WHAT'S WRONG WITH MCCOY?

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The Bankruptcy Code explicitly provides for the discharge of tax debts even when a taxpayer files a late return. Section 523(a)(1)(B)(ii) states that tax debts may be dischargeable if the taxpayer files a timely tax return, or if a late return is filed more than two years prior to the petition date.[2] Despite the plain language of the Code, in In re McCoy,[3] the Fifth Circuit Court of Appeals held that a late filed tax return is not a "return" for purposes of the Bankruptcy code (the "McCoy Rule"). The result is that a tax debt for which a late return was filed can never be discharged. This major departure from past practice is not warranted by either the plain language of the Code or the legislative history of BAPCPA, neither of which suggests that Congress intended to make tax debts related to late filed returns non-dischargeable in all circumstances.[4]

The McCoy Decision

The McCoy Rule completely disregards section 523(a)(1)(B)(ii), which according to the Fifth Circuit plays no role in the dischargeability analysis. Instead, the court in *McCoy* relied exclusively on the hanging paragraph of section 523(a)(19). In relevant part, the hanging paragraph states:

> For purposes of this subsection, "the term 'return' means a return that satisfies the requirements of applicable non-bankruptcy law *(including applicable filing requirements)*… [emphasis added].

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[2] Section 523(a)(1)(B)(ii) states:

(a) A discharge…does not discharge an individual debtor from any debt—
(1) for a tax or customs duty—
…
(B) with respect to which a return, or equivalent report or notice, if required—
…
(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition…

[3] 666 F.3d 924 (5th Cir. 2012).

[4] For up-to-date information on cases addressing this issue, see www.latefiledreturn.com.

Focusing on the language "(including applicable filing requirements)" the *McCoy* court held that the phrase means if a return is required to be filed by a certain date and it is filed late, then by definition it is not a return for purposes of determining dischargeability.

Problem #1 – Section 523(a)(1)(B)(ii) is nullified by the *McCoy* decision.

If the document is filed late and hence it is by definition not a "return," it is not subject to section 523(a)(1)(B)(ii) because that section only applies to "returns." If, on the other hand, the return is filed timely, again, it is not subject to section 523(a)(1)(B)(ii) because that section only applies to late-filed returns.

If that's the case, then why, while Congress was busy amending section 523(a)(1)(B)(ii) in other ways, did Congress not delete the second part of section 523(a)(1)(B)(ii), which provides that for a late-filed return to be excepted from discharge it must have been filed both late and *within 2 years of the bankruptcy*? Why, in fact, did Congress not simply delete section 523(a)(1)(B)(ii) entirely?

According to the McCoy Rule section 523(a)(1)(B)(ii) serves no purpose.[5]

In the absence of legislative history justifying it, nullifying section 523(a)(1)(B)(ii) violates a long-established rule of statutory construction that no statute should be interpreted to render a portion of it superfluous. A widely used rule of construction is that courts should " … give effect, if possible, to every clause and word in a statute, avoiding, if it may be, any construction which implies that the legislature was ignorant of the meaning of the language it employed."[6]

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[5] IRS Memorandum CC-2010-016 (September 2, 2010), identifies other text that would be pointless if the *McCoy* Rule is adopted (" … [the rule 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.")

[6] *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (refusing to read one provision of the Bankruptcy Code to render another superfluous); *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991); *Montclair v. Ramsdell*, 107 U.S. 147 (1883).

A recent bankruptcy case rejected the *McCoy* Rule for this reason. The court in In re *Martin* referring to *McCoy* said; "*This interpretation says too much . . . essentially rendering § 523(a)(1)(B)(ii) superfluous*."(emphasis added). [7]

Problem #2 – *McCoy* allows the general to trump the specific.

"[A] general statute will not be held to have repealed by implication a more specific one unless there is 'clear intention otherwise."[8] The principle that specific overrides general terms that relate to the same exercise or enactment is widely followed. *McCoy* replaces a specific term (late and filed within two years of bankruptcy) with a general or ambiguous term ("applicable filing requirements").

Problem #3 – *McCoy* misconstrues applicable nonbankruptcy law.

The third flaw in the *McCoy* opinion is that, in addition to nullifying section 523(a)(1)(B)(ii), it renders superfluous the words that begin the definition of a return pursuant to the hanging paragraph (the very words inserted by BAPCPA in the 2005 Act).

That language states, "For purposes of this section a return is a return that satisfies the applicable requirements of *non-bankruptcy law* …" (emphasis added)

If we are looking at federal income taxes, the most obvious body of applicable non-bankruptcy law is the Internal Revenue Code and associated Treasury Regulations.[9] But *McCoy* and its progeny essentially shut out the IRS definition of a return and replace it with their own.

The current definition of a valid return under IRS regulations rejects *McCoy* and provides that, in fact, a return is a return if it satisfies the 4-part criteria of what is sometimes called the *Beard*[10] test, and at other times the *Hindenlang*[11] test. An official memorandum from the Office of Chief Counsel of the IRS, promulgated in September 2010 stated: " … the better view is that Congress

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[7] *Martin v. U.S.*, 482 B.R. 635 (Bankr. D. Colo. 2012).
[8] *Morton v. Mancari*, 417 U.S. 535, 550-51 (1974); *Fourco Glass Co. v. Transmirra Products Corp*. 353 U.S. 222, 228 (1957).
[9] *Green v. U.S.,* 472 B.R. 347, 357 (Bankr. W.D. Tex. 2012).
[10] *Beard v. Comm'r of Internal Revenue*, 82 T.C. 766, 82 T.C. No. 60 (U.S.T.C. 1984) (*citing Zellerbach Paper Co. v. Helvering,* 293 U.S. 172, 55 S.Ct. 127, 79 L.Ed. 264 (1934)); *Diamond v. U.S.*, 107 Fed. Cl. 702 (Fed. Cl. Dec. 11, 2012).
[11] *U.S. v. Hindenlang*, 164 F.3d 1029 (6th Cir. 1999).

did not intend to repeal the longstanding law that taxes assessed in accordance with a return filed late are governed primarily by section 523(a)(1)(B)(ii) ...."[12]

The four prongs of the *Beard* Rule are:

- First, there must be sufficient data to calculate tax liability;
- Second, the document must purport to be a return;
- Third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and
- Fourth, the taxpayer must execute the return under penalties of perjury.

Note that timely filing is not one of the prongs of the *Beard* test. And, this rule is employed by all United States Tax Courts and the vast majority of bankruptcy courts, even for cases arising after the adoption of the 2005 amendments to the Code.[13]

Problem #4 – Legislative intent does not support *McCoy.*

Several of the cases that have adopted the McCoy rule appear to cite what they think is legislative intent for support. But these cases typically do not cite legislative history or other evidence in the record, instead merely assuming what Congress meant, or simply citing each other as authority without doing any research.

One example is Shinn v. Internal Revenue Service,[14] which attempts to justify the *McCoy* Rule based on legislative intent. In rejecting the IRS position (that a late-filed return can be a valid return) it makes some sweeping statements such as, "Presumably, Congress was made aware of the IRS's position during the eight years that bankruptcy reform legislation was pending …"[15] But the opinion cites nothing to support this presumption.

Several bankruptcy courts have cited the salient rule of statutory construction:

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[12] IRS Chief Counsel Notice, CC-2010-016, 2010 WL 3617597 (Sept. 10, 2010).
[13] *See, e.g.,* In re *Wogoman*, 475 B.R. 239 (B.A.P. 10th Cir. 2012); In re *Brown*, 2013 WL 951797 (Bankr. D. Mass. Mar. 11, 2013); In re *Smythe*, 2012 WL 843435 (Bankr. W.D. Wash. Mar. 12, 2012); In re *Shorton*, 375 B.R. 26 (Bankr. Mass. 2007).
[14] *Shinn v. Internal Revenue Serv.* (*In re Shinn*), 2012 WL 986752 (Bankr. C.D. Ill. Mar. 22, 2012).
[15] *Shinn*, 2012 WL 986752 at *6.

> This Court has been reluctant to accept arguments that would interpret the Code, … to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.[16]

Why did Congress add the "applicable filing requirements" to section 523?

One of the authoritative sources of legislative intent is Congressional committee reports. In this case the most germane document is H.R. Report 109-31.[17] The only thing the Report says is that an agreed return under 26 U.S.C. § 6020(a) is a valid return, but an unagreed return under section 6020(b) is not. There is no evidence here that Congress's intent was to eliminate the function of section 523(a)(1)(B)(ii) or to impose a temporal filing requirement as part of the definition of a return.[18]

It is clear that in adopting the 2005 amendments to the Code, Congress studied, debated, and amended for almost a decade before a final version was signed into law. Congress was looking carefully at section 523(a)(1)(B)(ii) and made several changes to that subsection; hence, leaving the late-filed and two-year language in section 523(a)(1)(B)(ii) as is cannot be deemed a legislative oversight.

H.R. 901-31 relates to the last version of BAPCPA in 2005. Looking back in time to the earliest history regarding the Act, a report of the Committee on the Judiciary in connection with The Bankruptcy Reform Act of 1999 contains this brief remark:

> Sec. 814. Income tax returns prepared by tax authorities.
> Under this section, for purposes of 11 U.S.C. § 523(a)(1)(B)(ii), "return" includes returns filed by the governmental unit or a written stipulation to judgment entered by a nonbankruptcy tribunal.[19]

Again, no evidence of intent to do away with 523(a)(1)(B)(ii).

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[16] *Dewsnup v. Timm*, 502 U.S. 410, 419 112 S.Ct. 773, 116 L.Ed.2d 903 (1992); *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 563 110 S.Ct. 2126 (1990).

[17] H.R. Rep. 109-31, at 103, 109th Cong., 1st Sess., 2005 U.S.C.C.A.N. 88, 167 (2005).

[18] *Martin v. U.S.*, 482 B.R. 635 (Bankr. D. Colo. 2012) ("There is nothing in the legislative history to the BAPCPA amendment that indicates it was intended to have such an effect on § 523(a)(1)(B)(ii)"); *see also Wogoman v. IRS*, 475 B.R. 239, 249 (B.A.P. 10th Cir. 2012) ("Our own research has uncovered nothing to support the conclusion that the hanging paragraph was intended to create the rule that a late-filed federal income tax return can never lead to discharge.").

[19] Statement of the National Bankruptcy Conference prepared for the Hearing Regarding "The Bankruptcy Reform Act of 1999" (H.R. 833), U.S. House of Representative, Committee on Commercial and Administrative Law (Mar. 17, 1999), *available at* http://judiciary.house.gov/legacy/106-klee.htm.

Digging a little deeper we find, from the "Unpublished Legislative History,"[20] that the intent of the amendments was to overrule In re *Elmore*,[21] and codify In re *Hindenlang*.[22] *Elmore* held that providing information at a Tax Court trial was equivalent to "filing" a return, and *Hindenlang* held that a return filed after the assessment was not a good-faith effort to comply with tax regulations. Neither opinion attempted to negate section 523(a)(1)(B)(ii).
Ironically, both opinions relied on *Beard* to define a return.

Finally, from the 1997 Final Report of The Tax Advisory Committee:

> "Filing of returns" presumes returns are properly filed -- i.e., with the right agency, at the right address, with the right tax identification numbers, with the requisite signatures, and subject to penalties of perjury/false filing. If not taken up in the context of discussion on "notice rules," such presumptions may need to be added to this proposal. "Returns" for purposes of this section would include substitutes for return that the debtor has signed and nonbankruptcy tax tribunal stipulations of liability.[23]

Once again, no mention of a temporal filing requirement.

If Congress had actually intended to make late-filed returns, without more, result in nondischargeability, it could have said this by amending section 523(a)(1)(B)(ii) to say, simply, " … or was untimely filed" and delete the two-year" language. The courts have invoked this rule in many decisions. For example, in *FCC v. Nextwave Personal Communications, Inc*.,[24] the Supreme Court stated that:

> [W]here Congress has intended to provide regulatory exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly, rather than by a device so subtle as denominating a motive as cause.[25]

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[20] *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005; Analysis and Explanation of the Title VII Tax*., James I. Shepard, J.D., LLM (taxation), Fresno, Ca., *available at* http://statesbankruptcy.com/pdfs/SABA%20Tax%20Provisions%20Explanation.pdf Shepard was a member of the original National Bankruptcy Review Commission.
[21] In re *Elmore*, 165 B.R. 35 (Bankr. S.D. Ind. 1994).
[22] *U.S. v. Hindenlang*, 164 F.3d 1029 (6th Cir. 1999).
[23] 26 CFR § 1.6011.1; *see* 26 U.S.C. §§ 6011, 6012 *et seq*.; *Huff v. Comm'r Internal Revenue*, 138 T.C. No. 1, 138 T.C. 1 (U.S.T.C. 2012).
[24] *FCC v. Nextwave Personal Comm., Inc*., 537 U.S. 293, 154 L.Ed.2d 863 (2003); *see also* In re *Hedrick*, 524 F.3d 1175 (11th Cir. 2008).
[25] *Nextwave,* 537 U.S. at 302.

Here, where Congress expressed no intention to eliminate the two-year, late-filed return rule, its silence must be viewed as controlling.[26]

RECONCILING THE TWO CLAUSES

Assuming, arguendo, that the McCoy rule is invalid, and that mere late-filing cannot, without more, result in non-dischargeability, we need to reconcile the two clauses in order to give each a logical purpose. Just as it is not correct to interpret "applicable filing requirements" to obliterate section 523(a)(1)(B)(ii), we must avoid rendering "applicable filing requirements" useless.

The IRS does have "applicable filing requirements" that bear on the definition of a return. What are they?

Refining the *Beard* criteria, we know that to be valid the return must be *filed* with the IRS.[27] It must contain financial *information* (not blanks or zeros).[28] It must be *signed*.[29] It must not be *frivolous*.[30] The jurat must not be altered.[31] And, it has to be *made by the taxpayer*, not the IRS; hence an IRS-filed "substitute for return" (SFR) or 6020(b) is not a valid return.

Any of those things can disqualify a 1040 as a valid return, *but late-filing, by itself, is not one of them*.[32] The date the return is filed bears only on whether the tax is excepted from discharge per section 523(a)(1)(B)(ii).

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[26] *Griffith v. U.S.*, 206 F.3d 1389 (11th Cir. 2000) ("Where Congress knows how to say something but chooses not to, its silence is controlling) *citing* In re *Haas,* 48 F.3d 1153 (11th Cir. 1995); In re *Turner*, 195 B.R. 476 (Bankr. N.D. Ala., 1996), *citing BFP v. Resolution Trust Corp*., 511 U.S. 531, 114 S. Ct. 1757 (1994)).

[27] 26 CFR § 1.6011; *see* 26 U.S.C. §§ 6011, 6012 *et seq*.; *Huff v. Comm'r Internal Revenue*, 138 T.C. No. 1, 138 T.C. 1 (U.S.T.C. 2012).

[28] *Oman v. Comm'r of Internal Revenue*, T.C. Memo 2010-276, 2010 WL 5209360 (U.S.T.C. Dec. 15, 2010); *Buckardt* v. *Comm'r of Internal Revenue*, T.C. Memo. 2010-145, 2010 WL 2540129 (U.S.T.C. July 1, 2010).

[29] 26 U.S.C. § 6061; In re *Allison*, 232 B.R. 195 (Bankr. Mont. 1998).

[30] *Campbell v. U.S.*, 140 B.R. 571 (W.D. Okla. 1992).

[31] *U.S. v. Moore*, 627 F.2d 830 (7th Cir. 1980).

[32] The IRS typically argues that a return filed after the taxes have been assessed is not a valid return because *it serves no purpose* once the assessment is made. This argument does not apply to a late-filed return that is filed before the assessment is made.

So, what we are left with is a two-step process that employs both provisions; first one decides whether the document in question is, or is not, a "return" per the hanging paragraph (without a temporal filing requirement). Then, if determined to be a "return" it is next subject to section 523(a)(1)(B)(ii) to determine dischargeability based on the temporal filing criterion prescribed by that provision. Hence, both clauses serve a purpose and they work together rather than against each other.

All of these suggest that the McCoy rule was at best hastily and superficially analyzed in connection with the meaning of the hanging paragraph. It should be revisited and reversed.