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U.S. BANKRUPTCY COURT

New Mexico

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Case Name: Merrill v. Internal Revenue Service
Case Number: 06-01086-s
Document Number:

Docket Text:
Memorandum Opinion (RE: related document(s)[11] Motion for Summary Judgment filed by Plaintiff James Calder Merrill) (jeb)

The following document(s) are associated with this transaction:

06-01086-s Notice will be electronically mailed to:

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06-01086-s Notice will not be electronically mailed to:

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
JAMES CALDER MERRILL,
Debtor. No. 7-06-10250 SL

JAMES CALDER MERRILL,
Plaintiff,
v. Adv. No. 06-1086 S

INTERNAL REVENUE SERVICE,
Defendant.

MEMORANDUM OPINION ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This matter is before the Court on Plaintiff's Motion for Summary Judgment ("Motion")(doc 11) with accompanying Memorandum (doc 12), Defendant United States Internal Revenue Service's ("IRS") Response (doc 20) and Plaintiff's Reply (doc 22[1]). Plaintiff seeks a ruling that any taxes he owed for CY 1997 are discharged and that only the property that he owned on the date of the filing of his bankruptcy petition is subject to any lien of the Internal Revenue Service. The Court rules for the Plaintiff on the first issue and for the Internal Revenue Service on the second.[2]

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[1]Docket entry 21 is designated as the Reply, but is actually a duplicate of the Memorandum (doc 12).

[2] The Court has subject matter and personal jurisdiction pursuant to 28 U.S.C. §§1334 and 157(b); this is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I) and (K); and these are findings of fact and conclusions of law as required by Rule 7052 F.R.B.P. The underlying chapter 7 case was filed after the effective date of the applicable provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No.

(continued...)

Summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. Bankruptcy Rule 7056(c). In determining the facts for summary judgment purposes, the Court may rely on affidavits made with personal knowledge that set forth specific facts otherwise admissible in evidence and sworn or certified copies of papers attached to the affidavits. Fed.R.Civ.P. 56(e). When a motion for summary judgment is made and supported by affidavits or other evidence, an adverse party may not rest upon mere allegations or denials. Id. The court does not try the case on competing affidavits or depositions; the court's function is only to determine if there is a genuine issue for trial. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986).

UNDISPUTED FACTS

The relevant facts are undisputed[3].

1. Plaintiff filed his 1997 Form 1040 tax return on April 29, 2003. A copy of the return was attached as Exhibit 1. IRS claims it received the tax return on May 28, 2003.

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[2](...continued)
109-08, 119 Stat. 23, and therefore the changes enacted by that legislation are applicable to this adversary proceeding.

[3]IRS did not specifically address each numbered proposed undisputed fact in Plaintiff's Motion, and they are thus deemed undisputed by NM LBR 7056-1. IRS's own version of undisputed facts basically agrees with Plaintiff's version in any event.

2. In 1997 Plaintiff received early distributions of retirement assets he had put aside in 1989. He had been retired and living in Central America since 1990, and he used the money to pay debts he had accumulated there. The administrators of the retirement funds sent in Form 1099's to the IRS. Copies of the 1099's were attached as Exhibits 2 and 3: from Lincoln National Life Insurance Company for $310,150, and from Scudder Trust Company for $186,062. Together these total $496,212.

3. On July 24, 2000, IRS notified Plaintiff that it was going to make a consent to assessment and collection against him unless he appealed to the Tax Court within 90 days. Exhibit 4. Plaintiff did not appeal to the Tax Court and the assessment for 1997 taxes was made by IRS in the amount of $322,514.36. Plaintiff was then living in Guatemala.

4. Plaintiff subsequently returned to the United States and lived for a time in Spokane, Washington. The IRS filed tax liens against him in the State of Washington. The tax liens cited the date the taxes were assessed as October 22, 2001. Exhibits 5 and 6. The assessments were made pursuant to 26 U.S.C. § 6020(b) and the IRS was the preparer of the § 6020(b) return.

5. When Plaintiff filed his own tax return for 1997 Form 1040 taxes on April 29, 2003, he claimed exemptions and

deductions which were not present in the assessment made by the IRS on October 22, 2001.

6. The IRS accepted Plaintiff's 1997 return. Exhibit 7. IRS also raised Plaintiff's tax liability from $365,649.04 to $478,467.14 based upon the return. Exhibit 8. Of the increase, $6,982.88 was stated to be a "filing late" penalty.

7. Plaintiff did not ever submit an offer in compromise that was still pending within 240 days of his Chapter 7 petition date.

8. Plaintiff filed his chapter 7 petition on February 28, 2006 and received a discharge. He had filed no previous bankruptcies.

9. Plaintiff's assets, as shown on his bankruptcy schedules, Exhibit 9, consist of no real property and $890.00 worth of personal property. IRS has not challenged that the $890.00 of personalty is the extent of the collateral for the tax lien.

10. Plaintiff had insufficient income for the years 1990 through 1996 and 1998 through 2002 to be required to file tax returns for those years. Exhibit 10 (Affidavit).

11. There are no allegations that Plaintiff's return was fraudulent or made in an manner to evade or defeat the tax laws.

12. IRS objects to the Motion, arguing that "as a matter of law, because the Forms 1040 for 1997 was submitted after the taxes had been assessed, the Forms 1040 for that year did not constitute returns within the meaning of Section 523(a)(1)(B)(i)." Response, pp. 4-5 (doc 20).

DISCUSSION

A. DISCHARGEABILITY OF TAX DEBT

A determination regarding the dischargeability of a debt must begin with the recognition that exceptions to discharge are narrowly construed and any doubts must be resolved in favor of permitting the debtor to discharge the debt. See Bellco First Federal Credit Union v. Kaspar (In re Kaspar), 125 F.3d 1358, 1361 (10th Cir.1997). The exceptions to discharge are contained in Section 523 of the Bankruptcy Code. Section 523(a)(1) deals with taxes:

> (a) A discharge under section 727 ... of this title does not discharge an individual debtor from any debt--
> (1) for a tax or a customs duty--
> (A) of the kind and for the periods specified in section 507(a)(3)[4] or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
> (B) with respect to which a return, or equivalent report or notice, if required--
> (i) was not filed or given; or
> (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any

[4]Section 507(a)(3) claims arise in involuntary bankruptcy proceedings, and are not relevant to this case.

extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax[.]

...

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)[5] of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

Section 507(a)(8) provides in relevant part:

(a) The 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--

---

[5]26 U.S.C. § 6020 provides:

Returns prepared for or executed by Secretary.

(a) 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.

(b) Execution of return by Secretary.--

(1) 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.

> (A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition--
>
> (i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
>
> (ii) assessed within 240 days before the date of the filing of the petition, exclusive of--
>
> (I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and
>
> (II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days.
>
> (iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;
>
> ... or
>
> (G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.
>
> An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days.

Section 523(a)(1) therefore excludes from discharge three distinct types of tax: (1) priority taxes under 507(a)(8), (2) unfiled and certain late filed returns, and (3) returns that are fraudulent or made in an attempt to defeat the tax laws. Each of the three categories will be discussed.

First, Plaintiff's 1997 tax is not a Section 507(a)(8) priority tax. The 1997 return was due April 15, 1998, which is more than three years before the bankruptcy filing date. See § 507(a)(8)(A)(i). The 1997 return's taxes were initially assessed by IRS on October 22, 2001; the Debtor then self-assessed[6] additional taxes when he filed his return on April 29, 2003. Therefore, the 1997 taxes were not assessed within 240 days before the filing of the bankruptcy petition. See § 507(a)(8)(A)(ii). Finally, the 1997 taxes were not assessable after the commencement of the bankruptcy case. See § 507(a)(8)(A)(iii).

Second, IRS argues that the 1997 return was not submitted until after IRS had assessed the taxes and that therefore it was not a "return." See § 523(a)(1)(B)(i). IRS has support for this proposition; a line of cases has found that returns filed after the IRS has assessed a tax do not constitute a "return." These cases follow United States v. Hindenlang (In re Hindenlang), 164 F.3d 1029 (6th Cir. 1999).

> The Sixth Circuit framed the issue as "whether Forms 1040 filed after the IRS has made an assessment can constitute returns for purposes of § 523(a)(1)(B)." Hindenlang, 164 F.3d at 1032. Finding no formal definition of the term "return" in either the Bankruptcy Code or the Tax Code, the court adopted the four-part "Beard test" as the applicable test of

[6]The United States' tax system is based on self-assessment by individual taxpayers. See, e.g., United States v. Boyle, 469 U.S. 241, 249 (1985).

> whether a document qualifies as a return. Id. at 1034. The Beard test was derived from two Supreme Court cases, Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304, 60 S.Ct. 566, 84 L.Ed. 770 (1940), and Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 55 S.Ct. 127, 79 L.Ed. 264 (1934), and is so called because the four prongs of the test were first combined in Beard v. Commissioner of Internal Revenue, 82 T.C. 766, 1984 WL 15573 (1984). "In order for a document to qualify as a return: (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." Hindenlang, 164 F.3d at 1033 (quoting the district court's decision, 214 B.R. at 848). The deciding issue in Hindenlang was whether the forms represented "an honest and reasonable attempt to satisfy the requirements of the tax law." Hindenlang, 164 F.3d at 1034.
>
> The Sixth Circuit concluded that "when the debtor has failed to respond to both the thirty-day and the ninety-day deficiency letters sent by the IRS, and the government has assessed the deficiency, then the [debtor's] Forms 1040 serve no tax purpose, and the government thereby has met its burden of showing that the debtor's actions were not an honest and reasonable effort to satisfy the tax law." Id. at 1034-35. The court held as a matter of law that the debtor's forms were not returns within the meaning of § 523(a)(1)(B).

Colsen v. United States (In re Colsen), 311 B.R. 765, 769 (Bankr. N.D. Iowa 2004), aff'd., 322 B.R. 118 (8th Cir. BAP 2005), aff'd., 446 F.3d 836 (8th Cir. 2006). See also, e.g., Moroney v. United States (In re Moroney), 352 F.3d 902, 907 (4th Cir. 2003)(Holding that income tax returns filed after IRS has prepared substitute returns and assessed taxes do not constitute "returns" for purpose of 11 U.S.C. § 523(a)(1)(B)(i).)

There is, however, another line of cases that reject Hindenlang.

The case of United States v. Nunez (In re Nunez), 232 B.R. 778 (9th Cir. BAP 1999), represents a second line of cases dealing with the issue. In In re Nunez, the debtor failed to file timely federal income tax returns for tax years 1985, 1986, 1987, and 1989. The IRS prepared SFRs [Substitute For Return] for these tax years. By April 1993, the IRS had assessed the taxes owing, based on its own calculations. In 1994, the debtor filed Forms 1040 for the tax years at issue, reporting the same income as calculated by the IRS. In 1997, debtor filed a Chapter 7 bankruptcy petition and filed a complaint to determine the dischargeability of his income tax debt.

The United States argued in Nunez that a Form 1040 filed post-assessment cannot qualify as a return, because it does not serve the purpose of providing the information necessary to calculate the tax. The court rejected this argument as reading into § 523(a)(1)(B) a requirement that is not in the text of the statute. Congress did not condition the discharge of tax debt on whether a return was filed prior to assessment. In re Nunez, 232 B.R. at 781-82.

The government argued alternatively that the debtor's Forms 1040 did not represent an honest and reasonable attempt to comply with the tax laws, and thus did not meet the fourth prong of the Beard test. The court concluded, however, that good faith in the context of the Beard test should be construed narrowly. The question is whether the tax form appears “on its face to constitute an honest and genuine endeavor to satisfy the law.” Id. at 783 (citing Savage v. Internal Revenue Service (In re Savage), 218 B.R. 126 (10th Cir. BAP 1998)).

The United States alleged in In re Nunez that the debtor had filed a bankruptcy petition solely to avoid paying his tax liability. It argued that certain facts, including the number of years the debtor had failed to file a timely return, were indicia of bad faith. The essence of the government's claim was that the debtor had attempted to evade his taxes. In re Nunez, 232 B.R. at 783. As such, the government's focus was relevant to § 523(a)(1)(C). Because the United States had not raised § 523(a)(1)(C) as a basis for nondischargeability, the court granted the debtor's motion for summary judgment. Id.

Colsen, 311 B.R. at 769-70. See also Colsen v. United States (In re Colsen), 446 F.3d 836 (8th Cir. 2006)(Affirming lower courts' rulings that tax returns filed after IRS assessments were "returns" subject to discharge.) The Court of Appeals for the Tenth Circuit has not yet ruled on this issue[7]. However, in Savage v. Internal Revenue Service (In re Savage), 218 B.R. 126, 132 (10th Cir. BAP 1998) the Bankruptcy Appellate Panel for the Tenth Circuit ruled that "amended" returns filed by a debtor after IRS's substitute returns were "returns" subject to discharge under § 523(a)(1)(B)(i). This Court agrees with the reasoning of both Savage and the three Colsen cases and finds that Debtor's 1997 Form 1040 was a "return" that was filed.

Third, there are no allegations that Plaintiff's return was fraudulent or made in an attempt to defeat the tax laws. In fact, IRS used the return to increase Plaintiff's tax liabilities. The return did serve a "tax purpose", contrary to the facts in Hindenlang, 164 F.3d 1035, by actually increasing Plaintiff's liability as suggested by Maroney, 352 F.3d at 907.

[7]Compare Bergstrom v. United States (In re Bergstrom), 949 F.2d 341, 343 (10th Cir. 1991)("We hold that [IRS prepared] substitute returns do not constitute filed returns in the absence of the signature of the taxpayer, as required by 26 U.S.C. § 6020(a).")(Court also agreed that IRS's preparation of a substitute return did not excuse the taxpayer from the filing requirements; this suggests that the Court would treat a subsequently filed required return as a "return.")

Thus, even were the Court to accept Hindenlang and Moroney as correctly decided, they would be distinguishable on the facts.

Therefore, Plaintiff's 1997 taxes do not fit within any of the three categories of nondischargeable tax debts. Summary judgment should be granted declaring the 1997 taxes are dischargeable. The undisputed facts also establish that Plaintiff has no other tax liabilities for the years 1990 through 1996 and 1998 through 2002.

B. LIEN AVOIDANCE

Plaintiff seeks an Order limiting the IRS's tax lien to the sum of $890 as of the Chapter 7 petition date, and a finding that he may satisfy the lien by payment of the sum of $890 to the IRS. "The extent of a federal tax lien is determined by the amount of collateral on hand as of bankruptcy petition date, absent compelling equitable circumstances. 11 U.S.C. §§ 506, 552. Matter of Dente/Pender, 60 B.R. 164 (Bankr. M.D. Fla. 1986)." Complaint ¶ 10 (doc 1). The Court finds that Plaintiff is not entitled to this relief.

This is a chapter 7 bankruptcy case. Lien stripping is not available to a chapter 7 debtor. Dewsnup v. Timm, 502 U.S. 410, 417 (1992)("[W]e hold that § 506(d) does not allow petitioner to 'strip down' respondent's lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to §

502.").[8] See also Concannon v. Imperial Capital Bank (In re Concannon), 338 B.R. 90, 94 (9th Cir. BAP 2006)("Dewsnup teaches that, unless and until there is a claims allowance process, there is no predicate for voiding a lien under § 506(d). Absent either a disposition of the putative collateral or valuation of the secured claim for plan confirmation in Chapter 11, 12 or 13, there is simply no basis on which to avoid a lien under § 506(d)."; In re Stone, 329 B.R. 882, 884-85 (Bankr. M.D. Fla. 2005)("[A]ny lien of the IRS passes through the Chapter 7 case, and no authority exists to permit the Debtors to restrict the lien to the value of the Debtors' property as of the date that they filed their bankruptcy petition."); Mulligan v. United States (In re Mulligan), 234 B.R. 229, 236 (Bankr. D. N.H. 1999) ("The Court finds that [IRS] continues to hold its lien on the [Chapter 7 Debtor-] Plaintiff's real and personal property, and the Court also declines to effectively 'strip down' the [IRS's] lien by judicially determining the value of the Plaintiff's

[8] Plaintiff argues that Dewsnup v. Timm was expressly limited in its application to the redemption of real property from contractual mortgage, and therefore is inapplicable to these facts. Memorandum of [sic] Debtor-Plaintiff's Motion for Summary Judgment at 4 (doc 12), presumably referring to 502 U.S. at 416-17 ("We therefore focus upon the case before us and allow other facts to await their legal resolution on another day."). That statement was meant merely to avoid the interpretation of the statute to all possible fact situations in one opinion. Id. at 416. And the plethora of decisions cited in this opinion which apply Dewsnup v. Timm to a variety of situations illustrates that.

personal property."); Cleary v. United States (In re Cleary), 210 B.R. 741, 746 (Bankr. N.D. Ill. 1997)("The weight of reasoned authority holds that federal tax liens may not be 'stripped' down to the value of collateral securing them.")(Chapter 7 case.); Crossroads of Hillsville v. Payne, 179 B.R. 486, 490 (W.D. Va. 1995)(Dewsnup applies to all liens in a chapter 7 bankruptcy whether consensual or nonconsensual.); In re Place, 173 B.R. 911, 912 (Bankr. E.D. Ark. 1994)(After Dewsnup chapter 7 debtors may not strip down a creditor's lien to the value of the collateral, real or personal, under section 506(d).); In re Doviak, 161 B.R. 379, 381 (Bankr. E.D. Tex. 1993)("[T]he post-Dewsnup cases which have considered this issue in the context of chapter 7 have all held that § 506(d) is unavailable as a mechanism for reducing undersecured tax liens.") Plaintiff's citation to Matter of Dente/Pender is not persuasive. Dente/Pender was decided before Dewsnup and relies on the 506(a)/506(d) bifurcation theory that was overruled in Dewsnup. Dewsnup also makes clear that, in a chapter 7 context, future appreciation on collateral properly goes to the creditor. Dewsnup, 502 U.S. at 417. Also, Plaintiff's reference to § 552 is unavailing. Section 552 is limited to consensual liens; IRS has a statutory lien. See Dente/Pender, 60 B.R. at 165. See also In re May Reporting Services, Inc., 115 B.R. 652, 657 (Bankr. D. S.D. 1990)("Section

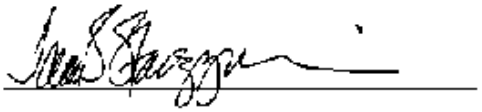
552(a) applies only to liens arising from consensual security agreements.")

Furthermore, tax liens pass through bankruptcy unaffected, even if the underlying tax debt is discharged. Isom v. United States (In re Isom), 901 F.2d 744, 745 (9th Cir. 1990)("We hold that 26 U.S.C. § 6325(a)(1) does not require the I.R.S. to release valid tax liens when the underlying tax debt is discharged in bankruptcy."). See also Warner v. United States (In re Warner), 146 B.R. 253, 256 (N.D. Cal. 1992)(Bankruptcy discharge of tax liability does not affect right of the government to proceed against the property subject to the lien.)

CONCLUSION

The Court will enter an Order Granting Plaintiff's Motion for Summary Judgment as to the dischargeability of the 1997 tax debt, and declaring that there is no tax liability for the years 1990 through 1996 and 1998 through 2002.

On the other hand, the Court will enter an Order granting summary judgment to IRS[9] on the issue of lien avoidance.



Honorable James S. Starzynski
United States Bankruptcy Judge

[9]IRS has not moved for summary judgment. A court may grant a non-moving party summary judgment sua sponte if it is clear that a case does not present an issue of material fact. Project Release v. Prevost, 722 F.2d 960, 969 (2nd Cir. 1983).

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