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Tax Trap: Priority Treatment of Tax Claims in Bankruptcy Court

Under 11 U.S.C. §507(a)(8) of the Bankruptcy Code, a tax claim is entitled to priority treatment if it is owed to a governmental unit for a tax on income for a pre-petition tax year for which a return was due within three years of the filing of the bankruptcy petition. The three-year period is referred to as the "lookback" period.

In 2005, 11 U.S.C. §507(a)(8) was amended, as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), by the addition of an "Unnumbered Paragraph," which provides:

"An otherwise applicable time period specified in this paragraph shall be suspended for . . . any time during which the stay of proceedings was in effect in a prior case under this title . . . plus 90 days."

The author of this article was recently involved in a case with the following chronology:

- August 15, 2005 – Filing deadline on debtor's tax year ending December 31, 2004 (Note: extension deadlines may vary)
- July 20, 2007 – First Chapter 13 petition filed
- August 20, 2007 – First Chapter 13 dismissed, 31 days after filing
- August 15, 2008 – Three years from filing deadline for 2004 taxes
- September 26, 2008 – Second Chapter 13 petition filed

In the second Chapter 13, the IRS filed an unsecured priority claim for the tax period ending December 31, 2004. Our position was that this claim should be classified as an unsecured general claim. The resolution of the dispute depended on the court's interpretation of the Unnumbered Paragraph of §507(a)(8).

If the phrase "plus 90 days" in the Unnumbered Paragraph was interpreted to add 90 days to the "three-year rule" when a prior bankruptcy case is filed, in addition to the time period during which the automatic stay was in effect with respect to the prior case, then the IRS claim for 2004 taxes would be an unsecured priority claim. On the other hand, if the phrase "plus 90 days" was interpreted as suspending the expiration of the three-year period during a prior case, plus 90 days, then the IRS claim for 2004 taxes would be an unsecured general claim.

We argued that the second interpretation reflects a better reading of the development of the law in this area. We pointed out that before BAPCPA was enacted, courts were presented with arguments that prior bankruptcy cases – during which the IRS could not file a lien or collect a tax – should not affect the running of the "three-year rule." Two lines of cases developed in response to these arguments.

In the Ninth Circuit, 11 U.S.C. §108(c) of the Bankruptcy Code regarding Extensions of Time was used to incorporate Internal Revenue Code §6503, resulting in the rule that in the circumstances described above, the three-year time frame would not expire during the prior case, nor would it expire for six months afterwards. *See In re West,* 5 F.3d 423 (9th Cir. 1993) and the cases cited therein, including *Brickley v. United States*

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(In re Brickley), 70 B.R. 113 (9th Cir. 1986), and *see United States v. Deitz (In re Deitz),* 116 B.R. 792, 794 (D.Col.1990).

The other line of cases used the principle of equitable tolling, culminating in the United States Supreme Court decision in *Young v. U.S.,* 535 U.S. 43 (2002), in which the Court held that, under equitable principles, a prior bankruptcy case will toll the "three-year rule."

In 2005, after a five-year legislative history, BAPCPA was enacted, resulting in the Unnumbered Paragraph. We argued that the Unnumbered Paragraph was intended to codify the equitable tolling rule of the *Young* case. Congressional Report on H.R. 2415, 146 Cong. Rec. at 511715; Report to Accompany S. 256:

"Though the statute is silent, the Supreme Court in *Young v. United States,* 535 U.S. 93 [sic 43] (2002), held that the three-year period is tolled during the pendency of a previous bankruptcy case. Section 705 amends Section 507(a)(8) of the Bankruptcy Code to codify the rule tolling priority periods during the pendency of a previous bankruptcy case, during the three year or 240 day period together with an additional 90 days."

We argued that, under the doctrine of equitable tolling, the goal is to protect the rights of parties but not to expand them.

Finally, we argued that by a proper reading of the Unnumbered Paragraph, if the three-year time period had not run when a prior bankruptcy case was filed, then such period would run the later of 90 days after the end of the prior bankruptcy case or the full three-year period. This interpretation allows the three-year rule to remain intact. Further, this interpretation fulfills the purpose of the legislation – to allow the IRS time to secure its claim or otherwise collect the debt.

The Oregon bankruptcy judge who presided over our case thought our arguments had appeal but concluded they ran afoul of the plain language of the statute.

The judge stated that the Unnumbered Paragraph provides that an otherwise applicable time period specified in this paragraph shall be suspended for any time during which the stay of proceedings was in effect in a prior case plus 90 days. The judge concluded that the lookback period ceases to run during the time that a debtor is in bankruptcy plus 90 days.

Given this decision, it is important to keep in mind that the phrase "plus 90 days" in the Unnumbered Paragraph adds 90 days to the three-year rule when a prior bankruptcy is filed, in addition to the time period during which the automatic stay was in effect during the prior case.

(Note: The rule discussed in this article does not change the rule in *In re West,* cited above, that the three-year time frame does not expire during the prior case, nor for six months afterward.)

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