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EQUITABLE
Eleventh Circuit Agrees Bankruptcy Courts May Toll Priority Periods

In **United States v. Morgan, 1999 U.S. App. LEXIS 10741 (11th Cir. July 26, 1999)**, the first of a trio of appellate cases considering the Government's latest arguments on the issue of equitable tolling in bankruptcy,[1] the Eleventh Circuit concluded that the plain language of B.C. § 108(c) does not provide for the tolling of the priority period under B.C. § 507(a)(8)(A)(i) due to prior bankruptcy cases. However, the appellate court held that bankruptcy courts have the equitable power under B.C. § 105(a) to toll the priority period.

The debtors filed their first Chapter 13 bankruptcy in August, 1990. They failed to make all of their payments under the plan, and their case was dismissed by motion of the United States' Trustee in October, 1994. In January, 1995, the Morgans filed their second Chapter 13 petition. The Service again filed a proof of claim for priority taxes, but the debtors objected. Section 507(a)(8)(A)(i) allows priority status only to taxes less than three years old and, due to the intervening bankruptcy, the Service's claims now were stale, the debtors argued. The bankruptcy court disagreed, finding the priority period was tolled during the pendency of an earlier bankruptcy. The district court affirmed, and the debtors appealed.

Both parties agreed that the taxes in question were more than three years old, and therefore were dischargeable under B.C. § 1328(a). The parties agreed that the Service had been prevented by the automatic stay from collecting these taxes during the pendency of the debtors' first Chapter 13 bankruptcy. And the parties agreed that the plain language of the Bankruptcy Code fails to explicitly provide for the tolling of the three year period in section 507(a)(8)(A)(i). The Eleventh Circuit thus was left with the question of whether the priority period could be tolled in the absence of explicit language so permitting.

The Eleventh Circuit recognized that most of the appellate courts to examine this issue found B.C. § 108(c) extends the statute of limitations for creditors if applicable nonbankruptcy law so permits. However, the appellate court agreed with the contrary view

[1] Still pending are Sterns in the 5th Circuit and Palmer in the 6th Circuit.

of the Fifth Circuit in In re Quenzer, 19 F.3d 163 (5th Cir. 1993), which found the plain language of section 108(c) cannot apply to the priority period of section 507(a)(8)(A)(i), because that section is bankruptcy law. (Although some lower courts are still finding for the Service on section 108(c) grounds, the Government no longer argues this position).

However, the Eleventh Circuit agreed with the Service that the bankruptcy court's equitable powers under section 105(a) were broad enough to permit equitable tolling. Because such a determination is best made by the trial court on a case-by-case basis, the appellate court remanded. In remanding, though, the Eleventh Circuit provided some favorable guidance, holding that the equities will generally favor the Government in such cases. The appeals court found Congressional intent favors allowing the Government sufficient time to collect taxes. Further, the court recognized that some taxpayers could abuse the bankruptcy process to avoid paying taxes. In this case, the Eleventh Circuit found, the debtors agreed to pay their full liability to the Service in their first Chapter 13 plan, but failed to do so, and the Government was prevented from collection by the automatic stay. [2]

BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment: Suspension Under Bankruptcy Code

1. BANKRUPTCY CODE CASES: Automatic Stay
BANKRUPTCY CODE CASES: Chapter 13: Property of the Estate
BANKRUPTCY CODE CASES: Refunds: Setoff
In re Holden, No. 97-1020 (Bankr. D. Vt. July 21, 1999) - The Service's "v. freeze" code, preventing tax refunds from being issued to bankrupt debtors, violates the automatic stay. The bankruptcy court adopted the view that upon confirmation of a chapter 13 plan, property is revested in the debtor. Therefore, because a tax refund is property of the estate, the Service had no right of setoff, and its freeze of the debtor's funds was a violation of the confirmation order.

2. BANKRUPTCY CODE CASES: Automatic Stay: Duration
In re Hakim, 84 AFTR2d ¶ 99-5228 (Bankr. N.D. Cal. Aug. 12, 1999) - The court determined that the question of whether the automatic stay is reinstated after the court vacates a prior order dismissing the case is answered by whether or not the stay was in effect when the prior case was dismissed. Although this was a chapter 11 case, the court analyzed the process under all three chapters. Under chapter 13, the court found, the automatic stay would be reinstated upon vacating the order of dismissal to afford the debtor an opportunity to complete plan payments and

[2] There is no indication in the opinion that the Court considered the Service's current position on this issue, that the legislative history of section 507(a)(8)(A)(i) illustrates Congressional intent that the Service be allowed a full three years to collect priority taxes, unencumbered by intervening bankruptcies.

receive a discharge. In chapter 7, because the automatic stay was not in effect when the debtor received his discharge, the stay is not reinstated when the case is reopened. Finally, chapter 11 cases depend on whether or not the plan was confirmed before dismissal. A chapter 11 debtor with a confirmed plan does not need the automatic stay because the plan binds creditors.

3. BANKRUPTCY CODE CASES: Chapter 11: Effect of Confirmation (§ 1141): Post-Confirmation Taxes
BANKRUPTCY CODE CASES: Returns by Trustee, Debtor-In-Possession or Debtor: Individual: Debtor's Election to Close Taxable Year
In re Wood, 1999 U.S. Dist. LEXIS 12207 (C.D. Cal. July 15, 1999) - Debtor filed ch. 11 bankruptcy in October, 1995. The Service's claims were untimely filed, but the debtor included unpaid taxes in his plan of reorganization. The Service did not object to the plan. Following confirmation, the Service attempted collection against the debtor's 1995 tax liabilities. The Service argued that because the taxes were nondischargeable under B.C. § 523 and a post-petition debt, collection was proper. The debtor argued that by including provisions in his plan governing the payment of the 1995 taxes, the plan controlled their collection. The district court, overruling the bankruptcy court, found that because the debtor did not bifurcate the 1995 tax year, all of the 1995 taxes were post-petition debts. The court further found that because the Service had not subjected itself to the jurisdiction of the bankruptcy court by filing timely proofs of claim, the Anti-Injunction Act, I.R.C. § 7421(a), prohibits the bankruptcy court from restraining the Service's collection efforts.

4. BANKRUPTCY CODE CASES: Interest: Administrative and "Gap" Expenses
In re Weinstein, 1999 Bankr. LEXIS 1017 (Bankr. D. Mass. August 6, 1999) - Court chooses to follow minority position of In re Hospitality Associates of Laurel, 212 B.R. 188 (Bankr. D. N.H. 1997) and hold that postpetition interest on tax claims is not paid as an administrative expense. The court found the plain meaning of B.C. § 726(a)(5) is that postpetition interest has a fifth, not first, priority, and that the legislative history of section 503(b) indicates that a provision providing for interest on taxes was deleted.

5. BANKRUPTCY CODE CASES: Property of the Estate
In re Saunders, 1999 Bankr. LEXIS 947 (Bankr. S.D. Fla. July 2, 1999) - Bankruptcy court determines it has jurisdiction under 28 U.S.C. § 1334(e) over exempt pension funds, even though not part of the bankruptcy estate, because Service filed a claim in the debtor's chapter 7 bankruptcy and because satisfying this claim with the debtor's exempt funds affects distribution to other creditors.

6. BANKRUPTCY CODE CASES: Returns by Trustee, Debtor-in-Possession or Debtor
RETURNS: What Constitutes
In re Pierchoski, 1999 Bankr. LEXIS 1003 (Bankr. W.D. Penn. July 28, 1999) - On remand, the bankruptcy court held that the Forms 1040 filed by the debtor were

not returns under B.C. § 523(a)(1)(B)(i) and so the debtor's taxes were nondischargeable. Although the debtor argued that his challenges to the tax assessments were made in good faith, the court found as a matter of law under In re Hindenlang, 164 F.3d 1029 (6th Cir. 1999) that a return filed after the Service assessed the taxpayer can never represent an honest and reasonable attempt to satisfy the requirements of the tax laws.

7. BANKRUPTCY CODE CASES: Use, Sale or Lease of Property

Johnson v. I.R.S. (In re Williams) 235 B.R. 795 (D. Md. 1999) - Bankruptcy trustee may exclude capital gains generated by the sale of a residence from the tax liability of the bankruptcy estate under I.R.C. § 121. [The Service now agrees that I.R.C. §§ 1398(c)(1), (f)(1) and (g)(6) support the bankruptcy estate's claim to the section 121 exclusion. Consequently, the Service no longer will argue only the debtor, and not the bankruptcy estate, is entitled to the exclusion].

8. DAMAGES, SUITS FOR: Against District Director or Employee

Leavell v. Kieffer, 1999 U.S. App. LEXIS 19660 (7th Cir. August 19, 1999) - Bivens action against revenue agent for falsely testifying at trial was untimely filed because statute of limitations begins running when agent testified in court, not when tax court made its decision. Neither he ruling of the Tax Court nor its later decision quantifying the amount due was a fresh wrong committed by the revenue agent, nor was the claimed injury so trivial that a reasonable person would not have sought legal redress at the time it occurred.

9. DECEDENT'S ESTATES: Collection Procedures: Liability of Fiduciary
LIENS: Priority Over Miscellaneous Liens
TRANSFEREES AND FRAUDULENT CONVEYANCES: Uniform Fraudulent Conveyance Act

United States v. McLendon, Jr., 1999 U.S. Dist. LEXIS 12796 (N.D. Tex. July 28, 1999) - Insolvent estate borrowed money from related partnerships to pay creditors, including United States. The court found the Service lacked priority to the remaining funds on a number of grounds. First, the statute of limitations had expired on the estate tax claim under I.R.C. § 6324, leaving only a lien under section 6321, which was subordinate to the partnership's previously filed security interests. Next, the court found the partnership loans were subrogated to the administrator's right to reimbursement under Texas probate law, and so have priority under Texas law against tax claims. The court found the Government's fraudulent conveyance claim not properly pled and beyond the state statute of limitations, holding the Uniform Fraudulent Transfer Act a statute of repose (not of limitations) and so not governed by United States v. Summerlin, 310 U.S. 414 (1940) (United States not bound by state statutes of limitation). Finally, the judge rebuffed the Government's attempt to hold the estate's personal representative liable for paying claims ahead of the federal taxes. The court found the representative did not know the estate would become insolvent, and since the Government had no priority to rely on, it would not have been entitled to any additional assets in any case.

10. LIENS: Priority Over Security Interests

Plymouth Savings Bank v. United States, 1999 U.S. App. LEXIS 20797 (1st Cir. August 12, 1999) - Bank and Service both claimed funds owed by hospital to taxpayer under personal services contract. I.R.C. § 6323(c) extends the priority of prior security interests to certain qualified property obtained by the taxpayer within 45 days of the tax lien filing. The First Circuit held that even though the proceeds of the contract were only accounts receivables, under the Regulations for section 6323, contract rights and the proceeds thereof are acquired at the same time the parties enter into the contract. Because the taxpayer entered into the service contract 45 days after the Government filed its tax lien (even though she had not yet performed and had not been paid), the bank's security interest was superior to the Service's.

11. LIENS: Release

Bloom v. United States, 1999 U.S. Dist. LEXIS 11017 (M.D. Penn. July 1, 1999) - Taxpayer wrote to Service, asking for a "discharge" of a federal tax lien so he could sell his property. The taxpayer then filed suit under I.R.C. §§ 7432 and 7433 for improper assessment and failure to release the tax lien. The court found the taxpayer's letter did not comply with the requirements of Treas. Reg. 401.6325-1(f), neither stating the grounds on which the lien release was sought nor including a copy of the lien. Because the taxpayer failed to properly petition the Service for relief, the court found the taxpayer had failed to exhaust his administrative remedies, and therefore the court had no jurisdiction over his section 7432 claim. Further, the court found that the standard for negligent failure to release a lien under section 7432 was whether the proper Service employee knew or should have known that under section 6325 there was an actual or constructive finding, based on the contents of the taxpayer's letter, that the lien should have been released, a standard not met by the taxpayer. Finally, the court held that section 7433 does not provide a cause of action for lawful collection procedures taken in connection with an erroneous tax assessment.

12. LIENS: When Lien Arises

United States v. Davidson, 1999 U.S. Dist. LEXIS 10510 (D. Colo. July 8, 1999) - Under Colorado law, a taxpayer's renunciation of a bequest prevented him from acquiring an interest in the property to which a federal tax lien could attach.

13. PENALTIES: Failure to Collect, Withhold or Pay Over: Responsible Officer

United States v. Chene, 1999 U.S. Dist. LEXIS 10896 (M.D. Fla. July 2, 1999) - Service assessed taxes against taxpayer's corporation, and assessed trust fund recovery penalties against the taxpayer and her husband. Both taxpayer and her husband made payments which equalled the original tax assessment. The Service then erroneously refunded monies to the husband, and issued him a Certificate of Relief of Tax Lien. The taxpayer filed for bankruptcy, and the bankruptcy court disallowed the Service's proof of claim, holding that once a tax liability is paid, no erroneous refund can revive it. The district court reversed, finding that I.R.C. § 6672

establishes joint and several liability when two responsible persons are assessed with the penalty. The court agreed with the Service that until the limitations period for seeking a refund had expired, the Government could not be certain that it could keep the funds it had collected. Therefore, since the taxpayer's liability was never satisfied, the taxpayer was not prejudiced by the Service's errors.

14. TRANSFEREES AND FRAUDULENT CONVEYANCES: Alter Ego/Nominee

United States v. Scherping, 1999 U.S. App. LEXIS 18618 (8th Cir. August 11, 1999) - Taxpayers conveyed property to trusts to avoid taxes. The Eighth Circuit first held that the taxpayers lacked standing to raise a statute of limitations defense on behalf of the trusts. On the primary issue, the appellate court found that the trusts were sham entities used by the taxpayers to avoid their tax liabilities. Although Minnesota law does not explicitly provide for "reverse piercing" of the corporate veil, where the court treats the individual and the corporation as one entity (as contrasted with the more common corporate veil piercing where the corporate fiction is disregarded and the shareholders are held liable), the appeals court found reverse piercing well established in federal law. Further, the court found strong policy reasons in this case to allow reverse piercing, namely, strong evidence that the transfers were fradulent, a strong degree of identity between the deliquent taxpayers and the trusts, and the fact that no innocent parties would be affected by the reverse piercing.

15. TRANSFEREES AND FRAUDULENT CONVEYANCES: Uniform Fraudulent Conveyance Act

United States v. Barson, 1999 U.S. Dist. LEXIS 12251 (D. Utah July 16, 1999) - Taxpayer and his wife purchased a home in 1978 as joint tenants. In 1980, the taxpayer stopped filing tax returns or paying taxes. In 1983, the taxpayer transfered his half-interest in the property to his wife and infant son, without consideration and without their knowledge. The Service assessed the taxpayer in 1985, and filed suit to enforce its liens in 1997. The court found the taxpayer's transfer of the real estate did not contain sufficient "badges of fraud" under the Uniform Fraudulent Transfer Act, primarily because the transfer was recorded prior to the tax assessments. Thus, the court found the transfer was not a fraudulent conveyance, nor were the taxpayer's wife and son his nominees.