Emerging Tax Issues: Tolling the 2-year Period, What's Up With McCoy & More

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WHERE IS HATFIELD WHEN WE NEED HIM?

The *McCoy* Rule Limits Tax Discharge in Bankruptcy

**OR DOES IT?**

*McCoy v. Mississippi State Tax Comm’n*, 666 F.3d 924 (5th Cir. 2012)

THE 5 BASIC RULES of TAX DISCHARGE

ISSUE REVOLVES AROUND
WHAT IS A RETURN?

11 U.S.C. § 523(a)(1)(B) requires a “return” or “equivalent report or notice” but does not define any of those terms.

Obviously a 1040 or analogous state tax return.

Prior to the hanging paragraph all courts used the Beard test.

Paraphrasing the BEARD 4-point test . . . it is a return if it . . .

1. contains sufficient information to permit a tax to be calculated, and
2. purports to be a return, and
3. is sworn to as such and
4. evinces an honest and genuine endeavor to satisfy the law.

Beard v. Commissioner, 82 T.C. 766 (1984), aff'd, 793 F.2d 139 (6th Cir. 1986)
THE McCoy RULING

A return that is filed late is, by definition, \textit{not a return}.

Hence, the 2-year rule can never be satisfied, and the tax can never be discharged.

\textit{McCoy v. Mississippi State Tax Comm'n, 666 F.3d 924 (5th Cir. 2012)}

THE IRS POSITION:

The IRS has repudiated the McCoy rule.*

IRS invokes the \textit{Beard} 4-part test.

* Office of Chief Counsel Notice 2010-016 (09/02/10).
IRS has declined to follow McCoy in numerous cases, including, \textit{Martin v. United States (In re Martin), 500 B.R. 1 (D. Colo. 2013); Smythe v. United States (In re Smythe), 2012 W.L. 843435 (Bankr. D. Wash. 2012); and Casano v. United States (In re Casano), 473 B.R. 504 (Bankr. E.D.N.Y. 2012).
IF THE IRS AND THE DEBTOR AGREE - WHAT IS THE PROBLEM?

A. Any case in the 5th Circuit
B. Courts outside 5th Circuit are using the McCoy rule to gloss over the post-assessment issue.* Debtor loses by default.
C. Abandoning the Beard test
D. State may not have rejected McCoy

*IRS argues only that a 1040 filed late and after the substitute-for-return assessment is not a valid return. This is not a § 523(a)(*) issue. Income tax returns are not subject to § 6020(b).
STATUTORY CONSTRUCTION

• Renders § 523(a)(1)(B)(ii) useless
  – An *untimely* return is not subject to § 523 because § 523 applies only to returns;
  – A *timely* return is not subject to § 523 because § 523 applies only to *untimely*
    returns.

ALSO RENDERS § 6020(b) USELESS

“If the parenthetical ‘(including applicable filing requirements)’ in the unnumbered paragraph created the rule that no late-filed return could qualify as a return, the provision in the same paragraph that returns made pursuant to section 6020(b) are not returns for discharge purposes would be entirely superfluous because a section 6020(b) return is always prepared after the due date.”

Office of Chief Counsel Notice 2010-016 at p.2 (September 2, 2010); and Gonzalez v. Mass. Dep’t of Revenue (In re Gonzalez), 2014 W.L. 888460 at *3 (1st Cir. B.A.P. 2014) taxing authority’s argument renders § 6020(b) superfluous.

Hence, there is no situation where the 2-year provision would apply to determine dischargeability.
Exalts general over specific.*

- § 523(a)(1)(B)(ii) is specific
- “applicable filing requirements” is vague and general

* “It is a well-settled principle of construction that specific terms covering the given subject-matter will prevail over general language of the same or another statute which might otherwise prove controlling.” *Thomas Kepner v. United States*, 195 U.S. 100, 125, 24 S.Ct. 797, 49 L.Ed. 114, 1 Ann. Cas. 655 (1904).

No legislative support

- A major departure from prior practice should be based on legislative intent.
- There is no relevant legislative history.*
- The cases, when they mention legislative intent at all, do not even attempt to cite relevant language. They simply assume.**


** E.g. “Presumably, Congress was made aware of the IRS’s position during the eight years that bankruptcy reform legislation was pending prior to the 2005 enactment of BAPCPA.” *Shinn v. Internal Revenue Serv. (In re Shinn)*, 2012 W.L. 986752 at *6 (Bankr. C.D. Ill. 2012).
Misconstrues non-bankruptcy (IRS) law

“A return that satisfies *applicable* non-bankruptcy law including *applicable* filing requirements”

The use of the term “applicable” acknowledges that some filing requirements *are not applicable*.

Applicable filing requirements include (i) filing the proper office; (ii) filing on the required forms; (iii) making sure the form is substantially complete; and (iv) signing under penalty of perjury.

In other words, a return meets applicable filing requirements if it qualifies as a return. *Gonzalez v. Mass. Dep’t of Revenue*, 2014 (W.L. 888460 (1sr Cir. B.A.P. 2014).

Applicable non-bankruptcy law for IRS does not make the date of filing the return a part of the definition of a return.

26 U.S.C. § 6072 requires that returns be filed on April 15 or October 15, *but failure to meet that date has no bearing on whether it is a return or not under IRS rules.*

*i.e.* the IRS filing date has never been *applicable to the IRS definition of a tax return.*

Shouldn’t the Bankruptcy Code definition match the Tax Code definition, as we are charged with looking at “applicable nonbankruptcy law”? 
Makes the tax on late-filed returns caused by circumstances out of the debtors’ control automatically nondischargeable:

Returns filed by servicemen in combat zones

Disaster victims


INTERPRETS OTHER BAPCPA CHANGES TO § 523(a) BASED ON LEGISLATIVE HISTORY

- 523(a)(1)(B)(i)
  “was not filed or given …”
- 523(a)(1)(B)(ii)
  “return, report, or notice …”

Is there a filing deadline to “give” an “equivalent report or notice …”? A strict reading of the terms suggest documents other than 1040 can satisfy the 2-year rule . . .

The addition of “equivalent report or notice” was intended to make state “follow-up” reporting requirements, i.e., state rules requiring notice to the state if changes were made to the federal return, returns for purposes of § 523(a)(1)(B). Cal. Franchise Tax Bd. v. Jackson (In re Jackson), 184 F.3d 1046 (9th Cir. 1999) (report of a change to the state taxing authority was not the equivalent of a return). Post BAPCPA cases include, Maryland v. Clotti (In re Clotti), 638 F.3d 276 (4th Cir. 2011) (audit change reported by IRS to Maryland, but, not by taxpayer; held, state tax nondischargeable); and Shorton v. Mass. (In re Shorton), 375 B.R. 26 (Bankr. D. Mass. 2007) (audit change reported by IRS to Massachusetts, but, not by taxpayer; held, state tax nondischargeable).
RECONCILING § 523(a)(1)(B)(ii) and “applicable filing requirements.”

- Applicable filing requirements cannot nullify (B)(ii)
- (B)(ii) should not nullify “applicable filing requirements.”

What respective roles do they play?

The hanging paragraph determines whether it is a valid return; (B)(ii) determines whether the valid return is filed more than 2 years prior to filing the petition.

WHAT CAN YOU DO?

- Avoid putting the question to the judge
- Get stipulation from IRS
- Write a powerful brief
  - Use Gonzalez as a guide. See also LateFiledReturn.com.
- Seek Amicus from NACBA
- Get stipulation in Tax Court
- Move to a different jurisdiction

• Late-filed* and more than 2 years before filing bankruptcy

• Does a prior bankruptcy, to the extent it’s automatic stay overlaps the running of the 2-year period, stop the clock on the two-year period?

*See LateFiledReturn.com


• Nothing in the Bankruptcy Code provides that anything tolls the 2-year period.

• Prior bankruptcy tolls the 3-year and the 240-day periods for the time the stay is in effect plus 90 days. 11 U.S.C. § 507(a)(8)(G) (“hanging paragraph”)

• Prior rule – nothing suspends the clock on the 2-year period. New IRS position – automatic stay of the period stops the clock based on equitable tolling and 11 U.S.C. § 108(c).


• Equitable tolling is based on the aphorism the Code allows the IRS two years to collect the taxes before they become dischargeable.

Rule:

A statute of limitations is tolled by equitable tolling.

The two-year period is a statute of limitations.

Rule adopted in *Putnam v. United States*

– Main arguments against:

1. 523(a)(1)(B)(ii) is not a statute of limitations. IRS does not lose ability to collect after the period expires; it depends on if or when the taxpayer filed bankruptcy.

Is it a “statute of repose”? 

ConsiderChapter13.org
Rule adopted in *Putnam v. United States*

- Main arguments against:
  2. Congress addressed tolling in BAPCPA amendments that specifically addressed both the 2-year rule and tolling, and did not include the 2-year period. Hence, lack of adding tolling to the 2-year rule suggests legislative intent to not toll the 2-year period.

*Putnam* rejects both theories.
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