NO. 16-497

IN THE

Supreme Court of the United States

MARTIN SMITH,

Petitioner,

v.

INTERNAL REVENUE SERVICE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF THE NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER AND THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS *AMICI CURIAE* IN SUPPORT OF CERTIORARI

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Dated: November 14, 2016

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INTEREST OF AMICI CURIAE[1]

The National Consumer Bankruptcy Rights Center (NCBRC) is a 501(c)(3) organization, dedicated to preserving the bankruptcy rights of consumer debtors and protecting the integrity of the bankruptcy system. The Bankruptcy Code grants financially distressed debtors certain rights that are critical to the functioning of the bankruptcy system as a whole. However, consumer debtors with their limited financial resources and minimal exposure to the system are often ill-equipped to protect those rights in the appellate process. NCBRC files amicus briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

The National Association of Consumer Bankruptcy Attorneys (NACBA) is a non-profit organization of approximately 3,000 consumer bankruptcy attorneys practicing throughout the country. Incorporated in 1992, NACBA is the only nationwide association of attorneys organized specifically to protect the rights of consumer bankruptcy debtors.

Among other things, NACBA works to educate the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy

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[1] No counsel for a party authored this brief in whole or in part. No person other than the *amici* or its counsel made a monetary contribution intended to fund the preparation or submission of this brief. The parties' letters consenting to the filing of this brief have been filed with the Clerk.

process. NACBA also advocates for consumer debtors on issues that cannot be addressed adequately by individual member attorneys. NACBA has filed amicus briefs in this Court in several cases involving the rights of consumer debtors. *See, e.g.*, *Bank of America v. Caulkett*, 135 S. Ct. 1995 (2015); *Harris v. Veigelahn*, 135 S. Ct. 1829 (2015); *Clark v. Rameker*, 134 S. Ct. 2242 (2014); *Schwab v. Reilly*, 560 U.S. 770 (2010) (amicus brief cited in dissenting opinion).

The primary issue in this case—whether tax liability based on late-filed tax returns is dischargeable in bankruptcy—directly implicates the interests of the consumers whose rights NCBRC and NACBA support. This issue has been widely litigated across the circuits, and the courts are fractured in their approach. The incongruous result is that the ability of debtors to discharge tax debt in a bankruptcy will depend upon their geography, leading to disparate treatment of debtors and an inconsistent application of federal bankruptcy law.

The uniformity of the Bankruptcy Code is undermined by the discord among the circuit courts, which cannot agree on a definition of "return" for dischargeability purposes. Certain courts reduce portions of the Bankruptcy Code to statutory surplusage. Other interpretations effectively make the IRS, not the courts or the Bankruptcy Code, the arbiter of whether tax obligations based on a late-filed return are dischargeable.

QUESTION PRESENTED

The deeply divided circuits have multiple, conflicting answers to the enquiry of whether the filing of a late tax return absolutely bars bankruptcy discharge of related tax obligations.

Exceptions to discharge are codified in section 523 of the Bankruptcy Code. 11 U.S.C. § 523. Among these exceptions are three categories of tax debts: 1) those for which a return was never filed, 2) those for which a return was filed late, and 3) those calculated on a fraudulent return. Section 523(a)(1)(B)(ii) contemplates discharge of taxes based on late-filed returns in certain circumstances. Despite the plain statutory text, the circuit courts struggle to decide whether tax obligations arising from late-filed returns may be dischargeable. In accordance with the statute, the Eighth Circuit may permit discharge if a bankruptcy petition is filed two years after a late-filed return. In the Fourth, Sixth, Seventh, Ninth and Eleventh Circuits, by contrast, any return filed after the IRS has made its own assessment of tax liability is not considered a return for purposes of bankruptcy dischargeability. The First, Fifth and Tenth Circuits have taken a more severe approach, ruling that all taxes described on late-filed returns—even those filed one day late for any reason—are barred from discharge.

The result is that taxpayers are treated differently during bankruptcy depending on where they are geographically situated; courts are both flummoxed as to the definition of "return," and divided over the joint issues of temporality and assessment.

OPINIONS BELOW

An overview of the case law leading to the sharp divisions is contextually helpful. Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) in 2005, the Bankruptcy Code did not define the term "return." Courts typically applied the four-part test from *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986). For a document to constitute a tax return under *Beard*, it needed to: 1) purport to be a return, 2) be executed under penalty of perjury, 3) contain data sufficient to calculate a tax liability and 4) represent an honest and reasonable attempt to comport with the requirements of tax law.

In 2005, BAPCPA added a definition of a return to section 523 in what has become known as the "hanging paragraph" or 523(a)(*), which provides that: "For purposes of this subsection, the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements)." The hanging paragraph additionally specifies that returns filed under section 6020(a) of the Internal Revenue Code are returns, but that returns filed under section 6020(b) are not.[2] Significantly, all the tax returns referred to in 26 U.S.C. § 6020 are returns prepared by the Internal Revenue Service on

[2] Returns filed under section 6020(a) are done so with the express cooperation of the delinquent tax-filer; returns prepared by the Service under section 6020(b) are done so without the benefit of any input from the tax-filer.

behalf of delinquent filers. Section 6020 does not address untimely returns filed by the taxpayer.

Despite the fact that the Bankruptcy Code itself contemplates late-filed returns and does not expressly bar discharge of obligations arising from them, courts have fragmented on the issue of what constitutes a return, when it is considered late, and which tax liabilities are therefore dischargeable.

The Fifth Circuit rejected the *Beard* test in *McCoy v. Mississippi State Tax Comm'n* (*In re McCoy*), 666 F.3d 924 (5th Cir. 2012), holding that filing by the due date is "an applicable filing requirement," and that tax liability arising from late returns can never be dischargeable unless the return meets the section 6020(a) exception in the Internal Revenue Code. Put another way, obligations resulting from a substitute return created by the IRS without the taxpayer's assistance are nondischargeable. Similarly, an untimely return filed directly by the taxpayer gives rise to nondischargeable tax obligations. But, liability resulting from a substitute return prepared by the IRS with the cooperation of the taxpayer is potentially subject to the bankruptcy discharge.

The Tenth Circuit followed *McCoy,* in dicta, in *Mallo v. IRS* (*In re Mallo*), 774 F.3d 1313 (10th Cir. 2014), rejecting arguments from the debtor that its ruling rendered the statutory provisions in both the Bankruptcy Code and the Internal Revenue Code superfluous. The First Circuit in *Fahey v. Massachusetts Dep't of Revenue* (*In re Fahey*), 779 F.3d 1 (1st Cir. 2015) also found that a debtor's failure to file a return on time rendered the debt nondischargeable, rejecting arguments regarding

statutory construction from the debtor, amici and a vigorous dissent from Circuit Judge Thompson.

The Fourth, Sixth, Seventh, Ninth and Eleventh Circuits adopt a different per se rule than the First, Fifth and Tenth Circuits. These courts conclude that once the IRS assesses tax liability based on a substitute for return (under section 6020(b)), then the resulting tax liability can never be dischargeable. These courts maintain that this is true, even where the taxpayer files a subsequent return correcting the return prepared by the IRS, and even when the taxpayer's return increases the taxpayer's liability. These courts conclude that taxpayers who file returns after assessment by the IRS can never satisfy the "honest and reasonable" prong of the *Beard* test. *Justice v. United States* (*In re Justice*), 817 F.3d 738 (11th Cir. 2016), *rehearing en banc denied*, No. 15-10273 (11th Cir. Sept. 19, 2016); *Smith v. United States* (*In re Smith*), 828 F.3d 1094 (9th Cir. 2016); *United States v. Hindenlang* (*In re Hindenlang*), 164 F.3d 1029, 1034 (6th Cir. 1999); *Moroney v. United States* (*In re Moroney*), 352 F.3d 902, 907 (4th Cir. 2003); *United States v. Payne* (*In re Payne*), 431 F.3d 1055, 1059–60 (7th Cir. 2005).

Finally, the Eighth Circuit in *Colsen v. United States* (*In re Colsen*), 446 F.3d 836 (8th Cir. 2006) adopted a more nuanced approach finding that so long as returns substantively complied with applicable filing requirements, they would be considered "returns" for bankruptcy purposes. Taxes based on these "returns" would therefore be dischargeable so long as the other provisions of section 523(a)(1) were satisfied.

Significantly, the IRS takes the position that debt reported on late-filed tax returns should be dischargeable, so long as the IRS has not already conducted its own assessment.[3]

REASONS FOR GRANTING THE WRIT

I. THERE IS A PERSISTENT AND WELL-DEVELOPED CONFLICT AMONG THE CIRCUITS

This case provides the Court with an opportunity to resolve a long-standing and well-entrenched conflict among the circuits over whether the filing of a late tax return absolutely bars the discharge of tax related obligations. This skirmish involves not only divergent outcomes, but also explicit disagreement among the courts of appeals over the reasoning that has led to the conflicting results. The multiplicity of answers to the enquiry reflects a fundamental discord among the courts as to how to interpret the Bankruptcy Code itself.

The circuits are squarely split on the judicial interpretation of late-filed tax returns, taking at least three different approaches to similar sets of facts. A plurality of the courts of appeals have held that such returns are a legal nullity in the bankruptcy world, despite references to late-filed returns in both the Bankruptcy Code and Internal Revenue Codes. *McCoy* and its progeny illustrate that courts are comfortable making rulings that

[3] Chief Counsel Notice 2010-016, 2010 WL 3617597 (Sept. 2, 2010); https://www.irs.gov/pub/irs-ccdm/cc_2010_016.pdf.

render statutory law meaningless. These "one-day-late" cases agree that an exception to the rule exists exclusively for returns filed under section 6020(a)—that is, instances where a taxpayer cooperates with the IRS in the creation of a substitute return. Oddly, the exception under the *McCoy* rule is not broad enough to include returns filed late by taxpayers on their own accord.

This is problematic for two reasons. First, section 523(a)(1)(B)(ii) of the Bankruptcy Code specifically contemplates the discharge of tax obligations based on late returns filed at least two years prior to the bankruptcy. If, as *McCoy*, *Mallo* and *Fahey* claim, tax returns filed even one day late are not tax returns for bankruptcy purposes, there would be no reason to have statutory references to late returns in either the Bankruptcy or Internal Revenue Codes. Indeed, if returns under 523(a)(*) are only those filed on time, section 523(a)(1)(B)(ii) is a toothless provision.

Second, the reading espoused by *McCoy* and its progeny renders the exclusion of returns filed under 26 U.S.C. § 6020(b) redundant. If the rule is that tax obligations based on late-filed returns are only dischargeable when they satisfy section 6020(a), then there is no need for section 6020(b). Under *McCoy*, returns pursuant to section 6020(b) would merely represent a subset of returns that fall into the general nondischargeability rule; there would be no need for Congress to explicitly state that tax obligations arising from 6020(b) substitute returns were nondischargeable. Further, because returns are almost never filed under 6020(a), the exception—recognized by some circuits—is illusory. The IRS itself acknowledges as much. *See* Chief Counsel

Notice 2010-16 at p. 2 ("the supposed 'safe harbor' of 6020(a) is illusory"); *see also Wogoman v. IRS* (*In re Wogoman*), 475 B.R. 239, 249 (10th Cir. B.A.P.). Finally, permitting tax obligations to be dischargeable only for late returns filed under section 6020(a) inexplicably punishes debtors who file late, but before the IRS devotes resources to creating a substitute return.

Though other circuits are less stringent in their evaluations of late filed returns, they have nonetheless ruled that post-assessment returns are not returns for bankruptcy purposes. There is no statutory support for such a position.

All of the "one-day-late" cases were decided after the 2005 amendments to the Bankruptcy Code added the hanging paragraph to clarify the definition of "return." The lower courts are in desperate need of resolution, to ensure that the Bankruptcy Code is applied uniformly, and to help elucidate the statutory references to late-filed returns which so many of these courts have been content to ignore.

II. THIS IS AN IMPORTANT ISSUE

The importance of developing a consonant body of law is undermined when tax debt is dischargeable in one jurisdiction but not another. Taxing authorities accept late-filed tax returns; they are not legal nullities. Yet bankruptcy courts are confounded by them.

When is late too late? Is it one day, as held by the First, Fifth and Tenth Circuits? Or is it any time prior to tax assessment by the IRS, as held by the Fourth, Sixth, Seventh, Ninth and Eleventh

Circuits? Or, is the question determined by the totality of the circumstances as is the case in the Eighth Circuit? Or should a late return be considered a return so long as the taxing authority considers it a return under applicable non-bankruptcy law?

The circuit conflict warrants resolution by this court. As it stands, the late-filing taxpayer who files for bankruptcy in Des Moines will be allowed to discharge their tax liability; a similarly situated resident of Dallas will remain saddled with the entire burden, and denied the fresh start anticipated by the Bankruptcy Code.

As a policy matter, this case punishes the late-filing, good faith taxpayer, who still makes an attempt to comport with the law; Petitioner Smith in fact self-assessed a greater tax liability than the IRS did. The Bankruptcy Code presupposes such a debtor in section 523(a)(1)(B)(ii), its late-filing provision. These lower court rulings effectively expunge the provision from the Bankruptcy Code while simultaneously superimposing subjective bad-faith upon all late filers.

Without resolution, the inconsistent lower court decisions will continue to wreak havoc on the bankruptcy bar and the debtors for whom bankruptcy offers a second chance.

III. THIS CASE IS AN APPROPRIATE VEHICLE FOR RESOLUTION

Courts have already wrangled with this issue in the First, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth and Eleventh Circuits and remain wildly divided. The conflicts have had many years to

develop in the circuits, and courts are no closer to reaching any consensus.

The adverse consequences of the lower court decisions will continue to affect debtors differently, depending upon where they live. The collisions among the disparate rulings have created a purgatory of statutory surplusage that must be emancipated—or at least clarified—by a uniform decision.

Because the IRS objects only to the dischargeability of post-assessment tax liability, this case also represents a clean opportunity for airing out the conflict with the IRS as a party, while also resolving the split over the "one-day-late rule"—a position not adopted by the Service.

In reviewing this matter, the court is empowered to answer a simple question that has confounded multiple courts in myriad ways. By determining whether a taxpayer filing a post-assessment return has filed a "return" under section 523(a)(1)(B), this court can free the lower courts of the encumbrance of looking to *Beard* for a definition of "return" and help to vindicate the existence of sections 523(a)(1)(B)(ii) and 6020(b).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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