

How to Interpret 11 U.S.C. § 523(A)(*): Unambiguous or Inharmonious?

By: Robert Meyer

Outside of bankruptcy, “. . . nothing can be said to be certain, except death and taxes.”¹ Inside of bankruptcy, nothing is certain about taxes, especially how they are treated in regard to an 11 U.S.C. §523 discharge. This article will preliminarily review the basic constructs of denying discharge to taxpayer debtors in bankruptcy and how there is a slight difference between late filers and timely filers. Then, this article will review how the Bankruptcy Abuse Prevention and Consumer Protection Act’s (BAPCPA)² now famous hanging paragraph has created a division among the circuits relating to any ability by a late-filing taxpayer having taxes discharged in bankruptcy.

Pre-BAPCPA Taxpayers Who Are Subjected to Potential Denial of Discharge for Tax Debt

Non-priority tax debt is generally dischargeable.³ In bankruptcy, Congress enacted exceptions to this general allowance of discharge. Essentially, three types of taxpayers need to be concerned: (1) tax protestors or scofflaws; (2) frauds; and (3) procrastinators. None of these exceptions are surprising, especially the first two. Tax protestors simply never file tax returns. Therefore, the consequences of their acts are denial of any tax liability for those tax years.⁴

Tax frauds file returns which are essentially fictional accounts of their income with an intended purpose of paying less than what is owed. The consequence of their fraud, is the denial of any tax liability for those years.⁵ Procrastinators, unlike scofflaws or frauds, do not have the requisite intent to deceive. In turn, their discharge for the taxes is altered. In order to be discharged of their tax liabilities, procrastinators need to wait two years from the tax return’s filing.⁶

Sometimes, the tardily filing taxpayer was subjected to review for his/her tardiness – were they intending to deceive as opposed to simply being dilatory? From this issue arose the application of the *Beard Test*.⁷ The *Beard Test* looks to the following or whether: (1) the document purports to be a return; (2) the document is signed under penalty of perjury; (3) the document contains sufficient data to calculate tax liability; and (4) the document represents an honest and reasonable attempt to satisfy the requirements of the tax law.⁸ Any 1040 form satisfies the first three elements. In bankruptcy, the fourth element, through jurisprudence, incorporated an “honest and reasonable attempt” standard. If the debtor’s attempts were “honest and reasonable”, the debtor would be discharged of the tax debt.

Hence, pre-BAPCPA, the simple rule of thumb for a bankruptcy discharge of a tax debt is a chronological test: If the bankruptcy petition is filed more than three (3) years after tax assessments of a *timely filed return*, the tax should

be discharged.⁹ The tax assessment date is measured by the date the IRS receives the taxpayer’s return. Alternatively, if the bankruptcy petition is filed more than two (2) years after tax assessments of an *untimely filed return*, the tax should be discharged – so long as the delay was honestly and reasonably caused.¹⁰

Post-BAPCPA Alteration of Late Filed Returns

The above-recited rule has subsequently been altered by BAPCPA.

BAPCPA made statutory revisions to 11 U.S.C. §523(a) by creating a definition of “return” in a hanging paragraph located after 11 U.S.C. §523(a)(19), which courts describe as 523(a)(*). That section reads:

For purposes of this subsection, the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a)¹¹ of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b)¹² of the Internal Revenue Code of 1986, or a similar State or local law.

By one code (bankruptcy) referencing another code (tax), and many practitioners being knowledgeable about one code and not the other, this clause becomes problematic on many levels. But, walking back and forth between the codes brings some clarity and delivers insight to the inequitable results which may occur.

BAPCPA Late Returns

BAPCPA created a new dichotomy. Because § 523(a)(1) uses the pre-BAPCPA language, while the 532(a)(*), or the hanging paragraph, creates new interpretation and potential modification of § 523(a)(1), draconian rulings have been entered which effectively assert any “late” return represents a tax liability which will not be discharged. This conflict between § 523(a)(1) and § 523(a)(*) has evolved to two interpretations: (1) a strict prohibition of a tardily filed tax return’s tax liability from being discharged; or (2) a weighing test to determine whether or not to discharge the tax liability of a tardily filed return.

(1) Strict Prohibition

Three circuits demand no discharge from any return filed after April 15, unless appropriate extension(s) were granted.¹³ Hypothetically these rulings conclude that a return

filed one minute late will make the debt nondischargeable. These courts assert that a late-filed return fails to meet the hanging paragraph's definition of "return" which describes such as meeting the "requirements of applicable nonbankruptcy law." The First Circuit concluded that timely filing was a "requirement of nonbankruptcy law." If untimely, there was a "no return." This is a valid argument using logical analysis. But, such rulings have their detractors.

(2) The *Beard* Weighing Test

The *Beard* Test governs in the Fourth, Sixth, Seventh, Eighth, Ninth and Eleventh Circuits.¹⁴ Instead of using chronologically rigid time lines, these courts create a test to determine if a tax debt, from an untimely filed return, would be dischargeable.¹⁵ These bankruptcy courts rely on the Tax Court's *Beard* opinion's definition of the term "return." In Bankruptcy, the *Beard* Test usually only reviews the fourth element, or whether or not the filed paper was "honest" and whether or not the delay was "reasonable."

Strict Statutory Construction's Reasoning

The hanging paragraph problem may essentially be a derivative of statutory myopia. Do you read the statute alone? Or, do you interpret the statute as it affects related provisions?

For decades, the United States Supreme Court has determined that bankruptcy is handled by strict statutory construction. In short, the plain meaning of the statutory language can hopefully determine the result through a simple analysis of the text governing the subject matter. Only if the statutory provision is not specific does the United States Supreme Court engage in holistic statutory interpretation.¹⁶ If the court can determine at the outset that the statutory provision is unambiguous on its face, the highest court would ordinarily rule by strict analysis and avoid concepts of equity or similar concerns. But, the "plain meaning" of a statute must read harmoniously with other statutes.

Recently, circuits were falling in line by denying tax discharge on strict statutory construction of a single statute.¹⁷ By adhering to a strict review of the hanging paragraph, these courts determined that § 523(a)(*) cannot be read any differently than its simple meaning: a "return" is only a "return" if it is timely filed. Under this interpretation, a late-filed tax return's liability – filed one day, one hour, one minute, even one moment late – is nondischargeable. These decisions *all* assert that the hanging paragraph is unambiguously written; because, timely filing is obviously what was meant by the term "applicable filing requirements."

Eleventh Circuit's *Shek*¹⁸ Decision

After three circuits (First, Fifth and Tenth) sided in denying the discharge by asserting any late filed return is not a return as defined under § 523(a)(*), the Eleventh commenced its opposite conclusion with this preface: "We do not, however, agree that the phrase 'applicable filing re-

quirements' unambiguously includes filing deadlines."¹⁹ The *Shek* court in the Eleventh Circuit further wrote, "this is the interpretation implicitly adopted by our sister circuits. And it may well be the best reading of the language 'applicable filing requirements' when considered in isolation."²⁰

The court looked to another bankruptcy decision, and found that "applicable" was not synonymous with "all."²¹ The *Shek* court then concluded that the term meant, "... those filing requirements that are 'relevant' or 'appropriate' to the task of defining a 'return'—that is, those that deal with what a return is."²² This last cited sentence essentially delivers the review to the first three elements of the *Beard* Test.

Understanding that the problem is created by the isolated review of the hanging paragraph, as opposed to the Bankruptcy Code as a whole, the Eleventh Circuit referenced a Justice Antonin Scalia treatise which states, "[c]ontext is a primary determinant of meaning," and "[t]he entirety of the document thus provides the context for each of its parts."²³ This conclusion answered the contradiction posed by the strict construction application's denial of discharge for a late-filed tax return under § 523(a)(*) which emasculated the allowance of a discharge of a late-filed tax return under § 523(a)(1)(B)(ii).²⁴ Strict statutory interpretation succumbs to literal interpretation when it delivers irrational, discordant, inharmonious or absurd conclusions.²⁵

Even the IRS Agrees to Discharge the Taxes

Before 2020, three circuits had absolutely denied the discharge of taxes for late-filing taxpayers who file bankruptcy. Before the 2020 Eleventh Circuit's *Shek* decision, this was true even though the IRS sided with the allowance of the discharge. Shocking to some, the strict *per se* rule continues not to be followed by the IRS. The Office of the Chief Counsel rejected the One-Day-Late Rule and stated, "[r]ead as a whole, section 523(a) [11 U.S.C. § 523(a)] does not provide that every tax for which a return was filed late is nondischargeable."²⁶

Legislation Always Will Have Weak Links

Congress, a collective made of human judgment, can err. Especially, when enacting legislation. And, Congress usually enacts legislation without envisioning all circumstances. Because legislative amendment is a slow process, some courts justify dynamic or nautical rulings. Alternatively, others limit themselves to strict statutory construction and avoid "dynamic"²⁷ or "nautical"²⁸ interpretation because they surmise that statutory corrections may only be implemented by Congressional action. One way to avoid this conflict is to address the question of whether or not there is disharmony in the floating paragraph. The Eleventh says there is; and, so it rules for the taxpayer debtor. The First,²⁹ Fifth³⁰ and Tenth³¹ ignore this concern and rule against the taxpayer bankruptcy debtor.

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CONCLUSION

Presently, the United States Supreme Court has denied review. Either the issue will reach the high court or be amended through legislation. Until then, this issue's resolution is guided by a debtor's residential jurisdiction's legal interpretation.

About the Author:



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Endnotes:

- Benjamin Franklin, in a letter to Jean-Baptiste Le Roy, 1789 Derived from, "Things as certain as death and taxes, can be more firmly believ'd." Daniel Defoe, *The Political History of the Devil*, 1726.
- The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) (Pub.L. 109-8, 119 Stat. 23, enacted April 20, 2005)
- Priority tax debt, in the alternative, is generally nondischargeable. 11 U.S.C. §§ 507(a)(3), (a)(8) (examples are: "trust fund" taxes; taxes incurred within a few years of the bankruptcy filing – neither of which require any bad intent of the debtor).
- § 523(a)(1)(B)(i)
- § 523(a)(1)(C)
- § 523(a)(1)(B)(ii)
- Beard v Comm'r of Internal Revenue*, 82 TC 766 (1984)
- The actual language is: "(1) it must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law."
- In re Moroney*, 352 F.3d 902 (4th Cir. 2003); *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999); *In re Payne*, 431 F.3d 1055 (7th Cir. 2005); *In re Colsen*, 446 F.3d 836 (8th Cir. 2006); *In re Smith*, F.3d (9th Cir. 2016) and *In re Justice*, 812 F.3d 738 (11th Cir. 2016)
- Id.*, § 523(a)(1)(B)(ii) and jurisprudential law of this clause with *Beard Test*.
- That sections reads:
 - Preparation of return by Secretary
If any person shall fail to make a return required by this title or by regulations prescribed thereunder, but shall consent to disclose all information necessary for the preparation thereof, then, and in that case, the Secretary may prepare such return, which, being signed by such person, may be received by the Secretary as the return of such person.
- That section reads:
 - Execution of return by Secretary
 - Authority of Secretary to execute return
- If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise.
- (2) Status of returns
Any return so made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes.
- In re Fahey*, 779 F.3d 1, 4 (1st Cir. 2015); *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014); and *In re McCoy*, 666 F.3d 924, 932 (5th Cir. 2012)
- 11 U.S.C. §§ 523(a)(1) and (8)
- Form 4868
- "Statutory construction, however, is a holistic endeavor. A position that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme because the same terminology is used elsewhere in a context that makes its meaning clear..." Justice Scalia, *United Sav. v Timbers of Inwood Forest*, 484 U.S. 365, 371 (1988)
- Dewsnup v Timm*, 502 U.S. 410 (1992), *Norwest Bank Worthing v Ahlers*, 485 U.S. 197 (1988), *United Savings Assn v Timbers of Inwood Forest*, 484 U.S. 365 (1988), *Patterson v Shumate*, 112 S. Ct. 2242 (1992), *Union Bank v Wolas*, 502 U.S. 151 (1991), *Toibb v Radloff*, 501 U.S. 167 (1991), *Pennsylvania DPW v Davenport*, 495 U.S. 552 (1990) and *United States v Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989)
- Mass. Dep't of Rev. v. Shek (In re Shek)*, 947 F.3d 770, 773 (11th Cir. 2020) appealed from *Shek v. Mass. Dep't of Rev. (In re Shek)*, 578 B.R. 918, 921 (Bankr. M.D. Fla. 2017) appealed from *Shek v. Mass. Dep't of Rev. (In re Shek)*, 578 B.R. 918, 919 (Bankr. M.D. Fla. 2017)
- Mass. Dep't of Rev. v. Shek (In re Shek)*, 947 F.3d 770, 775 (11th Cir. 2020)
- Shek* 947 F.3d at 776
- Shek* 947 F.3d at 776, citing *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69-70 (2011) (citing Webster's Third New International Dictionary 105 (2002); New Oxford American Dictionary 74 (2d ed. 2005); 1 Oxford English Dictionary 575 (2d ed. 1989)).
- Shek* 947 F.3d at 776, citing *Fahey*, 779 F.3d at 5
- Shek* 947 F.3d at 777, citing Antonin Scalia & Bryan Garner, *Reading Law: The Interpretation of Legal Texts* ("Reading Law") 167 (2012)
- This was one reason other courts would not apply strict construction. See *Maitland v. New Jersey, Div. Of Taxation (In re Maitland)*, 531 B.R. 516, (Bankr. N.J. 2015); *Johnson v. United States (In re Johnson)*, No. 14-CIV-80812, 2015 U.S. Dist. LEXIS 178488, at *28, 117. A.F.T.R.2d (RIA) 1418 (D.S.D. Fla. Feb. 5, 2015) In fact *Maitland* writes, "'If §523(a)(1)(B)(ii) is read so that it applies only to those few souls that the I.R.S. deems worthy of helping to file their tax returns, then the provision has undeniably been rendered insignificant.'" *Maitland* at 521(citing, *TRW Inv. v. Andrews*, 534 U.S. 19, 122 S. Ct. 441, 151 L. Ed. 2d 339 (2001)
- Criminal restitution discharge in Chapter 13 created a war of interpretation. *Pennsylvania Dept. Of Public Welfare Davenport*, 495 U.S. 552 (1990)
- Office of Chief Counsel Notice 2010-16 at 2, and see SBSE 05-0613-054 (June 28, 2013) citing Notice 2010-16 with approval.
- Dynamic statutory interpretation looks into three factors: (1) statutory text; (b) original legislative expectations; and (3) subsequent evolution of the statute. William N. Eckridge, Jr., *Dynamic Statutory Interpretation*, 135 U. PA. L. Rev. 1479, 1483 (1987)
- "Congress builds a ship and charts its initial course, but the ship's ports-of-call, safe harbors, and ultimate destination may be a product of the ship's captain, the weather, and other factors not identified at the time the ship sets sail." T. Alexander Aleinkoff, *Updating Statutory Interpretation*, 87 MICH. L. REV. 20, 21 (1987)
- In re Fahey*, 779 F.3d 1, 6 (1st Cir. 2015).
- In re McCoy*, 666 F.3d 924, 932 (5th Cir. 2012)
- In re Mallo*, 774 F.3d 1313, 1318 (10th Cir. 2014).

