

**Pre-Petition Tax Returns, Post-Petition Tax Payments,  
and the Proper Characterization of State Tax Claims**

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A. Mandatory Dismissal for Failure to File Pre-Petition Tax Returns

Section 1308(a), added to the Bankruptcy Code in 2005 by the BAPCPA amendments, requires Chapter 13 debtors to file all tax returns for taxable periods ending within four years prior to the petition date not later than the day before the first meeting of creditors, unless an extension of that deadline has been obtained.

At the same time Congress added § 1308 to the Bankruptcy Code, it added § 1307(e), which provides:

Upon the failure of the debtor to file a tax return under section 1308, on request of a party in interest ... and after notice and hearing, the court *shall* dismiss a case or convert a case under this chapter to a case under chapter 7 of this title, whichever is in the best interest of the creditors and the estate. (*Emphasis added.*)

Dismissal or conversion under § 1307(e) is mandatory if a party in interest requests it. The courts that have considered a motion under § 1307(e) where a debtor missed the § 1308(a) deadline have concluded that dismissal is mandatory, *even if a debtor belatedly files the missing returns.*

1. In re Cushing, 401 B.R. 528 (1st Cir. BAP 2009)(Debtor filed his prepetition federal income tax return prior to an extended due date granted by the IRS, but after the § 1308(a) deadline. Dismissal or conversion was mandatory under § 1307(e).)
2. In re Kuhar, 391 B.R. 733, 739 (Bankr. E.D. Pa. 2008)(Debtor filed required returns prior to hearing on a motion to dismiss under § 1307(e), but after the § 1308 deadline. "I agree with the numerous courts that have found the use of the word 'shall' evidences the mandatory nature of this provision.... Having found that the Debtor has not complied with § 1308, the Court must dismiss or convert this case...")
3. In re Perry, 389 B.R. 62, 66 (Bankr. N.D. Ohio 2008)(Even though debtor provided copy of his 2004 tax return prior to the hearing, but

after the § 1308 deadline, dismissal was mandatory. "Although the Debtor may view this as a harsh penalty, the Court must construe a statute according to its unambiguous terms.... [T]he plain meaning of the statute is consistent with Congressional intent and no further inquiry is necessary." Section 105 could not be used to alter the plain terms of § 1307(e).)

4. In re Casey, 274 Fed. Appx. 205, 207 (3d Cir. 2008)(Debtor failed to provide Chapter 7 trustee, at least seven days prior to the first meeting of creditors, with a copy of the debtor's most recently-filed prepetition tax return. Bankruptcy Code § 521(e)(2)(A)(I) requires that deadline to be met. Like § 1307(e), § 521(e)(2)(B) mandates that "the court shall dismiss the case" unless a debtor demonstrates that failure to meet the deadline was due to circumstances beyond the debtor's control. The debtor in Casey could not make that showing, so the Third Circuit held that the bankruptcy court "was required to dismiss" the petition.)
5. In re Forte, 2007 WL 2028894, \*4 (Bankr. E.D. Pa. 2007)("Where a party in interest seeks relief under section 1307(e), the statute provides that 'the court *shall* dismiss or convert the case...' (emphasis added)....Apparently, Congress intended that relief under section 1307(e) is not discretionary.")
6. In re McCluney, 2007 WL 2219112, \*3 (Bankr. D. Kan. 2007)(Date of § 341 meeting was 9/7/06. IRS moved on 9/18/06 to dismiss case based on debtor's failure to file 2002 income tax return. Return was filed 10/25/06. Debtor asked court to "ratify" the filing after the § 1308 deadline. Court refused: "The Court finds the meaning of § 1307(e) very plain.... Once ... grounds are established, the court has no discretion on whether to act. Congress has directed that it *shall* dismiss or convert, whichever is in the best interest of the estate or creditors.")

The U.S. Bankruptcy Court for the Northern District of Texas has also made express provisions for dismissal due to a debtor's noncompliance with § 1308. Paragraph 3 of General Order 2007-02 provides for the dismissal of a Chapter 13 case where a debtor fails to timely file tax returns as required by § 1308. And while we are focusing on dismissal of cases for failure to timely file tax returns under § 1308, it is important to note that Congress has made compliance with § 1308 a condition to confirmation by also adding § 1325(a)(9) to the Bankruptcy Code in 2005.

Where debtors are delinquent with pre-petition returns, and no extension has been obtained under § 1308(b), the Texas Attorney General's Office ("OAG") will move for dismissal on behalf

of the relevant state tax authority. It is imperative that debtors be made aware of the requirements of § 1308 and the deadlines for compliance.

B. Failure to Pay Post-Petition Taxes

The OAG has noticed an on-going problem with debtors who continue to operate after filing Chapter 13 bankruptcy, and do not file or pay required post-petition tax returns. The OAG regularly requests dismissal where a debtor fails to meet post-petition tax obligations in violation of Texas law.<sup>1</sup>

28 U.S.C. § 959(b) requires a debtor to manage and operate property of the estate according to the requirements of state law as he would be bound to do outside of bankruptcy. And 28 U.S.C. § 960, amended by BAPCPA in 2005, requires debtors remain current with taxes that come due post-petition under applicable nonbankruptcy law. A debtor who fails to meet post-petition tax obligations to state tax authorities is not in compliance with 28 U.S.C. §§ 959(b) and 960.

Failure to meet post-petition tax obligations may evidence of a lack of good faith. Lack of good faith is sufficient cause for dismissal of a Chapter 13 case. *See In re Love*, 957 F.2d 1350, 1354 (7<sup>th</sup> Cir. 1992); *In re Stathatos*, 163 B.R. 83, 87 (Bankr. N.D. Tex. 1993). Numerous courts, in this and other districts, have concluded that failure to pay post-petition taxes when due constitutes cause for dismissal as a lack of good faith. *In re Wigley*, 333 B.R. 768 (Bankr. N.D. Tex. 2005); *In re Gonzalez*, 2005 Bankr. LEXIS 1295 (Bankr. N.D. Tex. 2005); *In re Koval*, 205 B.R. 72 (Bankr. N.D. Tex. 1996); *In re Hopkins*, 201 B.R. 993 (D. Nev. 1996); *In re Vines*, 200 B.R. 940 (M.D. Fla. 1996); *In re MacLean*, 200 B.R. 417 (Bankr. M.D. Fla. 1996); *In re Bennett*, 200 B.R. 252 (Bankr. M.D. Fla. 1996).

When debtors become delinquent in paying post-petition taxes due state tax authorities represented by the OAG, dismissal will be requested.

C. Secured Claims of State Tax Authorities

The state tax authorities that are represented by the OAG handle the preparation and filing of proofs of claim. An issue may arise with regard to a tax claim for which the tax authority has recorded a lien. Pursuant to § 506(a)(1) of the Bankruptcy Code, a creditor with a lien on property of the estate has a secured claim to the extent of the value of the estate's interest in such property and an unsecured claim to the extent of any shortfall.

With some exceptions, the liability to state tax authorities is entitled to priority under § 507(a) of the Bankruptcy Code. Because of the high volume of claims and because state tax liens

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<sup>1</sup>While this section focuses on payment of post-petition taxes, note that § 521(j), added by the BAPCPA in 2005, also provides a means for conversion or dismissal of cases where a debtor fails to file post-petition tax returns or obtain an extension of the deadline to file such returns.

attach to all non-exempt (not a particular piece of) property of the person liable for the taxes, taxing authorities that have recorded liens are not always able to make a quick determination whether a claim is fully secured. Therefore, they file claims entitled “Secured” and allow the OAG to work with debtor’s counsel and/or the Trustee in determining the proper characterization of a claim for which there is a shortfall in collateral.

The Texas Comptroller of Public Accounts actually entitles such claims as “Secured and/or Priority” and includes the following language in Paragraph 4 of the claim: *CLASSIFICATION OF CLAIM: Secured claim to extent of collateral value. Unsecured Priority claim (11 U.S.C. § 507(a)(8)) to extent of any shortfall in collateral.* The Comptroller’s claims make clear that, where the Chapter 13 estate has insufficient assets to fully secure the claim, the shortfall should be characterized as an unsecured priority claim rather than a general unsecured claim.

Whenever a state tax authority has filed a claim secured by a lien and there is any question about the value of the collateral or the proper characterization of the claim, it is most efficient to contact the OAG directly for clarification, rather than to risk mischaracterizing the tax claim and drawing a time-consuming objection to confirmation.

D. Conclusion

In an effort to preserve limited state resources and valuable time for the court and all parties, the OAG prefers to resolve conflicts related to state tax claims without the need for a hearing. When there is a question about a state tax claim, a call to the OAG is likely the most efficient means of resolution. Direct telephone numbers of the attorneys and/or legal assistants assigned to a particular case are included in all notices of appearance filed in bankruptcy cases. It is to those designated contact persons that inquiries should be directed.