

In the United States Bankruptcy Court

for the Northern District of Iowa

LYLE R. FLETCHALL
DORIS L. FLETCHALL

Bankruptcy No. L90-01910W

Debtor(s).

Chapter 7

LYLE R. FLETCHALL
DORIS L. FLETCHALL Adversary No. 93-
6165KW

Adversary No. 93-6165KW

Plaintiff(s)

vs.

THE STATE OF IOWA Iowa Dept.
of Revenue & Finance

Defendant(s)

ORDER

On May 13, 1994, the above-captioned matter came on for hearing pursuant to assignment. Hearing was held by telephone conference call and a record was made by recording device. Plaintiff Lyle R. Fletchall participated in the hearing as did Attorney Barton Schwieger. Attorney Dale Baker appeared on behalf of the Defendant State of Iowa (Iowa Department of Revenue & Finance). The matter was argued after which the Court took the matter under advisement.

SUMMARY OF PENDING MATTERS

The matters before the Court for determination, as a result of the foregoing hearing, are a Motion for Summary Judgment filed by Defendant Department of Revenue (DOR), as well as a Motion to Compel Production of Documents and a Motion to Extend Discovery Deadlines. Both discovery motions were filed by Plaintiffs Lyle R. Fletchall and Doris L. Fletchall.

The basis for the discovery motions is self-evident. The summary judgment motion filed by DOR arises out of Debtors' adversary proceeding in which they allege that DOR is seeking to enforce tax obligations which were discharged in Debtors' Chapter 7 Bankruptcy. In its most simple terms, DOR asserts that there are no facts in dispute which would have an impact on this case and that DOR is entitled to summary judgment as the taxes in question are nondischargeable as a matter of law.

STATEMENT OF CASE

On May 25, 1984, the Iowa Department of Revenue (DOR) issued a Notice of Assessment for Withholding Tax in the amount of \$24,937.30. The assessment was delivered to Mr. Fletchall as

Responsible Party for Associated Engineers, Inc. on January 10, 1985. The tax periods covered by this notice were: November 1983, December 1983, January 1984, February 1984, and March 1984.

DOR issued another Notice of Assessment to the Fletchalls, dated December 14, 1989, for Income Tax in the amount of \$311,348.28 for tax years 1977, 1978, 1979, and 1983. The assessment was a "state adjustment per a federal audit". Of the total amount, \$135,236.32 was tax and the remainder consisted of penalties and interest. Mr. Fletchall responded to the notice by letter dated December 29, 1989. Substantial correspondence followed which is of little, if any, legal consequence.

On March 12, 1990, the Fletchalls filed a protest before the Iowa State Department of Revenue and Finance. Mr. Fletchall notified the Administrative Law Judge, Linda Erickson, of his desire to meet to resolve the matter. DOR informed Mr. Fletchall by letter dated April 10, 1990, that "it has been brought to [our] attention that the Protestors in [this] case are involved in a similar action involving the Internal Revenue Service [IRS]." In the same letter, DOR requested information regarding the alleged federal protest so DOR could determine whether its matter should be held in abeyance pending the outcome of the federal matter.

Mr. Fletchall, in a letter dated June 13, 1990, confirmed that an agreement was reached to delay further proceedings regarding the DOR matter until resolution of the IRS protest. Mr. Fletchall also agreed to regularly advise DOR of the status of the IRS litigation.

Debtors filed for Chapter 7 protection on November 2, 1990. They received a discharge on March 19, 1991. Debtors were again sent a notice of assessment for individual income tax for tax years 1989 and 1990 in the amount of \$1,019.22 on July 31, 1991. On January 15, 1993, DOR notified Debtors of its intention to proceed with the collection unless debtors filed a protest. Debtors did file a protest, and DOR answered on February 22, 1993. On February 25, 1993, DOR again notified Debtors that they must post a bond before an evidentiary hearing will be scheduled. Debtors replied to DOR's Answer and also filed a Motion to Dismiss on March 19, 1993. On May 13, 1993, DOR issued an Extension Order granting Debtors thirty days to pay the tax, penalty, and interest or to post a bond or the protest would be dismissed.

Debtors filed a complaint in the form of an "Adversary Proceeding for Reaffirmation of Discharge Order, Injunctive Relief, and Costs and Damages" with this Court on October 12, 1993. Debtors' argument is as follows: Debtors declared bankruptcy November 2, 1990 and listed DOR as a creditor. This Court set February 15, 1991 as a deadline for filing objections to discharge, and DOR did not object by that date. The Court issued an order discharging all debts on March 19, 1991. After discharge, employees of the State of Iowa, Gary L. Britson and Linda Erickson, have pursued collection in defiance of the discharge order. Debtor argues he is, therefore, entitled to injunctive relief in the form of a Cease and Desist order as well as damages.

DOR admits that a deadline for filing objections was set and that DOR did not file an objection. DOR also admits that subsequent to entry of the discharge order, its employees, Gary L. Britson and Linda Erickson, pursued collection of Iowa individual income tax liabilities by reactivating administrative proceedings commenced by Debtors prior to filing their petition for Relief under Chapter 7. DOR claims that the individual income tax liabilities which are the subject of the Complaint are excepted from discharge by the bankruptcy code and In re King, 961 F.2d 1423 (9th Cir. 1992). It also asserts the withholding tax liabilities are excepted from discharge by 11 U.S.C. §§ 523(a)(1)(A) and 507(a)(7)(C). Finally, DOR argues that the deadlines referred to in the complaint are unrelated to DOR's defenses.

On April 29, 1994, DOR filed this Motion for Summary Judgment pursuant to Fed.R.Civ.P. 56(c) and Fed.R.Bankr.P. 7056 claiming that no genuine issue of material fact exists and that DOR is entitled to judgment as a matter of law.

Debtors filed a resistance on May 4, 1994 claiming the following: (1) taxes for 1977, 1978, 1979, and 1983 were assessed more than 240 days prior to the Bankruptcy filing and the taxes for 1989 and 1990 were not legally assessed and should not be owing; (2) the statute of limitations has expired on all taxes; (3) King, 961 F.2d 1423, determines that a tax is assessed when demand for payment is made, here November 1989, and that it was more than 240 days prior to bankruptcy; (4) Rule 4004(c) states that the "Court shall forthwith grant the discharge unless . . . a complaint objecting to discharge has been filed. . . ." Rule 4004 bars untimely complaints, and Rule 4004(a) and (c) dictate that a "debt is not automatically excepted without timely filing of objections and sufficient justification."

Therefore, since DOR failed to appear and assert its rights, the tax debts are discharged and the request for Summary Judgment should be denied.

CONCLUSIONS

Summary judgment is appropriate when the moving party demonstrates that there is "no genuine issue of material fact," Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986), and it is entitled to judgment in its favor as a matter of law. Fed. R. Civ. P. 56(c). The moving party bears "the burden of showing that there is no genuine issue of [material] fact." Anderson, 477 U.S. at 256. If the moving party's assertions establish that no genuine issue of material fact exists, the burden then shifts to the non-moving party "to set forth affirmative evidence, specific facts, showing that there is a genuine dispute on a [material] issue." City of Mt. Pleasant, Iowa v. Associated Elec. Co-op., 838 F.2d 268, 274 (8th Cir. 1988), citing Anderson, 477 U.S. at 257. "The plain language of Rule 56(c) mandates the entry of summary judgment . . . against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). In this case, DOR must establish that no material facts are in dispute and that it is entitled to judgment as a matter of law.

Debtors claim that Rule 4004 mandates that DOR object to discharge of Fletchalls' debt before the February 15, 1991 deadline established by the Bankruptcy Court. Rule 4004(a) states that in a chapter 7 liquidation case a complaint objecting to the debtor's discharge under § 727(a) of the Code must be filed no later than 60 days following the first date set for the meeting of creditors. Rule 4004 provides the procedure for objections to a debtor's general discharge under Code § 727, as opposed to Rules addressing the dischargeability of specific debts. Treatment of the dischargeability of specific debts is found in § 523 and implemented by Rule 4007. Rule 4007(b) states: "A complaint other than under § 523(c) may be filed at any time." Here, § 523(a)(1) determines the nondischargeability of a tax or customs duty. 11 U.S.C. § 523(a)(1). As the issues here are controlled by § 523(a) and not § 523(c), Rule 4007 allows filing a complaint to obtain a determination of dischargeability at any time, even after the case is closed.

Debtors filed this complaint seeking a Reaffirmation of Discharge, which is an affirmative dischargeability determination. Rule 4007(a) limits the parties who have standing to file a complaint to obtain a determination of the dischargeability of any debt to the debtor or any creditor.

Fed.R.Bankr.P. 4007(a). The rules permit the debtor to seek an affirmative determination that they have been discharged. As Debtors are seeking such a determination, this complaint is properly brought.

As the Court is satisfied that this is a properly filed adversarial proceeding and that it is timely, the Court will address whether the taxes in dispute are nondischargeable as a matter of law.

LEGAL FRAMEWORK

For purposes of this analysis, the various tax claims can be placed in three distinct categories: (1) "withholding" taxes for periods November, 1983, December, 1983, January, 1984, February, 1984, and March 1984, (2) "income" taxes for 1977, 1978, 1979, and 1983, and (3) "income" taxes for 1989 and 1990. As the analysis varies as to each category, a separate determination of dischargeability is appropriate for each classification. The generally applicable code provisions will first be noted and subsequently analyzed as they apply to the foregoing categories.

The non-dischargeability of certain taxes is set forth under 11 U.S.C. § 523. It provides:

- a. A discharge under § 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt--
 - 1. for a tax . . . --
 - A. of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such a tax was filed or allowed;
 - B. with respect to which a return, if required--
 - i. was not filed; or
 - ii. was filed after the date on which such return was last due, under applicable law or under any extension, after two years before the date of the filing of the petition; or
 - C. with respect to which the debtor made a fraudulent return or willfully attempted any manner to evade to defect such tax.

11 U.S.C. § 523(a)(1).

If a tax claim is of a type specified in this section, it is nondischargeable. The Debtors' tax returns were timely filed and there is no claim of fraud. Therefore, the Court must examine § 523(a)(1)(A) and the priority of claims established under §§ 507(a)(2) and 507(a)(7) to determine whether DOR's claims for taxes are nondischargeable.

Section 507(a)(7)(A) gives priority if the debt is for a tax on or measured by income or gross receipts-

- i. for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
- 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; or
- iii. other than a tax of the kind specified in § 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after the commencement of the case.

11 U.S.C. § 507(a)(7)(A).

"Taxes . . . 'of the kind and for the period specified' in Code § 507(a)(7), a priority section, are excepted from discharge whether or not a claim is filed or allowed." William L. Norton, Jr., Norton Bankr. Law and Prac. 2d § 47:4. Subsection 507(a)(7)(C) provides priority for "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity." 11 U.S.C. § 507(a)(7)(C).

ANALYSIS

1. Withholding Taxes

The first category of taxes herein, the withholding taxes, are required to be collected or withheld and they constitute taxes for which debtor is liable in whatever capacity under 11 U.S.C. § 507(a)(7)(C). They are, therefore, nondischargeable. McKenzie v. United States, 536 F.2d 726 (7th Cir. 1976) (sum owed IRS in withholding taxes is nondischargeable indebtedness). See also In re Terrell, 75 B.R. 291 (Bankr. N.D. Ala. 1987) ("responsible person" is not discharged from penalty for failure of corporation to pay withholding tax liabilities). The time period for these taxes is irrelevant because "trust fund taxes are given priority regardless of age." See Rosenow v. Illinois, Dept. of Revenue, 715 F.2d 277 (7th Cir. 1983).

2. Income Taxes (1989 and 1990)

Tax liability which is due less than three years before filing a Chapter 7 petition, or after the petition date, is nondischargeable. In re Bieber, 151 B.R. 290 (Bankr. S.D. Ga. 1992); 11 U.S.C. § 507(a)(7)(A)(i). "The due date for filing . . . income tax return, and not date it was actually filed," is dispositive for determining whether tax liability is exempt from discharge because it is within the three year period before filing of petition. In re Wood, 78 B.R. 316 (Bankr. M.D. Fla. 1987), aff'd 866 F.2d 1367. Iowa income tax returns must be filed by the last day of the fourth month after expiration of the tax year. Iowa Code § 422.21. For tax year 1989, the tax liability was, therefore, due April 30, 1990 and for tax year 1990, the tax liability was due April 30, 1991. As the tax liability for these two years was due less than three years before the petition date of November 2, 1990, or after the petition date, they are entitled to priority under § 507(a)(7)(A)(i) and are consequently excepted from discharge pursuant to § 523(a)(1)(A).

3. Income Taxes (1977, 1978, 1979, 1983)

None of the taxable years for this category fall within three years of the date of filing of the petition, November 2, 1990, or after the petition date. Therefore, § 507(a)(7)(A)(i) is not applicable. The Court must look to § 507(a)(7)(A)(ii) in determining the status of this category. This category of taxes grants priority for income and gross receipt taxes assessed at any time within 240 days before the petition date. The date on which the DOR assesses the tax determines the priority for purposes of § 507(a)(7)(A)(ii). 124 Cong. Rec., H11112 (Sept. 28, 1978).

Debtors argue that the date of assessment is December 14, 1989, the date of the Notice of Assessment. They conclude, therefore, that assessment is not within the 240 day window and cannot receive priority protection under § 507(a)(7)(A)(ii). DOR argues that "assessment" occurs when the tax is final and all administrative appeals are extinguished.

Both parties cite In re King, 961 F.2d 1423 (9th Cir. 1992), in support of their positions. King addresses the issue of when assessment for the purposes of §§ 507(a)(7)(A)(ii) and 523(a)(1)(A) occurs. The Court determined that assessment under the federal scheme envisions a "specified period

of time after the notice is sent, or, if the taxpayer seeks a determination by the tax court, until a final determination by the tax court, which determination includes rights of appeal." Id. at 1425. The Court also noted "that an assessment is a 'formal, discrete act with specific legal consequences.'" Id. at 1426 (citing In re Heritage Village Church and Missionary Fellowship, 87 B.R. 401, 403 (D.S.C.), aff'd, 851 F.2d 104 (4th Cir. 1988)).

The King Court held that "determination of the precise date of assessment should be accomplished by reference to the specific tax code and practices involved." King, 961 F.2d at 1427. But, the Court also concluded that "common sense" requires that "a tax assessment, as a formal act with significant consequences, cannot occur before it is final." Id. Therefore, the assessment date cannot be earlier than the end of the statutory period allowed for appeals.

The Iowa Code uses the term assessment, in reference to income taxes, simultaneously with notice. Iowa Code §§ 422.25, 422.28 (1993). Based on the use of the term in this manner, Debtors claim that assessment occurs on the date of notice. However, to transplant the definition of assessment as used in the Iowa Code to § 523 in this way would result in inconsistency and uncertainty, both of which the Bankruptcy Code seek to avoid. See In re Suburban Motor Freight, 134 B.R. 617 (Bankr. S.D. Ohio 1991) (holding that label given by statute is not conclusive of question for bankruptcy purposes; substance of obligation, rather than its label, is determining factor). While there is some authority to the contrary, this Court finds the logic used by the King court to be most compelling. In re Thayer, 47 B.R. 90 (Bankr. D. Ver. 1985). Assessment for purposes of 11 U.S.C. § 523 occurs when all administrative appeals are final. This analysis produces a substantively consistent result while incorporating the statutory idiosyncracies of each state's appeal process. To hold otherwise exalts form over substance.

This Court holds that a tax is assessed and, therefore, final when all procedural steps are exhausted which may bring the collectability of the tax into question. Having made that determination, the result becomes self-evident. While the initial notice was sent to Debtors on December 14, 1989, the administrative process, as set forth in the initial statement of the case, has never been finalized because of an agreement between the DOR and Debtors to first finalize Debtors controversy with the Internal Revenue Service. As the taxes were not assessed outside the 240 day window provided by § 507(a)(7)(A)(ii), the same are entitled to priority status and are also excepted from discharge.

In analyzing the taxes under this category, an unresolved issue becomes apparent. Congress included a clause in the Bankruptcy Code which exempts periods in which an offer of compromise was made from the 240 day period of § 507(a)(7)(A)(ii). In June of 1990, an apparent agreement was reached to delay further proceedings on these taxes until Debtors had achieved some resolution of their IRS protest. It is unclear in the record, but it appears that Debtors are still in the process of completing that litigation. If this agreement would satisfy the intent of the statutory language relating to offer of compromise, the 240 day period in § 507(a)(7)(A)(ii) would be held in abeyance and the tax would, therefore, not be final and not assessed. This would constitute a second ground for the granting of summary judgment on this category of taxes. However, a determination as to whether this agreement would legally constitute an offer of compromise involves factual determinations which are outside this record and inappropriate for determination at this time. As the Court has granted summary judgment on an alternative ground, this issue is now moot and need not be factually resolved.

While the foregoing resolves the dischargeability issues relating to the taxes in controversy, the Court feels compelled to address another issue which has substantially intertwined itself with the issues already resolved. Debtors have attempted to posture this litigation in such a manner that this Court would be asked to redetermine the tax liability of the Debtors. The Bankruptcy Court is granted

authority to determine the amount or legality of any tax, whether or not previously assessed, whether or not paid, and whether or not contested. See 11 U.S.C. § 505(a) and 11 U.S.C. § 505(b). Though the Court is granted such authority, the Bankruptcy Court may, nevertheless, abstain from making a § 505 valuation if the impact of abstention on the general administration of the estate, and on the debtor, is minimal or non-existent. In re American Motor Club, Inc., 139 B.R. 578, 581 (Bankr. E.D.N.Y. 1992).

In this case, Debtors filed for Chapter 7 protection in November of 1990 and were granted a discharge in March of 1991. Based on the status of this estate, a redetermination of State and Federal taxes by this Court would be of no significant value to the administration of this estate. Also, any determination of the validity of underlying State tax would be advisory at best, as Debtors continue to be involved in litigation with the IRS. A determination favorable to Debtors on the IRS claim would, for all practical purposes, moot the claim by the DOR to additional taxes which were originally tied to the Federal tax audit. As such, abstention in this case, to the extent that it is still a part of this case, leaves the Debtors' status unaltered before the IRS and the DOR. Debtors retain all applicable administrative remedies before those bodies. As such, if revaluation remains an issue in this summary judgment proceeding, it is the determination of this Court that any Bankruptcy Court involvement in the determination of the amount or legality of any tax before the Federal or State taxing authorities would have no impact on the administration of this estate and this Court, therefore, abstains.

A final issue relates to the discovery motions filed by Debtors. As this Court has resolved all issues and since the Department of Revenue is entitled to summary judgment, the Motion to Compel Production and the Motion to Extend Discovery Deadlines filed by Debtors are now moot and no additional ruling is necessary on these two motions.

In summary, an adversarial proceeding is necessary to make a determination of dischargeability. The complaint filed October 12, 1993 constitutes an adversary proceeding and is, therefore, sufficient to determine dischargeability issues raised here. Further, for the reasons set forth in this opinion, this Court finds that the withholding taxes for calendar years 1983 and 1984 are excepted from discharge. Further, the income taxes for years 1989 and 1990 are determined to be nondischargeable. Further, income taxes from 1977, 1978, 1979, 1983 are exempt from discharge. Further, this Court makes the determination that there are no factual issues in controversy which preclude the granting of summary judgment. Further, the Court determines that while Bankruptcy Courts are granted statutory authority to determine taxes and to the extent any issue remains for this Court's determination on that issue, this Court concludes that redetermination of taxes would have no impact upon the administration of this estate and the Court, therefore, abstains. Further, the discovery motions filed by Debtors are moot based upon the granting of the summary judgment motion.

WHEREFORE, the tax liabilities giving rise to the complaint herein are determined to be excepted from discharge to the extent set forth in this ruling.

FURTHER, the Court finds that there are no genuine issues of material fact in dispute and Defendant's Motion for Summary Judgment should be and is hereby GRANTED for the reasons set forth in this opinion.

FURTHER, for the reasons set forth herein, the Court abstains from the redetermination of any Federal or State tax liability.

FURTHER, as the foregoing is completely dispositive of all issues in the complaint filed October 12, 1993, the complaint is DISMISSED.

FURTHER, judgment shall enter in favor of the Defendant and against the Plaintiffs/Debtors.

SO ORDERED this 17th day of June, 1994.

Paul J. Kilburg
U.S. Bankruptcy Judge