

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION**

In Re:

Richard John Notch,
Debtor.

CHAPTER 13

Bky. 93-33419

ORDER

This matter came on for hearing on June 9, 1999, on objection by the Debtor to the filed claim of the Minnesota Department of Revenue (MDR). Appearances are noted in the record. The Court, having heard arguments and reviewed the record, including briefs of counsel, and, now being fully advised in the matter, makes this **ORDER** pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

The Debtor filed his voluntary petition in this Chapter 13 case on July 14, 1993. On the same day, just prior to the bankruptcy filing, he filed his tax returns for the years 1986 through 1992. Minnesota Department of Revenue (MDR) subsequently filed its claim on October 5, 1995, for all the taxes as priority under 11 U.S.C. § 507(a)(8)(A), specifically claiming:

Period	Date Tax Assessed	Tax	Interest	Amount Due
12/86	07/14/93	\$858.00	\$479.65	1,337.65
12/87	07/14/93	260.00	124.51	384.51
12/88	07/14/93	686.00	271.77	957.77
12/89	07/14/93	1,158.00	347.08	1,505.08
12/90	07/14/93	1,204.00	232.71	1,436.71
12/91	07/14/93	1,287.00	123.53	1,410.53
12/92	07/14/93	1,414.00	20.92	<u>1,434.92</u>
TOTAL				\$8,467.17

In the meantime, the Debtor's plan was confirmed on October 18, 1993. The plan was to be funded by monthly payments of \$500 from the Debtor. It provided that all priority taxes would be paid in full, and that unsecured creditors would be paid 10% of the allowed amounts of their claims.

The Trustee notified the Debtor through Debtor's counsel, after the MDR claim was filed, that the state and federal priority tax claims as filed rendered the plan not feasible because the Debtor's scheduled payments into the plan would not be sufficient to pay even the priority tax claims; and, there could be no distribution to unsecured creditors. The Trustee further notified the Debtor that the Trustee intended to pay the tax claims, including the MDR claim, as filed. Thereafter, the Trustee made distributions only to the MDR and Internal Revenue Service (IRS) on the state and federal priority tax claims as filed.

The Debtor did not object to the filed state and federal tax claims, but continued making his scheduled payments into the plan, paying a total of \$30,038.56. On August 20, 1998, the Trustee filed his motion to dismiss the case for failure to make the payments required by the Debtor's plan. The motion, originally scheduled for hearing on September 10, 1998, was thereafter continued eight times until January 14, 1999, when this Court dismissed the case five years and nearly three months after the plan's confirmation.

On January 22, 1999, the Debtor filed his motion to vacate the order of dismissal, arguing that he should be allowed to now challenge the nature and allowed amounts of the filed state and federal tax claims. Neither the Trustee nor the state and federal tax claimants objected to the motion, and on March 22, 1999, the Court entered its order vacating the dismissal conditional upon the Debtor initiating the appropriate proceedings challenging the filed priority tax claims. On April 2, 1999, the Debtor filed his objection to the MDR claim, challenging priority of the taxes for the periods 1986 through 1989. Hearing was held on June 9, 1999.

II.

Positions Of The Parties In General.

The positions of the parties are fairly simple. MDR argues: 1) the objection is untimely and should not be heard; 2) the taxes for all the periods are clearly entitled to priority treatment because they were assessed upon the filing of the returns just prior to the filing of the bankruptcy, therefore coming within the 240 day rule of 11 U.S.C. § 507(a)(8)(A)(ii); and, 3) even if some of the taxes are not entitled to priority, MDR has not received a distribution sufficient to pay its undisputed priority under 11 U.S.C. § 507(a)(8)(A)(i) for the periods 1990 through 1992, rendering the objection moot.

The Debtor argues: 1) there is no prejudice to MDR in hearing the objection to its filed claim at this late date; 2) the taxes were not assessed for purposes of application of 11 U.S.C. § 507(a)(8)(A)(ii) by taxpayer filing of the returns; 3) MDR has failed to prove that the returns were in fact filed before the bankruptcy petition was filed; 4) 11 U.S.C. § 507(a)(8)(A)(ii) does not apply to general income taxes that are self assessed within the 240 days through the filing of returns by the taxpayer; 5) 11 U.S.C. § 507(a)(8)(A)(ii) does not apply here because the returns were filed, and the taxes assessed, on the date of bankruptcy, which is outside the 240 day period; and, 6) the Debtor will be entitled to a refund of plan payments made by the trustee to the IRS as a result of the Debtor's challenge to that claim, thereby allowing for redistribution of sufficient funds to complete the payments due MDR.

Timeliness.

MDR argues that the Debtor's objection to its claim is untimely, contending that:

The court should refuse the Debtor's attempted reconstruction at this late date. It is patently unfair to have held the Department at bay for all these years and now attempt to change the ground rules.

MDR Memorandum In Response To Debtor's Objection To Claim No. 9, May 14, 1999, p.3.

Subject to principles of waiver, estoppel and laches, claims can be objected to, determined and redetermined at any time during pendency of a case.¹ See, Fed. R. Bankr. P. 3007, 3008. While the Debtor should have filed his objection long ago, MDR has not shown any prejudice by the delay. MDR itself filed its claim on October 5, 1995, nearly two years after confirmation of the Debtor's plan. Significantly, MDR did not object to the Debtor's motion to vacate the order dismissing the case, even though MDR had notice of the motion, and of the intention of the Debtor to challenge its claim if the dismissal was vacated. Furthermore, determination of the claim is a matter of law, and MDR is in no worse position to have the claim determined now than earlier, had the issue been more timely raised. See, In re O'Connell, Ch. 13 Case No. 93-43192, Hon. Nancy C. Dreher (D. Minn. Bankr. May 26, 1999). Finally, MDR has not shown that it has detrimentally relied upon its treatment by the Trustee under the plan, nor that it is unable to reasonably account for any excess payments that might now be determined it received pursuant to its filed claim. Lack of timeliness in objecting to the claim by the Debtor does not bar consideration of the objection and determination of MDR's claim.

MDR Tax Claim As Priority.

Taxes for the periods 1990 through 1992 are priority under 11 U.S.C. § 507(a)(8)(A)(i), and are not in dispute. MDR argues that taxes for the periods 1986 through 1989 are also priority, but under 11 U.S.C. § 507(a)(8)(A)(ii). That statute creates a priority for income taxes:

(ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition...

MDR asserts that the taxes have priority under 11 U.S.C. § 507 (a)(8)(A) (ii) because they were assessed on the same day, but before, the bankruptcy petition was filed.

¹ For an excellent discussion of these principles as they apply to claims objections, see, In Re O'Connell, Ch. 13 Case No. 93-43192, Hon. Nancy C. Dreher (D. Minn. Bankr. May 26, 1999), at 9.

Pursuant to Minn. Stat. § 270.65, assessment of income taxes occurs at the later of when a return is due, or when a taxpayer files the return. The statute provides, in part: “For purposes of taxes administered by the commissioner the term ‘date of assessment’ means the date a return was filed or the date a return should have been filed, whichever is later.” Minn. Stat. § 270.65 (1998).

The Debtor argues that, despite the Minnesota statute, for purposes of application of §507(a)(8)(A)(ii), the taxes for the periods 1986 through 1989 were not assessed by the mere filing of the returns, citing State of Minnesota, Department of Revenue v. United States, 1999 WL 455668 (8th Cir. Minn.). However, in that case the Circuit Court ruled that the assessment of a tax under Minnesota law by the filing of a return is, by itself, insufficient to establish a choate interest of the taxing authority necessary to support the perfection of a tax lien. 11 U.S.C. § 507(a)(8)(A)(ii) deals with unsecured tax claims, not tax liens. The Circuit Court recognized that the filing of the return constituted the assessment of the tax under Minnesota law, but ruled that the assessment by taxpayer filing, with nothing more, was insufficient to perfect a tax lien. The case is not applicable here. In this case, the assessment occurred for the taxes in dispute, years 1986 through 1989, on July 14, 1993, the date the returns were filed.

The Debtor next argues that MDR has not shown that the returns were actually filed before the bankruptcy petition was filed. Although filed on the same day as the petition, if the returns were filed after the petition, they would not be entitled to priority under 11 U.S.C. § 507 (a)(8)(A) (ii). However, the Debtor conceded in his *Motion To Vacate The Order Of Dismissal* that the returns were filed on the same day, but before, the bankruptcy petition was filed; and, he is now estopped from claiming otherwise.²

² In his *Memorandum In Support Of Motion To Vacate*, the Debtor stated that “Debtor filed his 1986 through 1989 taxes immediately before the filing of this case.” *Memorandum*, p.1. MDR persuasively argues that, due to the length of time that has passed since the filing of its claim, MDR cannot now provide

The Debtor next argues that, despite its plain language, the statute should be interpreted to apply to only those taxes that are assessed other than by filing of a return, such as taxes assessed as the result of an audit.³ However, the plain language of the statute requires a broader application to include income taxes self assessed by the filing of a return, such as the taxes involved here. See, In re O'Connell, Ch. 13 Case No. 93-43192, Hon. Nancy C. Dreher (D. Minn. Bankr. May 26, 1999).

Finally, the Debtor argues that the taxes were not assessed within the 240 day provision of 11 U.S.C. § 507 (a)(8)(A) (ii) in any event, because they were filed on the day of the petition. Here, the Debtor relies upon the plain language of the statute, which provides a priority for taxes assessed within “240 days...*before the date* of the filing of the petition....” Since the taxes here were filed *on* the date of the petition, the Debtor argues, they were filed outside the 240 day period covered by the statute. The Court agrees.

MDR cites public policy and presumed legislative intent in urging that the Court interpret the statute to cover returns filed on the same date, but before, the petition, despite the clear and unambiguous language of the statute. However, MDR's earlier argument in urging application of the plain language to the type of taxes covered, is equally compelling here. MDR argued:

Debtor suggests that it makes no sense for the Department's claim to be treated as a priority claim if a return is filed hours before bankruptcy and as a general unsecured claim if filed shortly after. But such an argument can always be made with respect to a statutory bright line.

As the court said in In re Smith, 96 F.3d 800 (6th Cir. 1996):

This is a case where one of the parties gets a lucky break. Had Smith filed for bankruptcy two days later, he would now owe no

the necessary documentation or testimony on the issue.

³ The Debtor articulates a sophisticated argument detailing policy reasons for this, all of which were argued to, and rejected by, the court, Hon. Nancy C. Dreher, in In Re O'Connell, *supra*. Judge Dreher detailed the argument in O'Connell, and this Court will not repeat it here.

taxes. He filed when he filed, and therefore he does. The result strikes one as arbitrary, and it is arbitrary in the sense that two years is just an arbitrary number chosen to set a line somewhere in the proximity of reasonableness.... [T]he government was entitled to a full two-year period, and the result we reach guarantees that it has that time. We have recently held that the Bankruptcy Code should be read in a 'straightforward' manner.
Id. at 803 (citations omitted).

MDR *Responsive Memorandum*, May 14, 1999, at 8.

11 U.S.C. § 507 (a)(8)(A) (ii) is a bright line statute. The line separates priority tax debt that must be paid in full, from unsecured tax debt that is dischargeable upon completion of a confirmed plan. Whether the line be established immediately before petition, or before date of petition, is a legislative prerogative. Neither selection portends any particularly onerous or offensive consequence. Once the line is known, parties will presumably act in their best interests. If the line were at bankruptcy filing, presumably, a debtor would file returns that would otherwise be subject to priority under 11 U.S.C. § 507 (a)(8)(A) (ii), after bankruptcy filing; or, he might not file them at all. A debtor is obligated to schedule stale tax debts; but, he is not required to file tax returns as a condition of receiving a discharge of unsecured nonpriority tax debt upon completion of payments under a confirmed Chapter 13 plan. See, 11 U.S.C. § 1328(a). Regardless of where the line be drawn, presumably a debtor will trigger an assessment, through self filing, of a potential priority tax liability under 11 U.S.C. § 507 (a)(8)(A) (ii), if at all, only on the safe side of the line. Location of the line does not present public policy Issues. Furthermore, wherever the line be drawn, issues of a debtor's good faith and abuse of bankruptcy remain the same.

III.

The Shortfall On MDR's Priority Claim.

MDR has been paid \$3,557.05 on its undisputed priority claim of \$4,282.16 for the tax periods 1990 through 1992, resulting in a shortfall. The Debtor has filed an adversary proceeding against the Internal Revenue Service for overpayment of its allowable priority claim., He

represents that if he is successful in that litigation funds will be available to satisfy MDR's priority claim in full, and, presumably, the Debtor's obligation to unsecured creditors. If the plan cannot be fully consummated at conclusion of the litigation with the IRS, appropriate remedies can be pursued at that time.

IV.

Based On the forgoing, it is hereby **ORDERED** that the allowable priority tax claim of Minnesota Department of Revenue is limited to the income tax periods of 1990 through 1992, pursuant to 11 U.S.C. § 507(a)(8)(A)(i); and that the Debtor's liability for income taxes for the periods 1986 through 1989 are allowed as a general unsecured claim.

Dated: September 1, 1999.

By The Court:

/s/ Dennis D. O'Brien

DENNIS D. O'BRIEN

CHIEF U.S. BANKRUPTCY JUDGE

NOTICE OF ELECTRONIC ENTRY AND FILING ORDER OR JUDGMENT Filed and Docket Entry made on 9/1/99 Patrick G. De Wane, By DLR

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