

Is Your Late-Filed Form 1040 a Tax Return for Bankruptcy Discharge Purposes?

By Mary Lundstedt, Esq. & Jason Owens

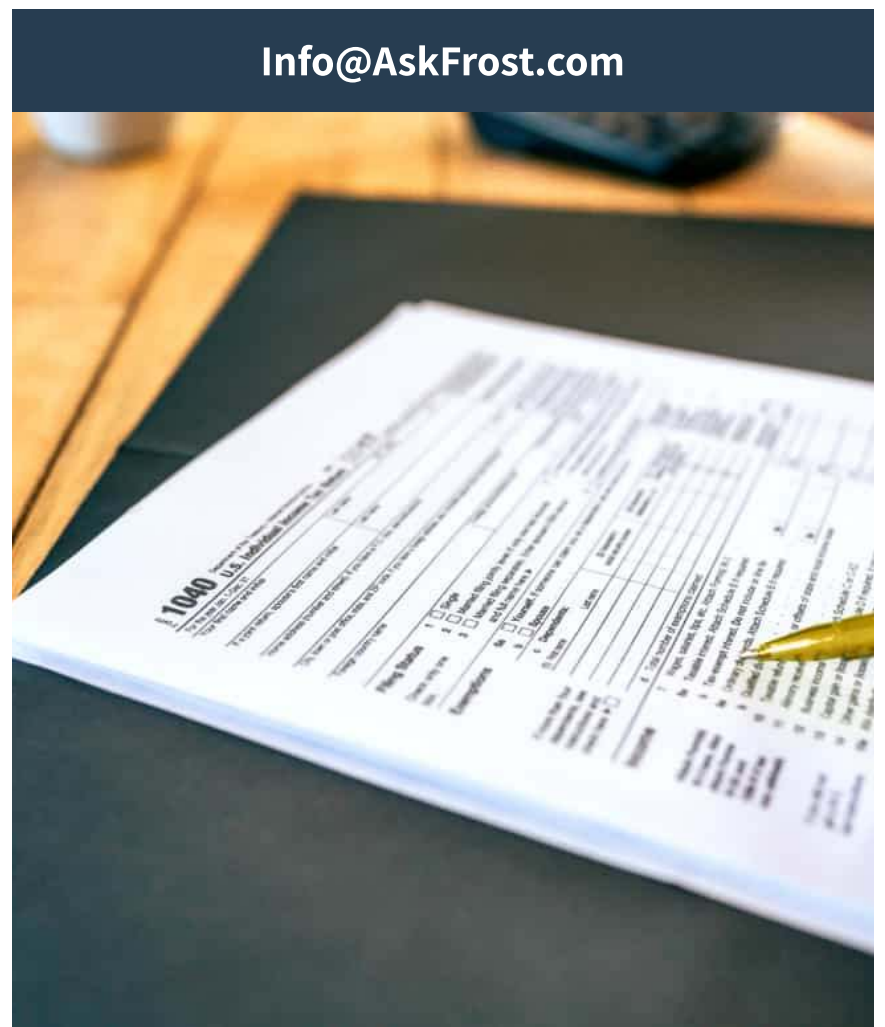
When is your federal tax return not a return? Is your tax return still a return if you file late? How late is too late? You might have thought you don't need a lawyer to answer those questions, but the answers impact whether your tax debt can be discharged in bankruptcy. A very recent case, *In re Starling*, reminds us how important these questions are—particularly when trying to answer whether a filing constitutes a “return” if it was filed after the IRS assesses the tax liability. As we consider that case here, remember, taxes and bankruptcy present both problems and opportunities—the sooner you consult with an experienced professional, the better!

In re Starling

Mr. Starling (Debtor) did not timely file his 2002 tax return. When the IRS notified Debtor in 2005 that it had assessed his taxes, he did not respond. Subsequently, the IRS sent him a final notice of deficiency stating the amount of tax deficiency and indicating that the Debtor could either accept this amount or contest it in Tax Court. After the 90-day period to petition the Tax Court lapsed, the IRS assessed taxes against Debtor for tax year 2002 on June 5, 2006. A little more than one year later, Debtor filed a Form 1040 for tax year 2002 that showed the same amount assessed by the IRS.

In 2013, Debtor filed a Chapter 13 bankruptcy plan, which the Bankruptcy Court approved in early 2014. Ultimately, in 2016, the Bankruptcy Court granted Debtor a discharge. According to the Chapter 13 trustee's 2016 final report:

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only a small portion of the IRS's total general unsecured debt had been paid through the plan. Specifically, only \$386.70 of the IRS's total general unsecured debt of \$21,312.05 (which included the debt from tax year 2002) had been paid.

Later, the IRS engaged a third-party private collection agency to attempt to collect on Debtor's overdue account. In November of 2017, the IRS notified Debtor of this action. Debtor's counsel responded to this IRS action with a letter demanding the IRS to cease collection, because the debts had been discharged. However, Debtor continued to receive collection notices from the private collection agency. Eventually, the IRS ceased collection efforts in 2019 after the ten-year statutory collection period expired.

However, after the IRS issued the second "Annual Notice of Tax Delinquency" in 2019, Debtor filed in Bankruptcy Court for contempt against the IRS and the private collection, arguing that his 2002 debt had been discharged in 2016 and the collection attempts from 2017 to 2019 violated the Discharge Order. The Bankruptcy Court agreed, finding both the IRS and the collection agency in contempt. Moreover, the Bankruptcy Court ordered the private collection agency

to pay \$500 in compensatory damages for emotional distress for each notice of debt it sent to Debtor and \$2,644 in attorney fees.

Applicable Law and Analysis

The United States District Court for the Southern District of New York, in a reversal of the bankruptcy court's ruling, held that a debtor's tax return, filed four years late and more than one year after the IRS assessed taxes, is not a return for purposes of discharging tax debt. Since the taxes were not discharged, the IRS was not in contempt of the discharge order when it attempted to collect the debt using a private debt collection agency. We briefly consider the court's analysis here.

First the court emphasized that whether Debtor's 2002 tax debt was in fact discharged "depends on whether Debtor's Form 1040, filed in 2007 after the IRS had assessed his 2002 tax liability in 2006, constitutes a properly filed 'return'" pursuant to §523(a)(1)(B). Prior to 2005, no statutory language existed to define "return." Ultimately, a majority of courts adopted a test employed in *Beard v. Commissioner* to determine whether a filing constituted a return. This four-pronged test requires that:

1. sufficient data exist to calculate tax liability;

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2. the document purports to be a return;
3. the document must evidence the taxpayer's "honest and reasonable attempt to satisfy the requirements of the tax law;" and
4. the taxpayer executes the return under penalties of perjury.

Some courts considered outside factors to interpret "honest and reasonable," concluding that a Form 1040 filed only after the IRS assessed taxes:

did not constitute a return, because "when the debtor has failed to respond to . . . deficiency letters sent by the IRS, and the government has assessed the deficiency, then the Forms 1040 serve no tax purpose, . . . showing that the debtor's actions were not an honest and reasonable effort to satisfy the tax law."

Whereas, the Eighth Circuit looked only at the document itself, finding that the:

honesty and genuineness of the filer's attempt to satisfy the tax laws should be determined from the face of the form itself, not from the filer's delinquency or the reasons for it.

In 2005, Congress added a definition of "return" located in a hanging paragraph to the Bankruptcy Abuse

Prevention and Consumer Protection Act, §523(a). In the paragraph, "return means a return that satisfies the requirements of applicable nonbankruptcy law

(including applicable filing requirements)." Some courts have held that the original filing deadline is an "applicable filing requirement"—meaning that a Form 1040 filed even a single day late is not a return. Other courts have continued to use the Beard test, holding that the filing deadline is not an applicable filing requirement for discharge purposes.

After considering all of the above, the court stated that "under each analysis the result is the same"—that Debtor's late-filed Form 1040 failed to qualify as a "return" and, thus, Debtor's debt was not discharged. The court noted that in the context of the one-day-late approach, Debtor's form was filed four years after the original due date. Furthermore, the court pointed out that even under the IRS's more lenient version of that rule, the form was still filed more than a year after the IRS assessed the tax liability. Additionally, according to the court, the Debtor could not meet the "honest and reasonable prong" of the majority's Beard test:

as he not only filed his return four years late and after the IRS assessed the tax, but he ignored numerous notices from the IRS giving him opportunities to resolve his tax obligations.



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Finally, the court opined that even the most lenient Eighth Circuit approach was “unlikely” to have rescued Debtor’s position here. The court recalled that the late-filed form at issue in that Eighth circuit decision provide new information to the IRS that assisted the IRS in determining the taxpayer’s actual tax liability. In contrast, Debtor’s return:

simply reiterated the tax assessment the IRS had already performed, and although this effort may have been an “honest” attempt to satisfy his obligations under the tax law, it was hardly “reasonable” to ignore multiple notices and only file years late with the same number the IRS had already come up with on its own.

Conclusion

While this case doesn’t establish a bright-line rule in the context of all late-filed Form 1040s and bankruptcy discharges, taxpayers/debtors who miss an original tax filing deadline and neglect the IRS notices issued before a final assessment is made should expect difficulties in proving their late-filed Form 1040 is a “return” sufficient to result in a discharge of debt. If you are contemplating bankruptcy and have late-filed returns, IRS substitutes for returns, or returns that still need filed, don’t wait to contact Frost Law now.

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