---

## In re Jon A. THIBAULT, and Vaughn Thibault, Debtors.

## Bankruptcy No. 90-00100.

United States Bankruptcy Court. D.Vermont.

April 8, 1992.

G. Glinka, Glinka & Palmer, Cabot, Vt., Chapter 7 Trustee, pro se (Trustee).

J.P. Cain, Blais, Cain, Keller & Fowler, Inc., Burlington, Vt., for creditor Adelard Lambert (Lambert).

C.B. Baril, Office of U.S. Attorney, for Internal Revenue Service (IRS).

MEMORANDUM OF DECISION ON OBJECTION TO IRS CLAIM TO § 507(a)(7)(C) PRIORITY

FRANCIS G. CONRAD, Bankruptcy Judge.

***1** Trustee and Lambert object [FN1] to an IRS Proof of Claim seeking allowance of $31,213.32 as a § 507(a)(7)(C) priority. Objectants argue that no claim exists because IRS did not, prepetition, assess Debtors for the taxes due. We will overrule the objection and allow the claim, because we believe that the language and structure of the Bankruptcy Code, as well as its underlying policy goals, all compel us to do so.

Debtors are shareholders in two corporations that failed to remit certain "trust fund taxes" to IRS. We outlined the broad parameters of this area of federal tax law in In re Vermont Fiberglass, Inc., 76 BR 358 (Bkrtcy.D.Vt 1987).

"Trust Fund Taxes" are those taxes withheld by employers from employees' wages that are required to be held in trust for the United States Treasury pursuant to 26 USC § 7501. When making payments of wages to employees, 26 USC § 3402 requires employers to deduct and withhold income taxes. Liability for payment of the tax required to be deducted and withheld is placed upon the employer under 26 USC § 3403. An employee receives credit for the withheld taxes regardless of whether the employer actually remits the "Trust Fund Taxes" to the government.

If the employer fails to remit the taxes, then the government may look to a "responsible person" for the willful nonpayment for recourse. Congress has provided the IRS with a powerful tool for recourse to prevent a presumed loss to the Treasury, 26 USC § 6672. Section 6672 [FN2] imposes personal liability upon ... one who has the power, duty, and control over the collection and remittance of "trust fund" taxes.

Id., at 360-61 (citations omitted); rev'd on other grounds by 88 BR 41 (D.Vt 1988), which was overruled by U.S. v. Energy Resources Co., 495 US 545, 109 L.Ed.2d 586, 110 S.Ct 2142 (1990). Trust fund taxes are afforded priority status under § 507(a)(7)(C), and are made nondischargeable by § 523(a)(1)(A).

Debtors' Chapter 7 petition, filed Feb. 20, 1990, lists IRS as a priority creditor on Schedule A-1, in the amount of $45,000, for "Federal employment tax (CRS & VET Corp. withholding)," with no indication that liability is disputed. The IRS Proof of Claim, filed April 11, 1991, indicates that Debtors are the "responsible persons" liable for payment of trust fund taxes of $19,775.56, owed by C.R.S. Corp. for the period ending Sept. 30, 1988; and $11,437.76, owed by V.E.T. Corp. for the period ending June 30, 1989. Although Debtors apparently acknowledge liability, 11 USC § 362 stays IRS from assessing the § 6672 penalty against Debtors during this bankruptcy proceeding. IRS eventually concluded that Debtor Vaughn Thibault, but not Debtor Jon Thibault, is the responsible person, and sent Vaughn notices of intent to assess the § 6672 penalties for both CRS and VET corporations.

Objectants characterize their objection as narrowly focused, [FN3] limited only to disputing IRS' claim for a § 507(a)(7) priority. It is also narrowly based. Conceding that there "is a dearth of cases in this area," they supply us with none. Their only argument is that

***2** the legislative history to Section 507(a)(7)(C) clearly indicates that the IRS must take some action to be entitled to priority status. The legislative history to Section 507(a)(7)(C) states that "[t]his priority will operate where a person found to be a responsible officer has himself filed under title 11, and the priority covers the debtor's ... liability regardless of the age of the tax year to which the tax relates."

Objectants' Memorandum, 3, quoting S.Rep. No. 989, 95th Cong., 2d Sess. (1978), reprinted in App. 3 Collier on Bankruptcy, V. S. Rep. 989 at 71 (15th ed.1991). (Objectants' emphasis). Unlike Objectants, however, we find that the plain language of the statute, the structure of the Code, and, the underlying policy goals articulated by Congress, each clearly indicates exactly the opposite.

The task of resolving the dispute over the meaning of [§ 507(a)(7)(C) ] begins where all such inquiries must begin: with the language of the statute itself.

United States v. Ron Pair Enterprises, Inc., 489 US 235, 241, 103 L.Ed.2d 290, 298, 109 S.Ct

1026, 1030 (1989).

Section 507(a)(7)(C) provides:

(a) The following expenses and claims have priority in the following order:

....

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for--

....

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity.

"Claim" as used by § 507(a)(7) is a bankruptcy term of art which is broadly defined by § 101 (5)(A) as a

right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

Objectants' theory is a throwback to the pre-Code concept of "provability," which prevailed under the Bankruptcy Act. As we noted recently,

[b]y redefining "claim" under the Code, and "giving it the broadest possible definition, and by the use of the term throughout ... title 11, ... the [Code] contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court."

Cohen v. The Drexel Burnham Lambert Group, Inc. (In re The Drexel Burnham Lambert Group, Inc., et al), --- B.R. ----, 1992 Bankr. LEXIS 366, 61, 1992 WL 36294, 18 (Bkrtcy.S.D.N.Y.1992), quoting H.R.Rep. No. 95-595, 95th Cong., 1st Sess. (1977), reprinted in App. 2 Collier on Bankruptcy, II. H.R. Rep. 595 at 309 (15th ed.1991).

The IRS claim for trust fund taxes fits, by any conceivable characterization, within the statutory definition of a "claim." We find in Congress' unrestricted use of that definition in § 507(a)(7)(C) not a whisper of intent to impose the additional requirement that liability for trust fund taxes must have been assessed prepetition to rise to the level of a "claim" for priority purposes.

***3** [W]here, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." Caminetti v. United States, 242 US 470, 485, 61 L.Ed. 442, 37 S.Ct 192 (1917) The language before us expresses Congress' intent ... with sufficient precision so that reference to legislative history and to pre-Code practice is hardly necessary.

United States v. Ron Pair Enterprises, Inc., supra, 489 US at 241, 103 L.Ed.2d at 298, 109 S. Ct at 1030. We will, however, address Objectants' legislative history argument by looking to the intention expressed by Congress when it passed the Code, and to the statutory provisions which provide the structure within which tax obligations are treated.

Nothing in the passage from the Senate Report recited by Objectants suggests that liability has to be "found" prepetition. Indeed, the Code and its legislative history both plainly state that a prepetition liability may be determined postpetition. So clearly is this stated, in fact, that even if we were to judicially legislate that a claim for trust fund taxes doesn't arise until after liability has been found, IRS probably still would be entitled to priority status. Section § 505(a)(1), for example, explicitly provides that "the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed...." (Emphasis added). Clearly, then, we are empowered to fix, postpetition, the amount of a prepetition tax liability. Section 502(i) [FN4] would seem to require that such a claim be allowed priority status even if, as under Objectants' theory, it didn't become a claim until after it had been determined, postpetition, under § 505(a).

Denial of Objectants' objection is mandated not only by the plain language of § 507(a)(7)(C), and the structure of the Code, but also by the policies expressly articulated by Congress in the legislative history. Section 507(a)(7) was intended by Congress to resolve

(a) three-way tension ... among (1) general creditors, who should not have the funds available for payment of debts exhausted by an excessive accumulation of taxes for past years; (2) the debtor, whose "fresh start" should likewise not be burdened with such an accumulation; and (3) the tax collector, who should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting.

S.Rep. No. 989, 95th Cong., 2d Sess. (1978), reprinted in App. 3 Collier on Bankruptcy, V. S. Rep. 989 at 14. Objectants' argument resolves that tension in favor of creditors, with consequences to taxing agencies and to debtors which the expressed purpose of Congress was to avoid. Those consequences are twofold. First, if we sustain the objections, estate funds will be reallocated away from IRS, and will become available for distribution to Debtors' general unsecured creditors. [FN5] Secondly, as Objectants concede, their position leaves Debtors' at significant risk of an impaired "fresh start." If the IRS claim is nonpriority and nondischargeable, then Debtors will remain liable to IRS, dollar for dollar, for the amounts that go to creditors instead of to IRS. The legislative history of § 507(a)(7) unequivocally states that it was enacted precisely to avoid both these consequences.

***4** A taxing authority is given preferred treatment because it is an involuntary creditor of the debtor. It cannot choose its debtors, nor can it take security in advance of the time that taxes become due. The Bankruptcy Act gives the taxing authority three years to pursue delinquent debtors and obtain secured status. If a debtor files bankruptcy before that three-year period has run, the taxing authority is given a priority in order to compensate for its temporarily disadvantaged position.

There is an additional reason for the priority. Because it takes a taxing authority time to locate and pursue delinquent tax debtors, taxes are made nondischargeable if they become legally due and owing within three years before bankruptcy.... The priority is tied to this nondischargeability provision, in order to aid the debtor's fresh start. By granting the nondischargeable tax a priority, more of it will be paid in the bankruptcy case, leaving less of a debt for the debtor after the case.

H.R.Rep. No. 95-595, 95th Cong., 1st Sess. (1977), reprinted in App. 2 Collier on Bankruptcy, II. H.R. Rep. 595 at 190 (15th ed.1991).

For the foregoing reasons, we conclude that the objection is groundless, and must be denied. Counsel for IRS is to settle an order consistent with the views expressed in this Memorandum of Decision.

FN1. Our subject matter jurisdiction over this controversy arises under 28 USC § 1334 (b) and the General Reference to this Court under Part V of the Local District Court Rules for the District of Vermont. This is a core matter under 28 USC §§ 157(b)(2)(A) and (B). This Memorandumof Decision constitutes conclusions of law under F.R.Civ.P. 52, as made applicable by Fed.R.Bkrtcy.P. 7052. The facts set forth in this Memorandum of Decision are drawn from a Stipulation of Facts among the parties to this dispute. The Debtors did not participate, and are not bound in any subsequent proceedings by our findings here.

FN2. Section 6672 provides, in pertinent part:

(a) General rule.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

FN3. In asserting that their objection is "narrowly focused," Objectants stress that they

argue only that the IRS does not have a seventh priority claim against the Debtors' estate. It may be that the IRS has some general claim against the Debtors by virtue of the expansive definition of a claim given by Section 101(5) of the Bankruptcy Code. It may also be that the IRS's claim against the Debtors survives the Debtors' bankruptcy.

Objectants' Memorandum of Law in Support of Objection to Claim Filed by the IRS, 4. We do not believe the impact of their objection can be so narrowly confined. If we assume, as Objectants do, that liability must be found prepetition for a priority claim to arise, then it would appear to us that if IRS has no priority under § 507(a)(7), then whatever claim it has is not excepted from discharge under § 523(a)(1). A claim for trust fund taxes might, however, be nondischargeable under some other provision, such as § 523(a)(4) or (6).

FN4. Section 502(i) provides, in pertinent part:

A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(7) of this title shall be determined, and shall be allowed ... the same as if such claim had arisen before the date of the filing of the petition.

FN5. Lambert, who filed a nonpriority, unsecured Proof of Claim for $223,762.79, appears to be the largest general unsecured creditor.

1992 WL 77619 (Bankr.D.Vt.)

---

Back to Opinions by Citation
Back to Opinions by Date

OR
Or Search for Keywords