No. 00-1567

In the Supreme Court of the United States

CORNELIUS P. YOUNG AND SUZANNE P. YOUNG,
PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether the three-year lookback period for determining the priority and nondischargeability of taxes pursuant to Sections 507(a)(8)(A)(i) and 523(a)(1)(A) of the Bankruptcy Code, 11 U.S.C. 507(a)(8)(A)(i), 523(a)(1)(A), is tolled during the pendency of a debtor's prior bankruptcy case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a) is reported at 233 F.3d 56. The opinion of the district court (Pet. App. 12a-13a) is unofficially reported at 2000-2 U.S. Tax Cas. (CCH) ¶ 50,522. The opinion of the bankruptcy court (Pet. App. 14a-22a) is unofficially reported at 99-1 U.S.Tax Cas. (CCH) ¶ 50,553.

JURISDICTION

The judgment of the court of appeals was entered on December 1, 2000. The petition for a writ of certiorari was filed on March 1, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

In addition to Sections 507, 523 and 727 of the Bankruptcy Code, 11 U.S.C. 507, 523 (1994 & Supp. V 1999), 727, which are set forth in relevant part at Pet. 1-3, the following statutes are involved in this case:

1. 11 U.S.C. 105(a) provides, in relevant part:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. * * *

2. 11 U.S.C. 108(c) provides, in relevant part:

> Except as provided in section 524 of this title, if applicable nonbankruptcy law * * * fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor, * * * and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of—
>
> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 30 days after notice of the termination or expiration of the stay under section 362 * * * of this title * * * with respect to such claim.

3. 11 U.S.C. 362(a) provides, in relevant part:

> Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title * * * operates as a stay, applicable to all entities, of—

> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title * * * .

4. 26 U.S.C. 6503(h) provides, in relevant part:

> The running of the period of limitations provided in section 6501 or 6502 [of the Internal Revenue Code] on the making of assessments or collection shall, in a case under title 11 of the United States Code, be suspended for the period during which the Secretary is prohibited by reason of such case from making the assessment or from collecting * * * .

STATEMENT

1. a. Petitioners requested and obtained an extension of time for filing their 1992 federal income tax return until October 15, 1993. They filed their return within that extended period but did not pay the amount that they acknowledged was due. Pet. App. 16a. The United States was able to collect only a portion of these past-due taxes before May 1, 1996. On that date, petitioners filed a petition for relief under Chapter 13 of the Bankruptcy Code. *Id.* at 2a. Upon the commencement of that bankruptcy case, the United States was barred by the "automatic stay" imposed under Section 362(a)(6) of the Bankruptcy Code from taking "any act to collect" the remaining unpaid taxes. 11 U.S.C. 362(a)(6). At the same time, the statute of limitations for the collection of these taxes was "suspended for the period during which" the automatic stay remained in effect. 26 U.S.C. 6503(h).

Every plan for administration of a Chapter 13 bankruptcy case must include a provision for making pay-

ment in full of the tax claims that are "priority" claims under Section 507 of the Bankruptcy Code. 11 U.S.C. 1322(a)(2). The tax claims given "priority" under Section 507 include income taxes for tax years for which the return was due (including extensions) no more than "three years before the date of the filing of the [bankruptcy] petition." 11 U.S.C. 507(a)(8)(A)(i) [hereinafter referred to as the "three-year lookback period" of Section 507(a)(8)]. Because petitioners' Chapter 13 bankruptcy case was filed less than three years after October 15, 1993—when their tax return for the 1992 tax year was due—petitioners were required to submit a Chapter 13 plan that provided for full payment of the government's claim. Pet. App. 15a.

b. Although petitioners submitted such a Chapter 13 plan, they thereafter failed to seek or obtain confirmation of that plan. Pet. App. 16a. Instead, on October 23, 1996 (eight days after the three-year lookback period of Section 507(a)(8) expired), petitioners filed a notice of dismissal of their Chapter 13 bankruptcy case. That dismissal was filed under the provision of Chapter 13 that authorizes debtors to dismiss their cases voluntarily at any time. *Id.* at 2a; see 11 U.S.C. 1307(b). When (as here) such a dismissal occurs before a plan is confirmed in a Chapter 13 case, any payments that have been made by the debtors to the Chapter 13 trustee are returned to the debtors. 11 U.S.C. 1326(a)(2). As a result, nothing was paid to the United States from the aborted Chapter 13 proceeding.

2. Just before the formal order dismissing the Chapter 13 bankruptcy case was entered by the bankruptcy court, however, petitioners filed a second petition for relief in bankruptcy. Pet. App. 16a. The second petition was filed under Chapter 7 of the Bankruptcy Code. Chapter 7, unlike Chapter 13, does

not require full payment of priority tax claims. Instead, priority tax claims that are not paid in a Chapter 7 case are excepted from the discharge obtained by the debtor under Section 523(a)(1)(A) of the Bankruptcy Code. 11 U.S.C. 523(a)(1)(A); see 11 U.S.C. 727(b). When, as here, the Chapter 7 case makes no provision for payment of priority taxes, the government is free to seek collection of these taxes upon the expiration of the automatic stay of the bankruptcy case.

In the present case, the government sought to collect the outstanding taxes owed by petitioners following the completion of the Chapter 7 case. In response, petitioners sought a determination from the bankruptcy court that the taxes they owe for their 1992 tax year were discharged in the Chapter 7 case. Pet. App. 16a. Petitioners asserted that these taxes were discharged in that second bankruptcy case because, (i) by the time that case was commenced (in 1997), more than three years had elapsed since the return for the 1992 tax year was due and that, (ii) as a result, the 1992 taxes were not "priority" taxes under Section 507(a)(8) and, (iii) that these taxes therefore were not excepted from discharge under Section 523(a)(1)(A).

3. a. The bankruptcy court rejected petitioners' contention. Pet. App. 14a-22a. The court agreed with the government that the taxes for 1992 were not discharged by the second bankruptcy case because the three-year lookback period under Section 507(a)(8) was tolled during the period in which the automatic stay was in effect during the first bankruptcy case. The court explained that the three-year lookback period of Section 507(a)(8) operates as a statute of limitations and is tolled by the provisions of the Bankruptcy Code and Internal Revenue Code that extend the statutes of limitations for collection of tax claims during the period

that the automatic stay is in effect. *Id.* at 19a (citing 11 U.S.C. 108(c); 26 U.S.C. 6503(b)). The court adopted the "well reasoned" decisions of the numerous courts that have concluded that the three-year lookback provisions of Section 507(a)(8) are tolled in these circumstances. Pet. App. 19a (citing, *e.g.*, *In re Waugh*, 109 F.3d 489 (8th Cir.), cert. denied, 522 U.S. 823 (1997); *In re Taylor*, 81 F.3d 20 (3d Cir. 1996); *In re West*, 5 F.3d 423 (9th Cir. 1993), cert. denied, 511 U.S. 1081 (1994); *In re Montoya*, 965 F.2d 554 (7th Cir. 1992)). The court emphasized that any other conclusion would result in "an absurd consequence unintended by Congress and would allow debtors to manipulate the bankruptcy system." Pet. App. 19a, 20a. Because the 1992 taxes thus remained priority taxes in the second bankruptcy case, the court held that these taxes were not discharged at the conclusion of that case and that the government's collection activities were therefore proper. *Id.* at 21a-22a.

b. The district court upheld the bankruptcy court's ruling. Pet. App. 12a-13a. The court noted that, "[w]hile there is a minor split of authority, the decided majority, and better reasoned, approach is that articulated by" the bankruptcy court in this case. *Id.* at 13a.

4. The court of appeals affirmed. Pet. App. 1a-11a. The court concluded that, even in the absence of an express statutory provision tolling the three-year lookback period of Section 507(a)(8) during the period of the automatic stay of a prior bankruptcy, courts may adopt a tolling rule "to assure that the underlying aims of Congress are not frustrated by conduct that thwarts" the plain purpose of the statute. *Id.* at 8a. The court noted that "[v]irtually all of the circuit cases dealing with successive bankruptcy petitions and the three-

year lookback provision have chosen to supplement the statute" with a judge-made tolling rule, and that "[t]he most common rule, adopted by five circuits, is that the lookback period is automatically tolled during a prior bankruptcy." *Ibid.* (citing *In re Waugh*, *supra*; *In re Taylor*, *supra*; *In re West*, *supra*; *In re Montoya*, *supra*; and *In re Richards*, 994 F.2d 763 (10th Cir. 1993)). The court observed that "three other circuits have held that the lookback period is not automatically tolled by a prior bankruptcy proceeding but that equitable considerations may permit tolling on a case-by-case basis." *Id.* at 9a (citing *In re Palmer*, 219 F.3d 580 (6th Cir. 2000); *In re Morgan*, 182 F.3d 775 (11th Cir. 1999); *In re Quenzer*, 19 F.3d 163 (5th Cir. 1993)). The court concluded, however, that it should "follow the majority view in favor of automatic tolling," for that rule avoids "taxpayer manipulation" of the bankruptcy process and preserves the "full three years" that Congress gave the government "to assess and collect taxes." *Id.* at 6a, 9a.

ARGUMENT

The courts of appeals acknowledge that they are in direct conflict on the question presented in this case. As the First Circuit explained in its decision below, six of the courts of appeals have now concluded that the priority of federal taxes in a second-filed bankruptcy case may not be avoided by the voluntary filing and dismissal of the taxpayer's first bankruptcy proceeding. Three other courts of appeals, however, have adopted the view that the facts and circumstances of each separate case are to be considered in applying an equitable tolling rule to the three-year lookback period of Section 507(a)(8). Although the courts of appeals have consistently recognized that granting a discharge in the

second case would yield a result that Congress did not intend, they have disagreed as to the circumstances that justify tolling of the lookback period. Different rules have thus been applied to reach disparate results in different circuits.

The question presented in this case arises with considerable frequency. Indeed, the use of successive bankruptcy petitions in an effort to avoid tax obligations has become such a widely known and commonly employed device that more than 150 cases are currently pending that present this same issue. The present case squarely presents the issue that has divided the circuits and would thus serve as an appropriate vehicle for the Court to resolve this recurring conflict. We therefore do not oppose the granting of the petition in this case.

It is important to note, however, that the House and Senate have passed bills that would resolve this matter prospectively by amending the Bankruptcy Code to provide that the three-year lookback period of Section 507(a)(8) is tolled and extended for any period in which the automatic stay was in effect in a prior bankruptcy case. See H.R. 333, 107th Cong., 1st Sess. § 705 (2001); S. 420, 107th Cong., 1st Sess. § 705 (2001). The provisions of these competing bankruptcy bills, however, have not yet been reconciled in conference. There is thus no guarantee that a bill will be enacted and signed into law either this year or in the foreseeable future.[1] If the pending bankruptcy legislation were hereafter enacted, however, there would no longer be a pressing need for this Court's resolution of the question

[1] A similar legislative solution to this recurring problem was advanced in bills introduced in prior Congresses that were not enacted into law.

presented in this case. Absent such legislation, review by this Court is warranted.[2]

1. a. Sections 523(a)(1)(A) and 727(b) of the Bankruptcy Code provide a discharge for a Chapter 7 debtor of income taxes that do not qualify as "priority" tax claims under Section 507 of the Code. 11 U.S.C. 523(a)(1)(A), 727(b). In turn, Section 507 provides that an income tax claim is not a "priority" claim if it is for a tax year for which the return was due more than three years prior to the filing of the bankruptcy case. 11 U.S.C. 507(a)(8)(A)(i). Under these provisions, a debtor who files under Chapter 7 of the Bankruptcy Code may be discharged from income tax claims for tax years for which the return was due more than three years prior to the commencement of the bankruptcy case. 11 U.S.C. 523(a)(1)(A); see 11 U.S.C. 507(a)(8)(A)(i).

This "three-year lookback rule" was first enacted by Congress in 1966. Prior to 1966, unsecured tax claims had been accorded priority over the claims of other unsecured creditors without regard to when the tax claims accrued. See 11 U.S.C. 35(1), 104(4) (Supp. II 1966); H.R. Rep. No. 687, 89th Cong., 1st Sess. 2 (1965); S. Rep. No. 1158, 89th Cong., 2d Sess. 2 (1966). Prior to the 1966 amendments, tax claims were also nondischargeable in bankruptcy regardless of their age. S. Rep. No. 1158, *supra*, at 2. Congress became concerned, however, that tax claims were allowed to "accumulate and remain unpaid for long periods of time." *Id.* at 4. This meant that the debtor's "fresh start" could be burdened with "what may be an overwhelming liability for accumulated taxes." *Id.* at 2. Congress thus determined in 1966 that it was necessary

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[2] We will endeavor to inform the Court if relevant legislative developments occur during the pendency of this case.

to put "some time limit upon the extent of taxes excepted from discharge," as well as on the time period for which tax claims would retain priority over the claims of other creditors. *Id.* at 2, 4. In doing so, however, Congress emphasized that it did not intend to "create a tax evasion device" or unduly impair the effectiveness of the government's tax collection efforts. *Id.* at 3-4.

The balance that Congress struck—the three-year lookback period for the priority and nondischargeability of tax claims now set forth in Section 507(a)(8) of the Bankruptcy Code—was chosen to balance these competing interests. *In re Waugh*, 109 F.3d at 492. In particular, Congress specifically sought to avoid "[a]n open-ended dischargeability policy [that] would provide an opportunity for tax evasion through bankruptcy, by permitting discharge of tax debts before a taxing authority has an opportunity to collect any taxes due." *Ibid.* (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 190 (1977)).

b. Many debtors have recently claimed, however, that a loophole exists in the three-year lookback rule that permits them to employ successive bankruptcy cases to obtain a discharge of their income tax debts before the government has had a full three-year period to collect the unpaid taxes. The debtors' theory involves the filing of multiple bankruptcy cases—usually a Chapter 13 bankruptcy followed by a Chapter 7 liquidation. The first bankruptcy is often filed shortly after the government begins to take collection action against the debtor for delinquent taxes. Upon the filing of the first bankruptcy case, the "automatic stay" of Section 362(a) of the Bankruptcy Code bars all collection activity. 11 U.S.C. 362(a). The debtor then maintains the bankruptcy case in place until three years has

elapsed from the due date of his delinquent tax return. The debtor then dismisses the first bankruptcy case (as he is entitled to do in a Chapter 13 case; see 11 U.S.C. 1307(b)) and immediately files a second bankruptcy case. By filing serial bankruptcy cases, the debtor is able to prevent the government from pursuing any collection actions throughout the three-year period that Congress had established for collections. See pages 4-5, *supra*. Unless the three-year lookback period of Section 507(a) is tolled during the first bankruptcy case—as a majority of courts have held it is—a debtor could thus preclude all tax collection efforts and still obtain a discharge of his unpaid taxes in the second bankruptcy case.

2. The question whether debtors can use serial bankruptcy filings in this manner to prevent the collection of taxes during the three-year lookback period has yielded starkly different conclusions in the lower courts. Nine circuits have splintered into several different camps on this issue.

a. The majority of courts—including the court below—have held that the three-year period is automatically tolled during the first bankruptcy case when the debtor files multiple bankruptcy cases. Pet. App. 9a ("We follow the majority view in favor of automatic tolling."); *In re Waugh*, 109 F.3d 489 (8th Cir.), cert. denied, 522 U.S. 823 (1997); *In re Taylor*, 81 F.3d 20 (3d Cir. 1996); *In re West*, 5 F.3d 423 (9th Cir. 1993), cert. denied, 511 U.S. 1081 (1994); *In re Richards*, 994 F.2d 763 (10th Cir. 1993); *In re Montoya*, 965 F.2d 554 (7th Cir. 1992). These courts have relied on the statutes that allow extensions of time for collection of taxes during the period of bankruptcy proceedings (11 U.S.C. 108(c); 26 U.S.C. 6503(c), (h)) and on the clear intent of Congress that, under the three-year lookback rule, the

government is to be allowed sufficient time to collect taxes before they can be discharged in bankruptcy cases.[3] *In re Waugh*, 109 F.3d at 492; *In re Taylor*, 81 F.3d at 23-24; *In re West*, 5 F.3d at 426.[4]

These courts have emphasized that, to interpret these statutes in the manner suggested by the debtors would "defeat the statutory purpose of [both] the Bankruptcy Code [and] the Internal Revenue Code" and "would lead to absurd results, as the government would lose its priority claim to back taxes as a result of the taxpayer's abuse of the bankruptcy process." *In re Taylor*, 81 F.3d at 23. See also Pet. App. 6a; *In re Waugh*, 109 F.3d at 493; *In re West*, 5 F.3d at 425 ("in the rare cases [in which] the literal application of a

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[3] The Internal Revenue Code suspends the limitations period for assessing and collecting taxes during the time that a taxpayer is in bankruptcy. 26 U.S.C. 6503(h). In addition, Section 108(c) of the Bankruptcy Code extends nonbankruptcy periods of limitations that had not expired when the bankruptcy case was commenced. 11 U.S.C. 108(c). Several courts have concluded that these statutes apply, by reasonable inference, to the three-year lookback rule of Section 507(a) of the Bankruptcy Code. See *In re Taylor*, 81 F.3d at 23-25; *In re Montoya*, 965 F.2d at 557-558; *In re Waugh*, 109 F.3d at 494 ("11 U.S.C. § 108(c) and 26 U.S.C. § 6503(b) and (h) operate to suspend" the priority period); *In re West*, 5 F.3d at 426-427.

[4] The present case, like the great majority of cases presenting this issue, involves the question whether the three-year lookback period of Section 507(a)(8)(A)(i) should be tolled when a debtor has filed serial bankruptcies. A closely similar question arises with respect to the 240-day lookback period in Section 507(a)(8)(A)(ii) and the two-year lookback period set forth in Section 523(a)(1)(B)(ii). The courts have generally applied the same rule to all three lookback periods. See, *e.g.*, *In re West*, 5 F.3d at 425 (240-day rule is tolled during serial bankruptcy filings); *Richards*, 994 F.2d at 763 (240-day rule); *In re Hollowell*, 222 B.R. 790, 793 (Bankr. N.D. Miss. 1998) (tolling of two-year lookback rule).

statute will produce a result demonstrably at odds with the intentions of its drafters, the intention of the drafters . . ., rather than the strict language, controls.") (internal quotation marks omitted).

The Tenth Circuit has relied on a different rationale in holding that the three-year lookback period of Section 507(a) is always tolled during the pendency of a prior bankruptcy case. That court has held that the suspension of the three-year lookback period is authorized by Section 105(a) of the Bankruptcy Code, which allows the bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. 11 U.S.C. 105(a). See *In re Richards*, 994 F.2d at 765. The Tenth Circuit concluded that, in order to accomplish the clear intent of Congress, tolling of this period is always "appropriate to carry out the provisions" of the Code when multiple bankruptcies are employed to preclude the collection of taxes. *Ibid.*

b. Three circuits do not follow the majority rule. *In re Palmer*, 219 F.3d 580 (6th Cir. 2000); *In re Morgan*, 182 F.3d 775 (11th Cir. 1999); *In re Quenzer*, 19 F.3d 163 (5th Cir. 1993)). These courts "have held that the lookback period is not automatically tolled by a prior bankruptcy proceeding but that equitable considerations may permit tolling on a case-by-case basis." Pet. App. 9a. As the court below correctly explained in this case (*ibid.*):

> The Eleventh Circuit states that the equities will usually favor the government [*In re Morgan*, 182 F.3d at 779-780]; the Sixth seems to require a showing of debtor misconduct [*In re Palmer*, 219 F.3d at 585]; and the Fifth agnostically demands a "[f]ull

development and examination of the facts." [*In re Quenzer*, 19 F.3d at 165].

Thus, while these three courts have joined in allowing equitable tolling of the three-year lookback period under Section 105(a) of the Bankruptcy Code, they have done so only when they believe such tolling to be warranted by examination of the particular facts of the case. In evaluating the relevant facts, moreover, they have not followed a single approach in determining when such tolling would be appropriate.

For example, the Eleventh Circuit has suggested that a presumption exists that such tolling will be appropriate in cases in which the debtor's multiple bankruptcies have prevented the government from collecting the outstanding taxes. *In re Morgan*, 182 F.3d at 780. The Fifth Circuit has applied a far more stringent standard. Tolling in that circuit is permitted only when the debtor (i) acted in a calculated manner in dismissing and refiling bankruptcy cases or (ii) consciously employed the automatic stay to shield himself from collection activity. *In re Hollowell*, 222 B.R. 790 (Bankr. N.D. Miss. 1998); *In re Miller*, 199 B.R. 631 (Bankr. S.D. Tex. 1996); *In re Clark*, 184 B.R. 728 (Bankr. N.D. Tex. 1995). The Sixth Circuit has adopted the most restrictive view of tolling. That court concluded that tolling would be appropriate only when the government shows that the debtor committed specific misconduct or intentionally manipulated the bankruptcy process. *In re Palmer*, 219 F.3d at 585, 587 (citing *In re Nolan*, 205 B.R. 885, 888 (Bankr. M.D. Tenn. 1997)).[5]

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[5] The Eleventh Circuit expressly rejected the standard adopted by the Sixth Circuit, holding that "we reject the notion * * * that a finding of dilatory conduct or bad faith is necessary to

3. We thus agree with petitioners that there exists a conflict among the circuits on the question whether the three-year lookback period of 11 U.S.C. 507(a)(8)(A)(i) should be tolled during the pendency of a prior bankruptcy case. We also agree with petitioners that this issue is one that has recently been raised frequently by taxpayers who seek to avoid their tax debts in bankruptcy cases. Unless the curative legislative proposals that are currently pending are enacted by Congress (see page 8, *supra*), resolution by this Court of this recurring question on which the courts of appeals are sharply divided is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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find the equities in favor of the government." *In re Morgan*, 182 F.3d at 780 n.8.