



Bankruptcy Primer: Priority, Discharge, and the Automatic Stay

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Priority — 11 U.S.C. § 507(a)(8)

Only an unsecured claim may enjoy priority; if claim is secured by properly perfected lien as of petition date, it is secured, see 11 U.S.C. § 506(a)(1);

- Most but not all “secured” claims are subject to bifurcation: secured to extent of value of creditor’s interest in estate property and unsecured as to the balance; unsecured portion of bifurcated claim may be entitled to priority if covered by § 507(a).

§ 507(a)(8) covers most, if not, all types of taxes but priority is limited by age for certain types of tax claims;

Ch. 7: Priority claims receive first distribution under § 726(a)(1); and

Ch. 11 and Ch. 13 plans must provide for payment in full of priority claims.



Priority — § 507(a)(8) (cont.)

§ 507(a)(8) defines when tax claim is entitled to priority:

(A) (i)-(iii) defines when claim for tax measured by income or gross receipts is entitled to priority

- Generally, if income tax debt is less than three years old or is assessed within 240 days of petition date, it enjoys priority;
 - This is an oversimplification, however, as 3-year or 240-day lookback periods are tolled if there was an offer in compromise or prior bankruptcy petition during the applicable look back period; and

(A) (iii) affords priority to taxes not assessed as of petition date but assessable under applicable law or by agreement after commencement of case.



Priority — § 507(a)(8) (cont.)

- (B) defines when pre-petition property taxes are entitled to priority;**
- (C) affords priority to “a tax required to be collected or withheld and for which the debtor is liable in whatever capacity”**
 - Trust Fund Taxes are entitled to priority regardless of age;
- (D) defines when an employment tax on wages, salary, or commission is entitled to priority**



Priority — § 507(a)(8) (cont.)

- (E) (i) – (iii) defines when “excise” taxes are entitled to priority**
- (F) (i)–(iii) defines when certain custom duties on the importation of merchandise may be entitled to priority; and**
- (G) affords priority to a penalty related to a claim of a kind specified in § 507(a)(8) and in compensation for actual pecuniary loss.**



Discharge

Scope of Discharge is Chapter Specific:

- **Chapter 7:** **11 U.S.C. § 727**
- **Chapter 9:** **11 U.S.C. § 941**
- **Chapter 11:** **11 U.S.C. § 1141**
- **Chapter 12:** **11 U.S.C. § 1228**
- **Chapter 13:** **11 U.S.C. § 1328**

§ 523 details whether and to what extent debts are excepted from discharge.



Chapter 7 Discharge — 11 U.S.C. § 727

Chapter 7 discharge only available to individual debtors; commercial entities do not receive a discharge under § 727;

Exceptions to availability of discharge enumerated in § 727(a):

- Deals with threshold question of whether debtor should be granted a general discharge, not with question of whether a particular debt is excepted from discharge, which is dealt with by § 523.
- Discharge is reserved for “honest but unfortunate debtor.”

§ 727(b) provides for discharge of all pre-petition debts except as provided for in § 523(a)



Chapter 11 Discharge — 11 U.S.C. § 1141

Discharge applicable to all debts except as otherwise provided for by plan;

Discharge occurs at confirmation;

Discharge provisions of § 1141 inapplicable if debtor liquidating under Ch. 11;

§ 1141 does not provide a discharge to a corporate debtor for debt owed to governmental unit based on fraud or false financial statements; or owed to person bringing qui tam action under False Claim Act (or similar state statute); and

§ 1141 does not provide a discharge to corporate debtor for debt for a tax or customs duty related to fraudulently filed return or debtor's willful attempt to evade or defeat a tax or customs duty.



Chapter 11 Discharge — § 1141 (cont.)

Individual debtor reorganizing under Ch. 11 receives discharge after plan completion unless, for good cause shown, court orders entry of discharge at confirmation;

Hardship discharge is available for individual debtors;

Individual Ch. 11 debtors are not discharged of personal liability for debts excepted under § 523;

Subchapter V — Small Business Reorganization

- If plan is consensual discharge occurs at confirmation
- If plan is confirmed under “cram down” provisions, confirmation occurs upon plan completion, see § 1191.



Chapter 13 Discharge — 11 U.S.C. § 1328

(a) Discharge enters upon plan completion and covers all debts provided for by plan except:

- Debts provided for under § 1322(b)(5) (long-term debts, i.e., mortgages);
- Debts identified by § 507(a)(8)(C) (trust fund taxes) and those identified in paragraphs (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of § 523(a);
- Debts for criminal restitution; and
- Debts for restitution or damages resulting from willful or malicious personal injury or death (part, but not all, of § 523(a)(6))
 - Note: Ch. 13 full compliance discharge is broader than general discharge under § 727(b);

(b) Hardship discharge is available.



Exceptions to Discharge — 11 U.S.C. § 523

§ 523(a)(1) defines what tax debts are excepted from discharge:

(A) Priority taxes defined in § 507(a)(8) are non-dischargeable

(B) Defines circumstances under which failure to file a return or filing of an untimely return renders tax due with unfiled or untimely return non-dischargeable

- *See In re Fahey*, 779 F.3d 1 (1st Cir. 2015) (late-filed tax returns are, by definition, ones that fail to satisfy requirements of applicable non-bankruptcy law, and which do not qualify as “returns,” for dischargeability purposes)

(C) Debtor’s filing of a fraudulent return or his attempt to willfully evade or defeat a tax renders associated tax debt non-dischargeable



The Automatic Stay — 11 U.S.C. § 362

The Automatic Stay codified at 11 U.S.C. § 362:

§ 362(a)(1)-(8) operate as a stay as to most (but not all) collection activity against debtor, debtor's property, and property of estate;

§ 362(b) provides an exhaustive list of stay exceptions;

§ 362(c) deals generally with duration of stay, procedures for extending stay in cases where, due to prior filing history, stay is temporary, and procedures for imposing stay when, due to prior filing history, stay is not automatic upon filing;

§ 362(d)-(g) deal with relief from stay and related issues; and

§ 362(k) provides a cause of action for stay violations.



Automatic Stay — Exceptions for Taxing Authority

§ 362(b)(9) excepts from stay:

- Audit by governmental unit for determination of tax liability;
- Issuance of a Tax Deficiency Notice;
- Demand for Tax Returns; and
- Making of an assessment of tax and demand for payment

§ 362(b)(26) excepts from stay setoff under applicable non-bankruptcy law of an income tax refund, by a governmental unit, with respect to a taxable period ending before the petition date against an income tax liability for period also ending before the petition date.



Boudreau v. U.S. (In re Boudreau), 622 B.R. 817 (B.A.P. 1st Cir. 2020) — FACTS:

Facts:

- After receiving his discharge under § 727, Debtor, then an inmate at a corrections facility in RI, commenced an adversary proceeding seeking determination of, *inter alia*, whether federal income tax debts scheduled in bankruptcy proceeding were discharged.
- Parties agreed that filing date of returns was dispositive:
 - If returns were filed in 2012, as debtor claimed, he would have no tax liability because IRS did not assess taxes against him within three years of filing of returns as required by § 6501(a) of the Internal Revenue Code ("I.R.C."). See 26 U.S.C. § 6501(a) (subject to exceptions not applicable here, federal income taxes must be assessed within three years of filing of a tax return).
 - **State of Maine analogue to IRC § 6501(a): 36 M.R.S.A. § 141(1) (subject to exceptions detailed in § 141(2), an assessment may not be made after 3 years from the date the return was filed or 3 years from the date prescribed for filing the return, whichever is later)**
 - If Debtor did not file returns until 2017, as IRS claimed, assessments in 2017 are timely, see 26 U.S.C. § 6501(c)(3) (limitations period for assessing federal income taxes does not begin to run until return is filed), and resulting tax liability is non-dischargeable under either § 523(a)(1)(A) or (B).
 - **State of Maine analogue to IRC § 6501(c)(3): 36 M.R.S.A § 141(2)(C) (assessment may be made at anytime with respect to a period for which a return has come due but not been filed)**



In re Boudreau, 622 B.R. 817 (cont.)

Question Presented:

- What constitutes legally sufficient evidence of a tax return's filing for purposes of discharge exceptions?

Positions of the Parties:

- IRS argues (a) it has produced documentary evidence sufficient to establish tax returns were not filed in 2012; (b) as a matter of law, exclusive methods for Debtor to rebut that evidence and show he filed the returns in 2012 are to produce direct proof (i) of actual delivery to IRS or (ii) of mailing of returns by registered or certified mail; and (c) he has failed to provide legally sufficient evidence of delivery of returns by one of these methods.
 - In effect, IRS argues that so-called "statutory mailbox rule", 26 U.S.C. § 7502, is exclusive means by which Debtor may prove he filed returns in 2012 (i.e., common law mailbox rules inapplicable in this context).
 - **State of Maine analogue to IRC § 7502(C) : 36 M.R.S.A. § 153 (date of USPS postmark stamped on envelope is deemed to be date of filing if document was deposited in mail, postage prepaid and properly addressed to intended recipient)**
- IRS also challenges subject matter jurisdiction of bankruptcy court, framing issue not as a determination of dischargeability but rather as a determination of whether 2017 Assessments were time barred under 26 U.S.C. § 6501(a).
 - Timeliness determination under § 6501(a) exists independent of bankruptcy proceeding, argues the IRS, such that such a determination does not come within even the bankruptcy court's "related to" jurisdiction, the broadest category of bankruptcy jurisdiction.



In re Boudreau, 622 B.R. 817 (cont.)

Position of Parties (cont.)

- Debtor argues that: (a) IRS's documentary evidence (Forms 4340) does not show tax returns were not actually received by IRS in 2012; (b) he may establish he filed returns on date alleged by use of the prison mailbox rule; and (c) his Declaration, is sufficient as a matter of law, to satisfy that rule.
 - In response, IRS maintains that even if Court applies a common law “mailbox rule” to determine whether returns were filed in 2012, Debtor’s uncorroborated, self-serving declaration—the entirety of his evidentiary submission—was insufficient, as a matter of law, to satisfy evidentiary requirements of mailbox rule or prison mailbox rule.
 - **SJC recognizes validity of the prison mailbox rule, at least as applied to court filings. See Martin v. Department of Corrections, 2018 ME 103.**



In re Boudreau, 622 B.R. 817 (cont.)

Holdings (Fagone, J.)

- In proceeding to except alleged tax debt from discharge, bankruptcy court had jurisdiction to resolve, not only the underlying dischargeability issue, but also the scope of debtor's tax liability;
- IRS certificates, reflecting that the IRS had no record of receiving tax returns for tax years in question until January 4, 2017, was sufficient to show that taxpayer had not previously filed returns; and
- Assuming prison mailbox rule applied outside context of court filings (tax return is not a court filing), debtor-taxpayer was required to produce something more than his self-serving declaration of mailing to obtain benefit of prison mailbox rule.