Benchnotes

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Third Circuit Declines to Discharge Taxes Subject to a Late-Filed Return

Section 523(a)(1)(B)(i) excepts from discharge taxes with respect to which a return was not filed or given. In a case of first impression for the Third Circuit, the debtor sought a discharge as to tax obligations owing after the debtor failed to timely file a return. In *In re Giacchi*,[1] the Third Circuit joined the Fourth, Sixth, Seventh, Eighth and Eleventh Circuits in adopting a four-part test applied in *Beard v. Commissioner of Internal Revenue*[2] for determining whether a tax filing qualifies as a "return."[3] Under *Beard*, a document must meet all of the following criteria in order to be considered as a return: It must (1) purport to be a return; (2) be executed under penalty of perjury; (3) contain sufficient data to allow calculation of tax; and (4) represent an honest and reasonable attempt to satisfy the requirements of the tax law.[4]

According to the Third Circuit in *Giacchi*, an untimely tax filing made after the Internal Revenue Service has already assessed taxes is not an "honest and reasonable attempt to satisfy the requirements of the tax law" as required under *Beard*; therefore, it is not considered a return for purposes of construing the applicability of 11 U.S.C. § 523(a)(1)(B)(i). Although the result might be the same in *Giacchi*, by construing the late filing as noncompliant with the *Beard* standards, the Third Circuit sidestepped in deciding the issue based on the so-called "one-day-late" rule adopted by the First, Fifth and Tenth Circuits, which stands for the proposition that a tax debt can never be discharged under § 523(a)(1)(B)(i) if the related return was filed late, even by one day.[5] Although it does not explain the circumstances by which a late filing would be construed as *Beard* compliant, by sidestepping the one-day-late rule, the Third Circuit explicitly left open the possibility that some "circumstance might ... demonstrate that the debtor, despite his delinquency, had attempted in good faith to comply with the tax laws."[6]

A Loan Is Not an "Educational Benefit"

In *Kashikar v. Turnstile Capital Management LLC*,[7] the Ninth Circuit Bankruptcy Appellate Panel (BAP) recently construed what it means to provide funds for an "educational benefit" and declined to extend the 11 U.S.C. § 523(a)(8) exception from discharge to a loan by a private lender for payment of tuition to a nonaccredited medical school.[8] In *Kashikar*, the debtor incurred a debt to a private lender when it applied for a "student loan" that was later funded by a private lender directly to a medical school in the Cayman Islands. The debtor filed a complaint seeking to discharge its liability to Turnstile Capital Management on the basis that the loan did not fall into the exceptions to discharge provided in § 523(a)(8).

Specifically, § 523(a)(8)(A)(ii) excepts from discharge an obligation to repay funds received as an educational benefit, scholarship or stipend. In her complaint, the debtor argued that her liability to Turnstile should not be excepted from discharge because the loan was funded directly to the school, therefore she never "received" the funds, and that the funds were not received as an "educational benefit."[9] The bankruptcy court initially rejected both arguments.

On appeal, the BAP agreed with the bankruptcy court that it is not necessary for a fund to be transferred to a debtor to be "received"; instead, funds advanced "to or *on behalf of a debtor*" qualify as having been received under § 523(a)(8).[10] However, a plain reading of the statute indicates that the reference to an "educational benefit" does not include loans, which are separately excepted under § 523(a)(8)(A)(i). In so doing, the BAP relied on and emphasized its holding in *Christoff*, in which it determined that "we must presume that, in organizing the provisions of § 523(a)(8) as it did in [the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005], Congress intended [for] each subsection to have a distinct function and to target different kinds of debts." All was not lost for Turnstile, however, as the BAP remanded the matter to see if the loan otherwise qualified for an exception to discharge pursuant to § 523(a)(8)(A)(i) as being made by a nonprofit entity.

Miscellaneous

• *In re Arm Ventures LLC*, 564 B.R. 77 (Bankr. S.D. Fla. 2017) ("[T]he law is very clear — a bankruptcy plan that proposes to be funded through income generated by the sale of marijuana products cannot be confirmed unless the business generating the income is legal under both state law

1 --- F.3d ---, 2017 WL 1753244 (3d Cir. 2017).
2 83 T.C. 766 (T.C. 1984), *aff'd*, 793 F. 2d 139 (6th Cir. 1986).
3 *See In re Justice*, 817 F.3d 738 (11th Cir. 2016); *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999); *In re Moroney*, 352 F.3d 902 (4th Cir. 2003); *In re Colsen*, 446 F.3d 836 (8th Cir. 2006); and *In re Payne*, 431 F.3d 1055 (7th Cir. 2005) (Easterbrook, J., dissenting).
4 *Id.* at 777.
5 *See In re Fahey*, 779 F.3d 1, 4 (1st Cir. 2015); *In re Mallo*, 774 F.3d 1313, 1317 (10th Cir. 2014), *cert. denied sub nom., Mallo v. IRS*, 135 S. Ct. 2889 (2015); and *In re McCoy*, 666 F.3d 924, 932 (5th Cir. 2012).
6 *In re Giacchi*, 2017 WL 1753244 (3d Cir. 2017) (quoting *In re Justice*, 817 F.3d at 746 n.8 (citations omitted)).
7 --- B.R. ---, 2017 WL 1535994 (B.A.P. 9th Cir. 2017).
8 *Giacchi* at *6.
9 *Kashikar* at *3.
10 *Id.* at *5 (citing *Institute of Imaginal Studies v. Christoff (In re Christoff)*, 527 B.R. 624, 634 n.9 (B.A.P. 9th Cir. 2015)).

and federal law"; feasibility of debtor's chapter 11 plan depended too heavily on proposed new tenant's ability to obtain licensing to sell marijuana, which court found to be "highly unlikely, and at a minimum ... an extremely remote possibility"; for that reason, court found plan to have been proposed in "bad faith" and granted secured creditor's motion for relief from automatic stay to continue its pre-bankruptcy foreclosure efforts);

• *In re Hardej*, 563 B.R. 855 (Bankr. N.D. Ill. 2017) (debtor's former business entity, stock of which was purchased from chapter 7 trustee, had actual knowledge of debtor's bankruptcy despite receiving no formal notice; debtor's knowledge could not be imputed since debtor was not officer or director; knowledge could be imputed through registered agent and local Illinois attorney, who actively participated in bankruptcy case; thus, entity and its new, adverse owners could not pursue breaches of fiduciary duty against debtor, because such actions violated debtor's discharge injunction);

• *In re Selenberg*, --- F.3d ---, 2017 WL 1822310 (5th Cir. 2017) (Fifth Circuit affirmed determination by bankruptcy court that debt arising out of attorney's malpractice was non-dischargeable pursuant to 11 U.S.C. § 523(a)(2)(A); debtor was attorney that committed malpractice by failing to file complaint within applicable statute of limitations; he settled malpractice claim by entering into promissory note with his client; however, in so doing, he failed to disclose to his client her right to independent counsel in settlement of malpractice claim despite his duty to do so under applicable state rules of professional responsibility; bankruptcy court found, and district court and court of appeals affirmed, that debtor's failure to fulfill his duty to disclose constituted false representation for purposes of § 523(a)(2));

• *Blixseth v. Yellowstone Mountain Club LLC (In re Blixseth)*, --- F.3d ---, 2017 WL 1379203 (9th Cir. 2017) (Ninth Circuit upheld award of attorneys' fees and costs against counsel for debtor for frivolously extending bankruptcy case and subsequent appeals; debtor's principal and his attorney were both sanctioned under Rule 38 of the Federal Rules of Appellate Procedure, which allows for award of damages and single or double costs for fees and costs of defending frivolous appeals; counsel was further sanctioned pursuant to 28 U.S.C. § 1927, which contains fee-shifting provision that permits award of attorney fees-on-fees, including, according to Ninth Circuit, fees incurred to obtain sanction awards);

• *Porter v. Nabors Drilling USA LP*, --- F.3d ---, 2017 WL 1404392 (9th Cir. 2017) (Ninth Circuit ruled that enforcement action brought by private citizen on behalf of state agency is not excepted from automatic stay; under California law, private citizens can pursue civil enforcement actions in name of state agency if private citizen has provided notice to state of alleged claim and state fails to timely act; Jeremy Porter, a former employee, filed complaint with California Labor and Workforce Development Agency (CLWDA) against defendant, Nabors Drilling, for violations of California Labor Code; after CLWDA declined to act, Porter filed suit on behalf of state to enforce California Labor Code, and action was subsequently removed to federal district court; during pendency of appeal, Nabors Drilling filed for bankruptcy and filed a suggestion of bankruptcy with court of appeals and subsequently moved to recognize automatic stay; after considering application of 11 U.S.C. § 362(b)(4), which excepts actions "by a governmental unit ... to enforce police and regulatory power" and that there had been no governmental involvement or intervention in case, court of appeals ruled that exception cannot apply);

• *In re Helming*, --- B.R. ---, 2017 WL 1717511 (B.A.P. 8th Cir. 2017) (BAP affirmed bankruptcy court holding that annuity purchased from proceeds of sale of debtor's home was not exempt under applicable Missouri law);

• *In re Ogden*, --- B.R. ---, 2017 WL 2124413 (Bankr. N.D. Ga. 2017) (bankruptcy court overruled chapter 13 trustee's objection to confirmation of debtors' plan on basis that it was proposed in bad faith because debtor proposed to retain $920 per month of her Social Security income as savings and unsecured creditors were likely to only recover 20 percent of their claims; bankruptcy court said that express exclusion of Social Security income from definition of "current monthly income" means that Social Security income need not be factored into chapter 13 plan payments); and

• *In re Fryar*, --- B.R. ---, 2017 WL 1489822 (Bankr. E.D. Tenn. 2017) (bankruptcy court applied U.S. Supreme Court's holding in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 985 (2017), to deny approval of settlement for being violative of Bankruptcy Code's priority scheme; in *Fryar*, debtor requested approval of a compromise that would result in sale of equity interests to third party; under this settlement, sale proceeds would be paid to debtor's senior lender, resulting in recovery to senior lender of more than $200,000 — more than if the senior lender were to foreclose on underlying assets securing its debt; Ninth Circuit determined that compromise, although ostensibly leaving debtor to continue with reorganization process, was "a preamble to a conversion or structured dismissal" and did not otherwise serve any significant Code-related objectives that might otherwise serve as exception to rule derived in *Jevic* precluding approval of structured dismissal that violates Code's priority-distribution scheme). abi