev. 1022 (1988) (suggesting state sovereign immunity may stem from both Eleventh Amendment and Article III of Constitution). Back To Text

[108] The statute was amended in order to overrule two Supreme Court cases which found that the language of the statute was not "unmistakably clear" with respect to waiving sovereign immunity of governmental units. *See* H.R. Rep. No. 835, *supra* note 68, at 42, *reprinted in* 1994 U.S.C.C.A.N. at 3350.Back To Text

[109] *See* 11 U.S.C. § 106 (1994). As amended, the statute is sufficiently clear such that the Court would have to acknowledge the difference between the statute in *Nordic Village*, and the current version of § 106. *See* Nordic Village, 503 U.S. at 34 (holding there was no waiver of sovereign immunity because language was not clear and unequivocal enough).Back To Text

[110] *See* 11 U.S.C. § 106 (providing for retroactive application to cases already filed). Back To Text

[111] *See* H.R. Rep. No. 835, supra note 68, at 42, *reprinted in* 1994 U.S.C.C.A.N. at 3450. The legislative history provided that:

> [t]his section would effectively overrule two Supreme Court cases that have held that the States and Federal Government are not deemed to have waived their sovereign immunity by virtue of enacting section 106(c) of the Bankruptcy Code. In enacting section 106(c), Congress intended to make provisions of Title 11 that encompassed the words `creditor,' `entity,' or `governmental unit' applicable to the states.

Id.Back To Text

[112] *See* id.; *see also* Sparkman v. State Dep't of Revenue (In re York−Hannover Devs., Inc.), 181 B.R. 271, 278 (Bankr. E.D.N.C. 1995) ("[T]he Congressional intent to abrogate sovereign immunity could not be clearer . . . . ").Back To Text

[113] *See generally* Loren Levine, Note, *State Taxpayers View of Section 106(a) of the* Bankruptcy Reform Act of 1994, 3 Am. Bankr. Inst. L. Rev. 441 (1995) (discussing constitutionality of § 106(a) of Bankruptcy Reform Act of 1994). Back To Text

[114] Sparkman v. State Dep't of Revenue (In re York−Hannover Devs., Inc.), 181 B.R. 271 (Bankr. E.D. N.C. 1995).Back To Text

[115] Id. at 272−73.Back To Text

[116] Id. at 278.Back To Text

[117] McVey Trucking, Inc. v. Secretary of Illinois (In re McVey Trucking, Inc.), 812 F.2d 311 (7th Cir.), cert. denied, 485 U.S. 895 (1987).Back To Text

[118] Id. at 323 ("Congress may abrogate state immunity to suit pursuant to any of its plenary powers.").Back To Text

[119] Id. at 328.Back To Text

[120] U.S. Const. art. I, § 8, cl. 3.Back To Text

[121] U.S. Const. art. I, § 8, cl. 4 (establishing power of congress to establish uniform bankruptcy law).Back To Text

[122] Hoffman v. Connecticut Dep't of Income Maintenance, 492 U.S. 96, 105 (1989) (Scalia, J., concurring) (stating that Congress had no power to abrogate States' Eleventh Amendment immunity, therefore, it was unnecessary to question whether Congress intended to do so).Back To Text

[123] *See* id. ("I would affirm . . . without the necessity of considering whether Congress intended to exercise a power it did not possess."). Back To Text

[124] Id.Back To Text

[125] *See* infra notes 137−44 and accompanying text.Back To Text

[126] *See* infra notes 143−50 and accompanying text.Back To Text

[127] 11 U.S.C. § 346 (1994).Back To Text

[128] 11 U.S.C. § 728 (1994).Back To Text

[129] 11 U.S.C. § 1146 (1994).Back To Text

[130] *See* 124 Cong. Rec. 17,406 (1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6512. "The House Ways and Means Committee and the Senate Finance Committee did not have the time to process a bankruptcy tax bill during the 95th Congress." Id. They had, at the time, anticipated amending the Internal Revenue Code and Title 11 early in the 96th Congress. Id.; *see* H.R. Rep. No. 595, supra note 52, at 275, *reprinted in* 1978 U.S.C.C.A.N. at 6232 (noting that H.R. 8200 had been amended to make sections inapplicable to federal taxes).Back To Text

[131] I.R.C. § 1398 (1988) (providing tax rules relating to Title 11 cases of individuals).Back To Text

[132] 11 U.S.C. § 1146(a) (1994) ("For the purposes of any *state or local law* imposing a tax on or measured by income . . . .").Back To Text

[133] *See, e.g.*, Donald D. Haber, The Declaratory Powers of Bankruptcy Courts to Determine the Federal Tax Consequences of Chapter 11 Plans, 3 Am. Bankr. Inst. L. Rev. 407 (1995).Back To Text

[134] 124 Cong. Rec. 17,406 (1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6512. "Since the special tax provisions are likely to be amended during the first part of the 96th Congress it is anticipated that the bench and bar will also study and comment on these special tax provisions prior to their revision." Id.Back To Text

[135] U.S. Const. art. I, § 8, cl. 4.Back To Text

[136] 382 U.S. 323 (1966) (upholding bankruptcy court's summary jurisdiction to compel claimant to surrender preference which under Bankruptcy Act would require disallowance of claim).Back To Text

[137] 11 U.S.C. § 346(a) (1994) (provides that provisions in § 346(b)−(j) are all subject to the IRC).Back To Text

[138] *See* In re Page, 163 B.R. 196, 197 (Bankr. D. Kan. 1994) (subsections listed in subdivision (a) of § 346 do not apply to IRC, but only to state and local laws). The section provides special tax provisions applying to state and local but not to federal law. 2 Collier on Bankruptcy, supra note 2, ¶ 346.01, at 346−6. Back To Text

[139] Kenneth N. Klee is a prominent member of the National Bankruptcy Conference and was a principal draftsman of the 1978 Bankruptcy Code.Back To Text

[140] *See* 2 Collier On Bankruptcy, supra note 2, ¶ 346.01, at 346−4 (citation omitted) (stating that "special tax provisions dealing with the treatment, under state or local, but not federal, tax law, of the method of taxing bankruptcy estates").Back To Text

[141] Id.Back To Text

[142] 11 U.S.C. § 1231 (1994) (providing special tax provision for certain state and local tax concerns).Back To Text

[143] *See generally* Todd Johnson, Note, *Two Codes Collide: Is Abandoning Property by a Chapter 7 Trustee a Tax Recognition Event for the Bankruptcy Estate*?, 14 J. Corp. L. 687 (1989).Back To Text

[144] In re A.J. Lane & Co., 133 B.R. 264, 274 (Bankr. D. Mass. 1991) (noting that taxing debtor upon foreclosure creates burden on debtor's fresh start).Back To Text

[145] In re Rubin, 154 B.R. 897, 902 (Bankr. D. Md. 1992) (finding that imposition of tax liability upon debtors would destroy opportunity for fresh start, therefore, where there is no overriding, countervailing policy, fresh start controls).Back To Text

[146] *See* id. at 901 (providing that abandonment was a recognizable transfer resulting in tax liability); A.J. Lane, 133 B.R. at 272 (same). *But see* Samore v. Olson, 930 F.2d 6, 8 (8th Cir. 1991) (holding abandonment of property when it is valueless or unprofitable is not taxable event for either state or federal taxes).Back To Text

[147] Johnston v. Webster (In re Johnston), 49 F.3d 538 (9th Cir. 1995).Back To Text

[148] Id. at 541 (holding abandonment of property by trustee proper where property was of inconsequential value to estate, regardless of fact that there might later be adverse tax consequences to debtor in form of taxable gain).Back To Text

[149] *See* 11 U.S.C. § 554(a) (1994). The effect of an abandonment divests the estate of title and revests title in the debtor. In re Argiannis, 156 B.R. 683, 688 (Bankr. M.D. Fla. 1993) ("The property becomes part of debtor's nonbankruptcy estate just as if no bankruptcy had occurred.") (quoting *In re* R−B−Co., 59 B.R. 43 (Bankr. W.D. La. 1986)); *see also* Jack F. Williams, The Tax Consequences of Abandonment Under the Bankruptcy Code, 67 Temp. L. Rev. 13, 20 (1994).Back To Text

[150] 11 U.S.C. § 554(c) (1994) (stating abandoned property is transferred to debtor unless court orders otherwise).Back To Text

[151] One example is where the creditor forecloses on the property. *See, e.g.*, A. J. Lane, 133 B.R. at 269. Of course the debtor, if possible, can always opt to redeem the property, or the debtor can reaffirm the debt and keep the property. *See* 11 U.S.C. §§ 524(c), 722 (1994).Back To Text

[152] *See* Williams, supra note 149, at 22 (discussing tax liability on net operating loss carryovers and abandonment).Back To Text

[153] *See* I.R.C. § 1398(a) (applies to individual cases falling under Chapters 7 and 11 of 11 U.S.C.); I.R.C. § 1398(g)(1) (providing that "estate shall succeed to and take into account . . . [n]et operating loss carryovers" that exist on first day of taxable year in which case commences).Back To Text

[154] *See* Rubin, 154 B.R. at 902 (holding that estate's abandonment of property does not shift tax liability to debtor); A.J. Lane, 133 B.R. at 272 (noting that it would be unfair to tax debtor on gain from foreclosure sale where he could not have benefit of using operating losses to offset gains from sale).Back To Text

[155] *See* 11 U.S.C. § 523(a) (1994); S. Rep. No. 989, 95th Cong., 2d Sess. 14 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800; H.R. Rep. No. 595, supra note 52, at 189, *reprinted in* 1978 U.S.C.C.A.N. at 6150; *cf.* Grant W. Newton & Gilbert D. Bloom, Bankruptcy & Insolvency Taxation 297 (1991).Back To Text

[156] *See* Todd Trierweiler, *When in* Debt Chapter 13 *Bankruptcy is* Better for Some Clients, 54 Or. St. B. Bull. 15, 18 (1994) (noting how taxing authority is prevented from seizing assets or garnishing wages by filing of Chapter 13 petition); Craig A. Gargotta, Death, Taxes and the Bankruptcy Reform Act of 1994, 13 Am. Bankr. Inst. J. 10, 13 (1995) (pointing out that in Chapter 13 unsecured general tax claims can be discharged with a nominal distribution).Back To Text

[157] I.R.C. § 6672 (1988 & Supp. V 1993) (permitting IRS to asses penalty against persons who willfully fail to pay or attempt to evade taxes equal to amount not paid). The IRS uses section 6672 to collect trust fund taxes from responsible persons. Id.Back To Text

[158] 11 U.S.C. § 507(a)(8)(G) (1994) (stating that "[t]he following expenses and claims have priority in the following order . . . (8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for . . . actual pecuniary loss"); *see* Paulson v. United States (In re Paulson), 152 B.R. 46, 48 (Bankr. W.D. Pa. 1992) (holding that punitive tax penalties could not receive priority treatment under statute which provides priority status for claims which are for actual pecuniary loss); In re Chief Freight Lines Co., 146 B.R. 291, 293 (Bankr. N.D. Okla. 1992) (stating that IRS penalty for nonpayment of employers portion of Federal Insurance Contributors Act (FICA) taxes was not "compensation for actual pecuniary loss" and thus did not receive priority under § 507(a)).Back To Text

[159] 11 U.S.C. § 523(a)(7) (1994); *see* Bleak v. United States, 817 F.2d 1368, 1370 (9th Cir. 1986) (holding tax penalties not dischargeable under § 523 of Bankruptcy Code); 3 Collier on Bankruptcy, supra note 2, ¶ 523.17, at

523−156 (stating that penalties become nondischargeable under subsection (a)(7) if underlying tax obligation which relates to the penalty is not dischargeable).Back To Text

[160] *See* 11 U.S.C. § 1322(a)(2) (1994) (requiring full payment of all claims entitled to priority under § 507).Back To Text

[161] *See* 11 U.S.C. § 1129(a)(9)(C) (1994) (providing that in Chapter 11 plans, claims made by governmental units for taxes will be paid out over six years, in an amount equal to value as of effective date of plan, equal to allowed amount of such claim); In re White Farm Equip. Co., 146 B.R. 736, 738−39 (Bankr. N.D. Ill. 1992) (holding no post confirmation interest is warranted despite actual delay in making payments), *aff'd sub nom.* United States v. White Farm Equip. Co., 157 B.R. 117 (N.D. Ill. 1993).Back To Text

[162] *See* 11 U.S.C. § 523(a)(1)(B), (C) (1994) (disallowing discharge where fraudulent return filed or where return was required but not filed or was filed late).Back To Text

[163] 11 U.S.C. § 1328(b) (1994) (allowing court to grant discharge, even after failure to complete all payments under the plan, where, for example, debtor's failure to complete such payments is "due to circumstances for which the debtor should not justly be held accountable"). Back To Text

[164] 11 U.S.C. § 1322(a)(2) (1994). All tax claims that are priority tax claims under § 507 must be paid in full, with the only exception being that the holder of a priority claim may consent to different treatment. Id. *See generally* 5 Collier on Bankruptcy, supra note 2, ¶ 1322.03, at 1322−7 to −11 (discussing treatment of priority claims under Chapter 13). Section 1322 further provides that the time period for payments must not exceed three years unless otherwise *approved* by the court in which case it shall not exceed five years. 11 U.S.C. § 1322(d) (1994) (emphasis added).Back To Text

[165] S. Rep. No. 989, supra note 155, at 13, *reprinted in* 1978 U.S.C.C.A.N. at 5799−801 (stating that principal purpose of giving debtor fresh start must be balanced with need for collection of tax claims in bankruptcy); *see also* id. at 5−6, *reprinted in* 1978 U.S.C.C.A.N. at 5791−92 (stating that Chapter 5 of Bankruptcy Reform Act of 1978 in part represents desire to give debtor fresh start).Back To Text

[166] *See* Williams, supra note 1, at 188 (pointing out that it seems that "Congress has subordinated a debtor's fresh start to several tax claims, including taxes arising within three years of the filing"); *see also* 2 Cowans Bankruptcy Law and Practice, supra note 2, § 13.1 (discussing how fresh start objective is diluted if debtor not provided with relief from tax liability).Back To Text

[167] *See* I.R.C. § 1275(a)(4) (1988), *as amended by* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101−508, § 11325(a)(2), 104 Stat. 1388 (striking paragraph (4) of subsection (a) and redesignating paragraph (5) as paragraph (4)). This section of the IRC, in situations where debt instruments were issued pursuant to a plan of reorganization for other debt instruments, treated the issue price of the new debt instrument as equal to the adjusted issue price of the old debt instrument where the new issue price is less than the adjusted issue price of the old debt instrument. *See* I.R.C. § 1275(a)(4) (1988 & Supp. V 1993).Back To Text

[168] The Omnibus Reconciliation Act of 1993, among other things, repeals the stock−for−debt exception which allowed bankrupt or insolvent taxpayers to avoid tax attribute reduction when their debts were forgiven or otherwise discharged. *See* Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103−66, § 13226(a), 107 Stat 312, 487−88 (1993). There seemed to have been a number of reasons for the repeal of the stock−for−debt exception. *See* McQueen & Williams, supra note 27, § 21.16. Among those reasons were the "mismeasurement of income, needless transactional complexity and tax planning to unduly influence transactional structuring." Id. at 21−19. *See generally*, Dr. Grant Newton & Dr. Paul Wertheim, Examining the Impact From the Repeal of the Stock−For−Debt Exception, 3 Am. Bankr. Inst. L. Rev. (1995) (reporting and analyzing results of study of publically traded companies after repeal of stock−for−debt exception).Back To Text

[169] I.R.C. § 108 (1988 & Supp. V 1993).Back To Text

[170] The stock−for−debt exception provided that "[t]he discharge of debt in exchange for equity of the debtor [would] remain tax free if the debtor corporation is in a Title 11 case or tot he extent the debtor corporation was insolvent before the exchange." McQueen & Williams, supra note 27, § 21.16 (citing I.R.C. § 108(e)(10)(B) (1988)). The exception had the added advantage of allowing the debtor to avoid tax attribute reduction when their debtor are forgiven or otherwise discharged. Id. Note, however, that the amendments to the stock−for−debt exception do not apply to stock which is transferred in satisfaction of a debt if the transfer was done pursuant to a "title 11 or similar case . . . which was filed on or before December 31, 1993. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103−66, § 13226(a)(3)(B), 107 Stat. 312, 488. The "grandfather provisions were intended to allow Congress to take a second look" at the repeal of the section. McQueen & Williams, supra note 27, § 12.16.Back To Text

[171] Historically, the stock−for−debt exception did not apply where the taxpayer issued only token shares of stock or where the stock was transferred on a relatively disproportionate basis. Williams, supra note 1, at 173 (citing I.R.C. § 108(e)(8)(A) (1988) (repealed 1993)).Back To Text

[172] Treas. Reg. § 1.108−1(b) (1994). The regulation provides that the stock−for−debt exception does not apply where debt is discharged for stock that is token or nominal. Id.Back To Text

[173] *See* 11 U.S.C. § 523 (1994). Many taxes are excepted from discharge under the Bankruptcy Code. *See* id. For example, involuntary gap tax claims under § 507(a)(2) and tax claims of governmental units are not dischargeable, whether or not such taxes were filed or allowed. Id § 523(a)(1)(A). Additionally, taxes relating to returns not filed are not dischargeable. Id § 523(a)(1)(B). All priority taxes under § 507 must be paid in full as required by § 1222(a)(2). 11 U.S.C. § 1222(a)(2) (1994). Similarly, § 1322(a)(2) requires that all priority taxes be paid in full. 11 U.S.C. § 1322(a)(2) (1994).Back To Text

[174] Haas v. IRS (In re Haas), 48 F.3d 1153 (11th Cir. 1995).Back To Text

[175] Id. at 1154 (stating that Haas used funds available to him to pay personal and business liabilities rather than his income tax liability).Back To Text

[176] *See* id. In 1987, Haas pled guilty to willful failure to pay his taxes for which he received a one year suspended prison term and five years of probation. Id. In addition to being convicted, the district court held that such taxes were not dischargeable because of debtor's tax evasion. Id. at 1155.Back To Text

[177] Id. at 1158 (holding that debtor's knowing failure to pay taxes, without more, did not constitute fraud).Back To Text

[178] Id. at 1161 (holding that debtor's intentional failure to pay was not a willful "`attempt in any manner to evade or defeat such tax' for purposes of § 523(a)(1)(C)").Back To Text

[179] *See generally* Lynn M. Murtha, Note, *"Willfulness" and* Attempts to Evade or Defeat Taxes Under the Bankruptcy Code's Section 523(a)(1)(C) Exception to Discharge, 3 Am. Bankr. Inst. L. Rev. 469 (1995).Back To Text

[180] *See* supra p. 32 (statement of Mr. Phelan).Back To Text

[181] *See* supra text accompanying notes 156−63 (noting problems faced by taxing authorities in Chapter 13 cases).Back To Text

[182] *See* 11 U.S.C. § 1129(a)(9)(C) (1994) (providing for deferred payments over a period not to exceed six years). Some courts have held reorganization plans feasible, under § 1129, which provide for a "balloon payment" to a creditor after a given period of payouts. United States v. Volle Electric, Inc. (In re Volle Electric, Inc.), 139 B.R. 451, 454 (C.D. Ill. 1992); In re Snowden's Landscaping Co., 110 B.R. 56, 59 (Bankr. S.D. Ala. 1990) (allowing plan with graduated quarterly payments).Back To Text

[183] *See* supra note 182.Back To Text