

# Putting the Hanging Paragraph Out to Pasture: Reconciling the Mandates of Bankruptcy and Tax Law

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*ABSTRACT: This Note explores an area of tension between bankruptcy and tax law. The question of when a tax return is dischargeable through bankruptcy is murky and controversial. The current statutory definition of a tax “return” is widely reviled because it is unnecessarily restrictive. This Note proposes redrafting the statutory definition of tax “return” to resolve the issue in a way favorable to debtors. Specifically, this Note proposes allowing a tax return to be discharged as long as it complies with applicable content requirements on its face. Unlike the current statutory scheme, this proposal would not prohibit the discharge of a tax return because it was submitted after either the passing of a statutory deadline or an independent assessment by a tax authority. This proposal also aligns with the purpose of the Bankruptcy Code—to give the honest debtor a fresh start.*

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## I. INTRODUCTION

Federal courts have consistently struggled to resolve a fundamental conflict at the nexus of our country’s systems of bankruptcy and taxation. The Bankruptcy Code exists for the economically and socially beneficial purpose of releasing debtors from otherwise inescapable debt.<sup>1</sup> A person trapped in perpetual insolvency by mounting debt is a burden to society.<sup>2</sup> Absolving debts, while adverse to creditors, is better for society than allowing this cycle of impoverishment to continue.<sup>3</sup> The primary advantage of declaring

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1. See *Fahey v. Mass. Dep’t of Revenue (In re Fahey)*, 779 F.3d 1, 11 (1st Cir. 2015) (Thompson, J., dissenting) (“Our nation’s bankruptcy system was built on the principle that sometimes, honest people fall on hard times. While the bankruptcy code has naturally gone through revisions and updates since its inception, that foundational philosophy has always laid at its root.”).

2. See *Sligh v. First Nat’l Bank of Holmes Cty.*, 704 So. 2d 1020, 1025 (Miss. 1997) (“Our statutes upon the subject of exemptions indicate a clear public policy that exemption from personal pauperism is of greater concern than the rights of creditors.” (quoting *Leigh v. Harrison*, 11 So. 604, 606 (Miss. 1892))). The “very purpose” of the Bankruptcy Code “is to protect debtors from pauperism.” *Id.* at 1028.

3. See *In re Fahey*, 779 F.3d at 17 (Thompson, J., dissenting) (“The primary purpose of the bankruptcy code has always been to ‘relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.’ . . . [A] ‘fresh start’ is a ‘fundamental bankruptcy concept.’” (quoting *Schwab v. Reilly*, 560 U.S. 770, 791 (2010); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934))).

bankruptcy for the debtor is the possibility of ultimately absolving unpayable debts through a discharge.<sup>4</sup> Most debts are dischargeable in this manner.<sup>5</sup>

Frequently at odds with the debtor's hope of discharging debts is the government's need to raise revenue. Collecting taxes allows the government to continue operating.<sup>6</sup> Income tax collection requires the individual taxpayer to self-report his or her income every year by filing a return.<sup>7</sup> As American taxpayers are well aware, federal income tax returns for a given year are due on April 15th of the following year.<sup>8</sup> Tension between the bankruptcy system and revenue collection becomes evident in the context of a debtor seeking to discharge tax liability through bankruptcy: Whereas the debtor seeks a "fresh start"<sup>9</sup> through the discharge of debts, the government still wants to collect taxes as a means of raising needed revenue.

Generally, the ends of the bankruptcy system are given greater weight than the needs of the tax system because enforcing a tax against an individual who lacks the means to pay it will do little to raise revenue.<sup>10</sup> That individual may need to seek assistance—or further assistance—from welfare programs,

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4. See *Saluja v. Mantra* (*In re Mantra*), 314 B.R. 723, 728 (Bankr. N.D. Ill. 2004) ("The discharge provided by the Bankruptcy Code is to effectuate the 'fresh start' goal of bankruptcy relief. In exchange for that fresh start, the Bankruptcy Code requires debtors to accurately and truthfully present themselves before the Court. A discharge is only for the honest debtor. Consequently, objections to discharge under 11 U.S.C. § 727 should be liberally construed in favor of debtors and strictly against objectors in order to grant debtors a fresh start." (citations omitted)).

5. See 11 U.S.C. § 523 (2012) (listing debts excepted from discharge).

6. See Jonathan L. Mills, Comment, *When a Return Is Not a Return: The Importance of a Timely Filed Income Tax Return for Discharge in a Chapter 7 Bankruptcy*, 44 CUMB. L. REV. 461, 491 (2014) ("The underlying purpose of any tax is to raise revenue. While seemingly unending policy reasons exist for the various provisions in our tax laws, the overarching objective is to raise money in support of the governmental functions that our society has deemed appropriate.").

7. I.R.C. § 6012 (2012) (requiring returns); see *In re Payne*, 431 F.3d 1055, 1057 (7th Cir. 2005) ("[T]he main purpose of the requirement that taxpayers file income-tax returns . . . [is] to spare the tax authorities the burden of trying to reconstruct a taxpayer's income and income-tax liability without any help from him."); see also Mills, *supra* note 6, at 491 ("Our voluntary system of filing and paying income taxes requires incentives to make the system run smoothly. If an individual does not file a tax return or fails to pay a tax liability, the individual faces consequences. These consequences include penalties, interest, additional taxes, and the threat of criminal sanctions as well. In light of these consequences, most individuals decide to file and pay their income taxes as the IRC or their state or local authorities require.").

8. I.R.C. § 6072(a); see Ryan G. Saharovich, Comment, *To Discharge or Not to Discharge: Tax Is the Question*, 33 EMORY BANKR. DEV. J. 219, 220–21 (2016). An exception is made when April 15th falls on a Saturday, Sunday, or legal holiday. I.R.C. § 7503. Individual taxpayers may also be able to obtain an extension on the filing deadline. I.R.C. § 6081.

9. See *Nilsen v. Mass. Dep't of Revenue*, 557 B.R. 1, 3 (D. Mass. 2016) ("The aim of a bankruptcy proceeding is to provide debtors with a 'fresh start.'" (citation omitted)); see also *Grogan v. Garner*, 498 U.S. 279, 283 (1991) ("[T]he general 'fresh start' policy that undergirds the Bankruptcy Code militated in favor of a broad construction favorable to the debtor.").

10. See *Sligh v. First Nat'l Bank of Holmes Cty.*, 704 So. 2d 1020, 1025 (Miss. 1997) (discussing the bankruptcy system's purpose in avoiding "pauperism"); see also 11 U.S.C. § 523 (generally allowing tax debt to be discharged except under specified circumstances).

thereby increasing governmental expenditures.<sup>11</sup> As a result, tax debts are generally dischargeable.<sup>12</sup> However, this principle is not absolute. The debtor's conduct and the source of the debt often determine when tax liability is excepted from discharge, meaning the debtor remains liable to pay.<sup>13</sup>

The Bankruptcy Code and Internal Revenue Code ("IRC") are both creatures of federal statutory law. Unfortunately, Congress's attempts to balance the demands of both codes have greatly frustrated both courts and debtors. The Bankruptcy Code requires a debtor to file a return for a given year before income tax liability from that year becomes dischargeable.<sup>14</sup> However, prior to an amendment to the Bankruptcy Code in 2005, Congress did not define the term "return."<sup>15</sup> This ambiguity forced courts to fall back on a common-law test for defining a "return" for dischargeability purposes.<sup>16</sup> Courts unanimously agreed on the common-law test to define "return," but a circuit split developed over the application and scope of that test.<sup>17</sup> Central to this controversy is how the timeliness of filing a return affects its dischargeability. In 2005, Congress amended the Bankruptcy Code to statutorily define the term "return."<sup>18</sup> However, rather than clarifying the definition of "return," the statutory language only increased confusion, and courts remain deeply divided over the dischargeability of tax debts.

In Part II, this Note reviews the history of tax debt dischargeability under the Bankruptcy Code. Part III proceeds to explore criticism of the current prevailing doctrine and examines previously proposed solutions. Next, Part IV reexamines the rationale underlying the current approach and proposes a new legislative solution. Part V concludes.

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11. See *Sligh*, 704 So. 2d at 1020; see also JEFF SESSIONS, U.S. SENATE BUDGET COMM., CRS REPORT: WELFARE SPENDING THE LARGEST ITEM IN THE FEDERAL BUDGET, <https://www.budget.senate.gov/imo/media/doc/CRS%20Report%20-%20Welfare%20Spending%20The%20Largest%20Item%20In%20The%20Federal%20Budget.pdf>.

12. See, e.g., 11 U.S.C. §§ 727, 1141, 1228, 1328 (providing for discharge of debts).

13. See *id.* § 523 (listing exceptions to discharge).

14. *Id.* § 523(a)(1)(B)(ii).

15. *In re Payne*, 431 F.3d 1055, 1057 (7th Cir. 2005); see also *Moroney v. United States (In re Moroney)*, 352 F.3d 902, 905 (4th Cir. 2003) ("Neither the Bankruptcy Code nor the Internal Revenue Code defines the term 'return.' The Internal Revenue Code generally requires that those owing taxes 'make a return or statement' on the necessary forms, without specifying how timely the forms must be in order to qualify as returns." (quoting I.R.C. § 6011(a) (2012))).

16. See *Bourd v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986) (describing a four-prong test for defining a "return").

17. Compare *United States v. Hatton (In re Hatton)*, 220 F.3d 1057, 1059-61 (9th Cir. 2000) (disallowing a tax return filed subsequent to an IRS assessment), with *Colsen v. United States (In re Colsen)*, 446 F.3d 836, 841 (8th Cir. 2006) (allowing a tax return filed subsequent to the IRS filing substitute returns).

18. See 11 U.S.C. § 523(a)(\*) (providing a definition of "return").

## II. BACKGROUND

### A. THE DISCHARGABILITY OF TAX DEBT THROUGH BANKRUPTCY

The Constitution gives Congress the exclusive power to create a bankruptcy system.<sup>19</sup> Pursuant to this power, Congress adopted the modern Bankruptcy Code in 1978, replacing the previous code from 1898.<sup>20</sup> The oft-repeated purpose of the Bankruptcy Code is to “relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.”<sup>21</sup> The debtor initiates bankruptcy proceedings in the hope of obtaining relief from debts through a discharge.<sup>22</sup> However, the Bankruptcy Code makes clear that not all debts are dischargeable.<sup>23</sup> While providing “the honest, but unfortunate, debtor a fresh start”<sup>24</sup> from insurmountable debt is undoubtedly a benefit to society, the Bankruptcy Code balances several competing public interests, including the rights of creditors.<sup>25</sup> Additionally, because many bankruptcy cases involve tax liability, the Bankruptcy Code must balance the proper and efficient administration of tax revenue collection against the interest of restoring the debtor to stable financial standing.<sup>26</sup>

19. U.S. CONST. art. I, § 8, cl. 4 (“The Congress shall have power . . . [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.”).

20. *Robinson v. JH Portfolio Debt Equities, LLC* (*In re Robinson*), 554 B.R. 800, 805 (Bankr. W.D. La. 2016).

21. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fid. & Guar. Co.*, 236 U.S. 549, 554–55 (1915)); *Fahey v. Mass. Dep’t of Revenue* (*In re Fahey*), 779 F.3d 1, 8 (1st Cir. 2015) (quoting *Local Loan Co.*, 292 U.S. at 244); *see also Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007) (“The principal purpose of the Bankruptcy Code is to grant a ‘fresh start’ to the ‘honest but unfortunate debtor.’” (quoting *Grogan v. Garner*, 498 U.S. 279, 286, 287 (1991))).

22. The relevant discharge provisions of the Bankruptcy Code are 11 U.S.C. §§ 727, 1141, 1228, and 1328.

23. *See* 11 U.S.C. § 523(a) (listing specific exceptions from discharge).

24. *Dalton v. I.R.S.*, 77 F.3d 1297, 1300 (10th Cir. 1996); *see also In re Fahey*, 779 F.3d at 11 (Thompson, J., dissenting) (“Our nation’s bankruptcy system was built on the principle that sometimes, honest people fall on hard times. While the bankruptcy code has naturally gone through revisions and updates since its inception, that foundational philosophy has always laid at its root.”).

25. *See Grogan*, 498 U.S. at 287 (“Congress evidently concluded that the creditors’ interest in recovering full payment of debts in these categories outweighed the debtors’ interest in a complete fresh start.”).

26. *See S. REP. NO. 95-989*, at 14 (1978) (noting that the interested parties in tension with each other are: “(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”).

Section 523 of the Bankruptcy Code lists categories of debts that are not excepted from discharge.<sup>27</sup> The first listed exception in § 523 concerns certain tax liabilities.<sup>28</sup> Tax liabilities are frequently a significant burden for financially distressed individuals.<sup>29</sup> Nevertheless, tax liability cannot be discharged “with respect to which a return, . . . if required—(i) was not filed or given; or (ii) was filed or given after the date on which such return . . . was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition.”<sup>30</sup> In other words, if a return is not filed, or late-filed within two years prior to declaring bankruptcy, it is excepted from discharge. Section 523(a)(1)(C) also excepts tax debts “with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.”<sup>31</sup>

### B. INITIAL APPLICATION OF THE BEARD TEST

The common-law test for defining a tax “return” originated, not in the bankruptcy context, but in the Tax Court case of *Beard v. Commissioner*.<sup>32</sup> In *Beard*, a taxpayer, as part of a coordinated tax protest, tampered with the contents of a Treasury Form 1040 to claim that his wages were not taxable gross income.<sup>33</sup> Over one dissent, the Tax Court ruled that the tampered form was not a “return” because it was not intended to give the Internal Revenue Service (“IRS”) the correct information.<sup>34</sup>

Later cases have uniformly looked to *Beard* to define a “return” and pulled from it a four-factor test. Simply stated, the *Beard* test holds that “a document qualified as a tax return if: (1) it purported to be a return; (2) was signed under penalty of perjury; (3) contained information sufficient to determine tax liability; and (4) was an honest and reasonable attempt to satisfy the tax law requirements.”<sup>35</sup> Of the four prongs of the *Beard* test, only

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27. 11 U.S.C. § 523.

28. *Id.* § 523(a)(1).

29. *See* Maitland v. N.J. Div. of Taxation (*In re Maitland*), 531 B.R. 516, 521 (Bankr. D.N.J. 2015) (claiming that another court “may have underappreciated the number of bankruptcy cases in which clearing up old tax debt is the primary purpose of the filing”).

30. 11 U.S.C. § 523(a)(1)(B).

31. *Id.* § 523(a)(1)(C).

32. *Beard v. Comm’r*, 82 T.C. 766, 777 (1984), *aff’d*, 793 F.2d 139 (6th Cir. 1986).

33. *Id.* at 768–71.

34. *Id.* at 777–80; *see also id.* at 784–87 (Chabot, J., concurring in part and dissenting in part) (arguing since the alterations to the Form 1040 did not interfere in verifying income, it was a tax return).

35. *Fahey v. Mass. Dep’t of Revenue (In re Fahey)*, 779 F.3d 1, 16 (1st Cir. 2015); *accord* *Justice v. United States (In re Justice)*, 817 F.3d 738, 740–41 (11th Cir. 2016); *Smith v. IRS (In re Smith)*, 828 F.3d 1094, 1096 (9th Cir. 2016); *McCoy v. Miss. State Tax Comm’n (In re McCoy)*, 666 F.3d 924, 927 n.6 (5th Cir. 2012); *Maryland v. Ciotti (In re Ciotti)*, 638 F.3d 276, 280 (4th Cir. 2011); *In re Payne*, 431 F.3d 1055, 1057 (7th Cir. 2005); *Moroney v. United States (In re Moroney)*, 352 F.3d 902, 905 (4th Cir. 2003); *United States v. Hatton (In re Hatton)*, 220 F.3d

the final prong—whether a purported return was “an honest and reasonable attempt to satisfy the requirements of the tax law”—has occupied significant time and attention by courts.<sup>36</sup>

Courts applying the *Beard* test were particularly troubled by one frequently occurring fact pattern: A debtor fails to file a return before the filing deadline, often for multiple years, and subsequently files a return only *after* the IRS prepares substitute returns and assesses tax liability.<sup>37</sup> Such substitute returns can be completed with or without the cooperation of the taxpayer.<sup>38</sup> Often, if the taxpayer is not involved in preparing substitute returns, it is because he or she refused.<sup>39</sup> Circuit courts split on whether a postassessment return—a return filed by a taxpayer subsequent to the IRS independently preparing substitute returns—represented “an honest and reasonable attempt to satisfy the tax law requirements” under the fourth prong of the *Beard* test.<sup>40</sup>

#### 1. Majority View under the *Beard* Test: The Fourth, Sixth, Seventh, and Ninth Circuits

The Fourth, Sixth, Seventh, and Ninth Circuits all found that a delinquent tax return did not satisfy the “honest and reasonable attempt” prong of the *Beard* test when submitted after a tax authority independently assessed liability.<sup>41</sup> Since the taxpayers in these cases did not file a “return,” their tax debts were nondischargeable pursuant to § 523(a)(1)(B)(i). In 1999, the Sixth Circuit became the first rule on a postassessment return case in *In re Hindenlang*.<sup>42</sup> In that case, the debtor refused to cooperate with the IRS, then submitted delinquent return forms after the IRS had independently

1057, 1060–61 (9th Cir. 2000); *United States v. Hindenlang* (*In re Hindenlang*), 164 F.3d 1029, 1033 (6th Cir. 1999); *Beard*, 82 T.C. at 777.

36. See, e.g., *In re Justice*, 817 F.3d at 744 (“Only the fourth prong of the *Beard* test—that there must be an honest and reasonable attempt to satisfy the requirements of the tax law—is disputed in this case.”). “Honesty and reasonableness” was originally the third prong of the *Beard* test, but courts almost exclusively renumber it. See *Beard*, 82 T.C. at 777. That convention is followed in this Note.

37. See, e.g., *Colsen v. United States* (*In re Colsen*), 446 F.3d 836, 838 (8th Cir. 2006); *In re Payne*, 431 F.3d at 1056; *In re Moroney*, 352 F.3d at 903–04; *In re Hindenlang*, 164 F.3d at 1031.

38. I.R.C. § 6020 (2012).

39. See, e.g., *In re Hindenlang*, 164 F.3d at 1031 (describing the debtor refusing to cooperate with the IRS after receiving a 90-day letter).

40. Compare *In re Hatton*, 220 F.3d at 1060–61 (disallowing a tax return filed subsequent to an IRS assessment), with *In re Colsen*, 446 F.3d at 840–41 (allowing a tax return filed subsequent to the IRS filing substitute returns).

41. *In re Payne*, 431 F.3d at 1057–59; *In re Moroney*, 352 F.3d at 906; *In re Hatton*, 220 F.3d at 1060–61; *In re Hindenlang*, 164 F.3d at 1034–35; see also *In re Justice*, 817 F.3d at 743–44 (assuming *arguendo* that the *Beard* test is governing law and following the majority approach).

42. See generally *In re Hindenlang*, 164 F.3d 1029 (holding that a postassessment return could never be “honest and reasonable” under the *Beard* test).

prepared substitute returns.<sup>43</sup> The debtor's delinquent returns "were simply mirror images of the Substitutes for Returns completed by the IRS."<sup>44</sup> In the court's view, the debtor's return was not honest and reasonable because "it no longer serve[d] any tax purpose or ha[d] any effect under the Internal Revenue Code."<sup>45</sup> In refusing to self-report his income or cooperate with the IRS, the debtor had actively flouted the very purpose of requiring a taxpayer to file a return.<sup>46</sup>

In *In re Hindenlang*, the Sixth Circuit created a per se rule that a postassessment return was nondischargeable because it was inherently inconsistent with the purpose of the tax system.<sup>47</sup> While the Fourth, Seventh, and Ninth Circuits all followed in holding that postassessment returns were nondischargeable, no circuit embraced the Sixth Circuit's per se approach.<sup>48</sup> Writing for the Seventh Circuit in *In re Payne*, Judge Posner wrote that "[w]e need not go that far in this case. There might . . . be circumstances beyond a taxpayer's control that prevented him from filing a timely return, or even from asking for an extension of the time to file, before the tax was assessed."<sup>49</sup> Thus, postassessment returns were nondischargeable unless the court found

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43. *Id.* at 1031.

44. *Id.* at 1034.

45. *Id.*; see also *In re Moroney*, 352 F.3d at 906 ("The very essence of our system of taxation lies in the self-reporting and self-assessment of one's tax liabilities. Timely filed federal income tax returns are the mainstay of that system. A reporting form filed after the IRS has completed the burdensome process of assessment without any assistance from the taxpayer does not serve the basic purpose of tax returns: to self-report to the IRS sufficient information that the returns may be readily processed and verified. Simply put, to belatedly accept responsibility for one's tax liabilities, only when the IRS has left one with no other choice, is hardly how honest and reasonable taxpayers attempt to comply with the tax code." (citations omitted)).

46. *In re Hindenlang*, 164 F.3d at 1033 ("As the Supreme Court has stated, '[t]he purpose [of the return] is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.'" (alterations in original) (quoting *Comm'r v. Lane-Wells Co.*, 321 U.S. 219, 223 (1944))).

47. *Id.* at 1034-35.

48. See, e.g., *Justice v. United States (In re Justice)*, 817 F.3d 738, 744 (11th Cir. 2016) ("A significant factor in our decision to adopt the majority position espoused by the Fourth, Fifth, Seventh, and Ninth Circuits is the fact that our system of taxation relies on prompt and honest self-reporting by taxpayers. A taxpayer who does not file a timely return and who submits no information at all until contacted by the IRS frustrates the requirements and objectives of that system. Indeed, filing tax documents only after the IRS has gathered the relevant information and assessed a deficiency significantly undermines the self-assessment system. Delinquency in filing, therefore, is evidence that the taxpayer failed to make a reasonable effort to comply with the law." (footnote omitted)); *In re Payne*, 431 F.3d 1055, 1057 (7th Cir. 2005) ("When [the debtor] filed, the IRS had already calculated the tax due from him, which means that he had succeeded in defeating the main purpose of the requirement that taxpayers file income-tax returns: to spare the tax authorities the burden of trying to reconstruct a taxpayer's income and income-tax liability without any help from him. A return filed after the authorities have borne that burden does not serve the purpose of the filing requirement.").

49. *In re Payne*, 431 F.3d at 1059-60.

a sufficient justification for the taxpayer's lateness. No court has yet to provide an example of when a postassessment return may nevertheless be allowable.

## 2. Minority View Under the *Beard* Test: Judge Easterbrook and the Eighth Circuit

Opposition to the majority view that postassessment returns were never—or almost never—“honest and reasonable” under the *Beard* test first emerged in Judge Easterbrook's dissent from the Seventh Circuit's decision in *In re Payne*.<sup>50</sup> Judge Easterbrook pointed out that, contrary to the majority's assertion that a return is useless once the IRS has independently prepared substitute documents, a postassessment return can supply the IRS with information it did not previously have.<sup>51</sup> Thus, even a postassessment return can serve a purpose by replacing the IRS's estimates with facts, which, in turn, can alter an assessment.<sup>52</sup> According to Judge Easterbrook, the majority erred by assuming that a return must be indispensable to revenue collection or else be contrary to the “purpose” of the tax system.<sup>53</sup> In any event, filing a tax return remains mandatory, even after the IRS prepares substitute returns.<sup>54</sup> Rather than considering the timeliness of the filing, Judge Easterbrook argued that courts should determine the honesty and reasonableness of a return strictly from the information provided in the document.<sup>55</sup>

In *In re Colsen*, the Eighth Circuit became the first circuit to break from the majority view of the *Beard* test in a decision that drew heavily from Judge Easterbrook's dissent in *In re Payne*.<sup>56</sup> The Eighth Circuit concluded that determining the honesty and reasonableness of a return required only an examination of “the face of the form itself.”<sup>57</sup> The Eighth Circuit strongly disapproved of any inquiry into the taxpayer's “subjective intent” in filing returns, finding that such an analysis would only “increase the difficulty of administration and introduce an inconsistency into the terminology of the tax

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50. *Id.* at 1060–63 (Easterbrook, J., dissenting).

51. *Id.*

52. *Id.* at 1060–61 (“Post-assessment returns can be useful, whether or not the agency insists on them, because otherwise it must make estimates. Truthful returns, no matter how late, replace estimates with facts. A taxpayer who provides all of the information required by the tax laws may show that his income was more (or less) than the Service believed, leading to a more accurate assessment. Securing this information from the person with the best knowledge about his income and deductible expenses is why tax law requires returns in the first place. Better late than never. The taxpayer then will be unable to deny that he had income; the agency will be able to levy on his assets without protest that it made up the numbers. A belated return will close off some avenues, narrow the dispute that remains should litigation ensue, and—well, it will facilitate compromise. When both sides have the same information, settlement is easier to achieve.”).

53. *Id.*

54. *Id.*

55. *Id.* at 1061–62.

56. *Colsen v. United States (In re Colsen)*, 446 F.3d 836, 840 (8th Cir. 2006).

57. *Id.*

laws.”<sup>58</sup> Rather, the key question should be whether “the document itself provides the information necessary to determine tax liability.”<sup>59</sup> The Eighth Circuit was the last circuit to consider the question of postassessment returns prior to Congress enacting a statutory definition of “return.”<sup>60</sup>

C. *THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 AND THE INTRODUCTION OF THE “HANGING PARAGRAPH”*

The controversy over defining “return” under § 523 changed dramatically when Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), which amended the statutory basis for excepting delinquent tax returns from discharge.<sup>61</sup> Most importantly, BAPCPA inserted a statutory definition of “return”:

For purposes of this subsection, the term “return” means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.<sup>62</sup>

IRC section 6020, mentioned in the definition’s second sentence, gives the IRS authority to create substitute returns.<sup>63</sup> Section 6020(a) concerns returns prepared with the cooperation of the taxpayer.<sup>64</sup> In contrast, section 6020(b) concerns substitute returns prepared by the IRS without the

58. *Id.*

59. *Mallo v. IRS (In re Mallo)*, 774 F.3d 1313, 1320 (10th Cir. 2014) (discussing *In re Colsen*).

60. Both *In re Payne* and *In re Colsen* were decided after the enactment of the amendment of the Bankruptcy Act in 2005, but both were decided under the applicable law when the cases arose. *See generally In re Payne*, 431 F.3d at 1060 (Easterbrook, J., dissenting) (arguing that the majority did not properly apply the relevant law); *In re Colsen*, 446 F.3d 836 (holding that the court should only look at the face of a return to determine whether it represents an “honest and genuine attempt” to satisfy tax law).

61. *Compare* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, *with* 11 U.S.C. § 523(a) (\*) (2012).

62. 11 U.S.C. § 523(a) (\*).

63. *See* I.R.C. § 6020 (2012).

64. *In re Mallo*, 774 F.3d at 1318 n.1; *accord* *Fahey v. Mass. Dep’t of Revenue (In re Fahey)*, 779 F.3d 1, 7 (1st Cir. 2015) (“Section 6020(a) is a tool for the I.R.S., invoked solely at its discretion, when it decides obtaining help from the late filing taxpayer is to the I.R.S.’s advantage. That Congress left the I.R.S. a carrot to offer a taxpayer in such infrequent cases does not mean that it was absurd for Congress not to extend this carrot categorically to large numbers of other late filers.”). “[I.R.C. section] 6020(a) returns are allowed only at the I.R.S.’s request and require the taxpayer’s cooperation, while returns filed under section 6020(b) do not involve assistance by the taxpayer and may involve willful fraud.” *Id.* at 4 n.2.

taxpayer's cooperation.<sup>65</sup> Prior to BAPCPA, several courts had ruled that section 6020(b) returns were not "returns" under the *Beard* test, but at least one court disagreed.<sup>66</sup>

In enacting BAPCPA, Congress intended "to reduce the spiraling cost to society of bankruptcies."<sup>67</sup> However, no legislative history sheds light on the purpose or intended interpretation of its statutory definition of "return."<sup>68</sup> This definitional provision, which is unnumbered and fits awkwardly into the structure of the statute, is commonly referred to as the "hanging paragraph" and is denoted with an asterisk.<sup>69</sup>

#### D. DEFINING "RETURN" AFTER BAPCPA

Although Congress intended to clarify the definition of "return" in § 523,<sup>70</sup> the hanging paragraph introduced an additional interpretive challenge and left courts further divided. Courts disagree both on what provisions are included in "the requirements of applicable nonbankruptcy law (including applicable filing requirements)" and whether the *Beard* test still applies.<sup>71</sup>

##### 1. Post-BAPCPA Majority View: The "One-Day-Late" Rule

Since the enactment of BAPCPA, the First, Fifth, and Tenth Circuits have all held that the plain meaning of "applicable filing requirements" includes filing due dates, meaning that any late-filed return—even one filed a single day late—fails as a "return" and can never be discharged through

65. I.R.C. § 6020(b).

66. *Compare* Bergstrom v. United States (*In re* Bergstrom), 949 F.2d 341, 343 (10th Cir. 1991), and Hofmann v. United States (*In re* Hofmann), 76 B.R. 853, 854 (Bankr. S.D. Fla. 1987) (holding that section 6020(b) returns are not "returns"), *with* Ridgway v. United States (*In re* Ridgway), 322 B.R. 19, 37 (Bankr. D. Conn. 2005) (holding that a substitute prepared by the IRS under section 6020(b) was a "return").

67. Maryland v. Ciotti (*In re* Ciotti), 638 F.3d 276, 279 (4th Cir. 2011).

[T]he legislation was motivated by four factors: the "recent escalation of consumer bankruptcy filings," the "significant losses . . . associated with bankruptcy filings," the fact that the "bankruptcy system has loopholes and incentives that allow and—sometimes—even encourage opportunistic personal filings and abuse," and "the fact that some bankruptcy debtors are able to repay a significant portion of their debts" . . . .

*Id.* (quoting H.R. REP. NO. 109-31, at 3-5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 90-92).

68. *In re Fahey*, 779 F.3d at 9 n.10.

69. Justice v. United States (*In re* Justice), 817 F.3d 738, 742 n.4 (11th Cir. 2016); *In re Mallo*, 774 F.3d at 1318. Unusually, although 11 U.S.C. § 523(a)(1) is the only relevant subsection to use the term "return," the hanging paragraph is located at the very end of subsection (a). *See* 11 U.S.C. § 523(a) (2012).

70. *See In re Fahey*, 779 F.3d at 16 (Thompson, J., dissenting) ("Presumably aware of this confusion that was ensuing in the courts, in 2005, Congress added the hanging paragraph . . .").

71. *Compare* McCoy v. Miss. State Tax Comm'n (*In re* McCoy), 666 F.3d 924, 932 (5th Cir. 2012) (holding that the *Beard* test is preempted by BAPCPA), *with* Rhodes v. United States (*In re* Rhodes), 498 B.R. 357, 360 (Bankr. N.D. Ga. 2013) (applying the *Beard* test as a part of BAPCPA).

bankruptcy.<sup>72</sup> Critics derisively refer to this strict approach as the “one-day-late” rule.<sup>73</sup> One notable aspect of the one-day-late rule is that it changes the relevant date for analysis from the day the IRS completes substitute returns to the date of the filing deadline.<sup>74</sup> In other words, the issue is no longer merely *postassessment* returns, but *all* late-filed returns. In his dissent in *In re Payne*, Judge Easterbrook predicted that such an interpretation would inevitably take hold given the wording of the hanging paragraph, saying that “[a]fter the 2005 legislation, an untimely return can not [sic] lead to a discharge.”<sup>75</sup> In *In re McCoy*, the Fifth Circuit became the first circuit to adopt the one-day-late rule.<sup>76</sup>

Interestingly, one-day-late jurisdictions could not agree among themselves whether the *Beard* test still applied. In *In re Fahey*, the First Circuit held that Congress intended the hanging paragraph’s definition of “return” to be exclusive, abrogating the *Beard* test.<sup>77</sup> By contrast, in *In re Mallo*, the Tenth Circuit found that the *Beard* test still applied as “applicable nonbankruptcy law.”<sup>78</sup>

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72. *In re Fahey*, 779 F.3d at 6; *In re Mallo*, 774 F.3d at 1325; *In re McCoy*, 666 F.3d at 931–32.

73. *In re Justice*, 817 F.3d at 743 (“This approach has been termed the ‘one-day-late rule’ because it prohibits discharge of a tax debt with respect to which a return was filed even one day late. In these ‘one-day-late’ jurisdictions, there are only the narrow statutory exceptions to the ‘one-day-late rule,’ e.g., late-filed documents that qualify as returns under this interpretation are those filed in accordance with § 6020(a) of the Internal Revenue Code of 1986.”).

74. *See In re Fahey*, 779 F.3d at 19 (Thompson, J., dissenting) (“The majority . . . opts to create a per se restriction that is contrary to the goal of our bankruptcy system to provide, as the former President [George W. Bush] put it in 2005, ‘fairness and compassion’ to ‘those who need it most.’”).

75. *In re Payne*, 431 F.3d 1055, 1060 (7th Cir. 2005) (Easterbrook, J., dissenting). BAPCPA was discussed in dicta in the *Payne* decision. BAPCPA had been enacted when the case was decided, but the case was not governed by that law because it arose well prior to the law’s effective date. *Id.*

76. *In re McCoy*, 666 F.3d at 932.

77. *In re Fahey*, 779 F.3d at 10–11 & n.12. The Fifth Circuit reached the same conclusion, but based on the fact that *Beard* had never been applied to state, rather than federal, tax returns. *In re McCoy*, 666 F.3d at 929–30.

78. *Mallo v. IRS (In re Mallo)*, 774 F.3d 1313, 1318–19 (10th Cir. 2014). The court did not address how a return could possibly satisfy all “applicable nonbankruptcy law (including applicable filing requirements)” and yet fail to be “honest and reasonable” under the *Beard* test. *See id.* (quoting 11 U.S.C. § 523(a)(\*) (2012)).

## 2. Post-BAPCPA Minority View: Lower Courts

While no circuit court has yet unambiguously rejected the one-day-late rule,<sup>79</sup> a number of lower courts have rejected it.<sup>80</sup> The first court to reach this conclusion was the Bankruptcy Court for the District of Massachusetts in *In re Brown*, which dismissed the one-day-late rule as “ill-conceived and unjustified.”<sup>81</sup> Courts following *In re Brown* would later call the one-day-late rule “draconian” for excepting a return from discharge based on minor mistakes by the taxpayer that did not harm either the bankruptcy or revenue system.<sup>82</sup> These courts refused to read a timeliness requirement into the phrase “applicable filing requirements.” Because these courts accepted at least some late-filed returns, they found themselves in the same place as the courts before BAPCPA—applying the *Beard* test and disagreeing on its application. Some courts adopted the pre-BAPCPA majority view that postassessment returns are almost always nondischargeable.<sup>83</sup> Other courts followed the reasoning of Judge Easterbrook and the Eighth Circuit and ruled that “honesty and reasonableness” should be determined exclusively by the

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79. To date, three federal circuits have decided late-filed tax return cases without adhering to the one-day-late rule. The Eleventh Circuit assumed *arguendo* that the one-day-late rule was not the correct interpretation but held that the taxpayer’s postassessment returns nevertheless failed as not honest and reasonable under the *Beard* test. *Justice v. United States (In re Justice)*, 817 F.3d 738, 743 (11th Cir. 2016). The Fourth Circuit has also found that a postassessment return was not honest and reasonable under the *Beard* test, rather than addressing the one-day-late rule head-on. *Smith v. United States (In re Smith)*, 828 F.3d 1094, 1096–97 (9th Cir. 2016). *But see* *Saharovich*, *supra* note 8, at 240–41 (arguing that *In re Smith* creates a circuit split). Most recently, the Third Circuit likewise expressly declined to reach the one-day-late rule and instead ruled against the taxpayer based on the *Beard* test. *Giacchi v. United States (In re Giacchi)*, 856 F.3d 244, 247–48 (3d Cir. 2017).

80. *See, e.g.*, *Pendergast v. Mass. Dep’t of Revenue (In re Pendergast)*, 510 B.R. 1, 8–9 (B.A.P. 1st Cir. 2014) (citing *Gonzalez v. Mass. Dep’t of Revenue (In re Gonzalez)*, 506 B.R. 317, 328 (B.A.P. 1st Cir. 2014)); *Briggs v. United States (In re Briggs)*, 511 B.R. 707, 714 (Bankr. N.D. Ga. 2014); *Martin v. IRS (In re Martin)*, 508 B.R. 717, 729 (Bankr. E.D. Cal. 2014), *vacated by* 542 B.R. 479 (B.A.P. 9th Cir. 2015); *Pitts v. United States (In re Pitts)*, 497 B.R. 73, 78 (Bankr. C.D. Cal. 2013); *Rhodes v. United States (In re Rhodes)*, 498 B.R. 357, 365 (Bankr. N.D. Ga. 2013); *Brown v. Mass. Dep’t of Revenue (In re Brown)*, 489 B.R. 1, 6 (Bankr. D. Mass. 2013).

81. *In re Brown*, 489 B.R. at 5.

82. *In re Fahey*, 779 F.3d at 17–18 (Thompson, J., dissenting); *Maitland v. N.J. Div. of Taxation (In re Maitland)*, 531 B.R. 516, 519–21 (Bankr. D.N.J. 2015); *see also* Timothy M. Todd, *Discharge of Late Tax Return Debt in Bankruptcy: Fixing BAPCPA’s Draconian Hanging Paragraph*, 24 AM. BANKR. INST. L. REV. 433, 436 (2016) (“[S]uch a harsh and draconian reading of the Bankruptcy Code is incorrect.”). Even the IRS explicitly rejects this view as too severe and has argued in court against applying the one-day-late rule. *In re Maitland*, 531 B.R. at 519 (“Notably, even the IRS has expressed concern over the Fifth Circuit’s interpretation of the hanging paragraph, which would render a one-day-late return not a ‘return’ at all for purposes of § 523. The IRS advocated against the *McCoy* result in a brief filed in a bankruptcy case in California, stating ‘The United States does not adopt this position, which creates a harsh result that appears inconsistent with the statute’s intent.’” Despite the IRS’s position, other Circuit courts have adopted *McCoy*’s draconian interpretation.” (footnote omitted) (quoting *In re Martin*, 508 B.R. 727 n.14)).

83. *See In re Pendergast*, 510 B.R. at 10–11.

form and substance of the document.<sup>84</sup> For instance, in *In re Martin*, the Bankruptcy Court for the Eastern District of California rejected the one-day-late rule and upheld a postassessment return under the *Beard* test based only on its face.<sup>85</sup> Minority-view courts refused to accept the idea that Congress intended the hanging paragraph to create a seismic change in the law absent clear evidence of congressional intent.<sup>86</sup> Under this approach, “applicable nonbankruptcy law (including applicable filing requirements)” can still include a wide array of rules and requirements, but not a strict timeliness requirement.<sup>87</sup>

### III. A CHORUS OF CRITICISM FOR THE ONE-DAY-LATE RULE

The rise of the one-day-late rule has generated a wave of criticism. In addition to courts dissenting from the majority view, legal commentators are unanimous in their disapproval of the rule. This Part introduces some of the legal and policy arguments against the one-day-late rule, then explores previous proposals from commentators on how to resolve the problems created by the rule.

#### A. WHEN “PLAIN MEANING” IS NOT PLAIN

Courts adopting the one-day-late rule stress that their approach interprets the hanging paragraph according to its plain meaning.<sup>88</sup> Filing deadlines, it follows, must be included in “applicable filing requirements” because due date provisions prescribe when a return *shall* be filed. Thus, a filing deadline is an “applicable filing requirement,” and any return not satisfying the deadline provision is not a “return” under the hanging paragraph.<sup>89</sup> Dissenting from the First Circuit’s adoption of the one-day-late rule in *In re Fahey*, Judge Thompson criticized the rule for taking “too academic and literal of an approach” and accused the majority of “a result that defies common sense, while also conveniently ignoring the plain meaning of other words in the very same paragraph, in order to reach a certain outcome.”<sup>90</sup> Specifically, Judge Thompson argued that the one-day-

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84. See *In re Rhodes*, 498 B.R. at 369.

85. See *In re Martin*, 508 B.R. at 731–32, 736.

86. *In re Fahey*, 779 F.3d at 18 (Thompson, J., dissenting).

87. *Id.* at 12 (quoting 11 U.S.C. § 523(a) (2012)) (discussing statutory interpretation of the hanging paragraph); *Brown v. Mass. Dep’t of Revenue (In re Brown)*, 489 B.R. 1, 5 (Bankr. D. Mass. 2013), *rev’d*, 779 F.3d 1 (1st Cir. 2015).

88. See, e.g., *In re Fahey*, 779 F.3d at 6; *Mallo v. IRS (In re Mallo)*, 774 F.3d 1313, 1325 (10th Cir. 2014).

89. See, e.g., *In re Fahey*, 779 F.3d at 4–5; *In re Mallo*, 774 F.3d at 1321; *McCoy v. Miss. State Tax Comm’n (In re McCoy)*, 666 F.3d 924, 928 (5th Cir. 2012).

90. *In re Fahey*, 779 F.3d at 11 (Thompson, J., dissenting).

Under the majority’s formulation, then, the scofflaw who sits on his hands at tax time, doesn’t bother to file a return, and then, after getting caught, cooperates with the authorities and lets the government file the substitute return for him, would be

late interpretation failed to satisfactorily account for § 523(a)(1)(B)(ii), which allows for the discharge of late-filed tax returns so long as they are filed more than two years prior to declaring bankruptcy.<sup>91</sup>

A number of other courts and commentators have taken up this argument, asserting that the one-day-late rule makes § 523(a)(1)(B)(ii) “superfluous.”<sup>92</sup> “The negative implication of [§ 523(a)(1)(B)(ii)] is that a tax debt is dischargeable even if the relevant returns are untimely filed, so long as the return was not filed within two years of the bankruptcy petition.”<sup>93</sup> But the one-day-late rule would prohibit all late-filed returns beginning the very day the taxpayer misses the deadline, meaning no return could possibly fall into § 523(a)(1)(B)(ii).<sup>94</sup>

Section 523(a)(1)(B)(ii) demonstrates just one way in which the one-day-late rule’s assertion of intuitive simplicity does not live up to the claim. Adhering to the “plain meaning” of the term “applicable filing requirements” forces courts to adopt unnatural readings of the Code. For instance, *In re Fahey* did not determine how minute an applicable “requirement” could be and left open the possibility that a tax return could become nondischargeable merely because it was not stapled properly.<sup>95</sup> Additionally, a tax authority will still accept a late-filed tax return, especially if the deadline has only recently passed

the *only* late filer who would be allowed to discharge his tax debt. The person who files his return one day late—which the state then accepts—would not be permitted to discharge, regardless of the reason for the tardiness.

*Id.* at 15.

91. *Id.* at 18–19. The Sixth Circuit explained the purpose of § 523(a)(1)(B)(ii) this way:

This provision appears to serve two purposes. First, the requirement of a two-year waiting period after filing a late return but before seeking discharge prevents a debtor who has ignored the filing requirements of the Internal Revenue Code from waiting until the eve of bankruptcy, filing a delayed but standard tax return form, and seeking discharge the next day. It is, in a sense, a provision affording notice and an opportunity to act, giving the IRS time to seek payment by levy or court proceeding. Second, § 523 forbids discharge when the debtor has acted fraudulently or in a manner calculated to evade or defeat a tax. This corresponds with the notion that “good faith and candor are necessary prerequisites to obtaining a fresh start.”

*United States v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1032 (6th Cir. 1999) (quoting *Indus. Ins. Servs., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1129 (6th Cir. 1991) (citation omitted)).

92. *See, e.g., Briggs v. United States (In re Briggs)*, 511 B.R. 707, 714 (Bankr. N.D. Ga. 2014) (“Courts excluding timeliness from the definition of a return also conclude that interpreting the statute otherwise would render Section 523(a)(1)(B)(ii) superfluous.”).

93. *In re Mallo*, 774 F.3d 1313, 1323 (10th Cir. 2014).

94. One potential counterargument to this critique is that § 523(a)(1)(B)(ii)’s two-year window applies to section 6020(a) assessments, not *all* late-filed tax returns. *See In re Fahey*, 779 F.3d at 6. However, this argument is belied by the fact that § 523(a)(1)(B)(ii) existed before the hanging paragraph, and it clearly referred to all late-filed tax returns prior to 2005. There is no reason to believe that Congress intended to change its function without changing its text or expressly stating its intention. *Id.* at 12–14 (Thompson, J., dissenting). *Compare* 11 U.S.C. § 523(a)(\*) (2012) (defining “return”), *with id.* § 523(a)(1)(B)(ii) (barring an individuals from discharging any debt from an unfilled tax).

95. *In re Fahey*, 779 F.3d at 5; *see also* Todd, *supra* note 82, at 465–66.

and no independent assessment has been made.<sup>96</sup> For comparison, a tax return submitted shortly after the statutory deadline may evidence greater honesty than an assessment completed pursuant to section 6020(a), which the hanging paragraph expressly allows.

Unusually, while the first sentence of the hanging paragraph, according to the one-day-late rule interpretation, bans all late-filed returns, the second sentence specifically provides that section 6020(a) returns are included.<sup>97</sup> Section 6020(a) refers to substitute returns prepared by the IRS with the taxpayer's assistance, which by definition are returns prepared after the deadline.<sup>98</sup> One-day-late adherents plausibly defend their interpretation by claiming that section 6020(a) is a "safe harbor" exception to the general rule against late-filed returns meant to encourage taxpayers to participate in the process.<sup>99</sup> However, critics of the one-day-late rule believe that the fact that the hanging paragraph "includes a return prepared pursuant to section 6020(a)"<sup>100</sup> is evidence that Congress contemplated other late-filed returns being acceptable as well.<sup>101</sup> Furthermore, critics point out that rather than treating section 6020(a) as the only exception to the general prohibition against late-filed returns, it is just as plausible to read the specific *exclusion* of section 6020(b)—returns prepared by the IRS without taxpayer cooperation—as the only exception to a general rule allowing late-filed returns (if timeliness is read out of applicable filing requirements).<sup>102</sup> Section

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96. *In re Fahey*, 779 F.3d at 12 (Thompson, J., dissenting) ("[A] tardy return will still be accepted by the state, and the debtor's tax liability will still be assessed.").

97. See 11 U.S.C. § 523(a)(\*) ("['Return'] includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, . . . but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986 . . .").

98. *Id.*; I.R.C. § 6020(a).

99. *McCoy v. Miss. State Tax Comm'n (In re McCoy)*, 666 F.3d 924, 932 (5th Cir. 2012) ("Unless it is filed under a 'safe harbor' provision similar to § 6020(a), a state income tax return that is filed late under the applicable nonbankruptcy state law is not a 'return' for bankruptcy discharge purposes under § 523(a)."); see also *In re Fahey*, 779 F.3d at 7 ("Here, in context, it simply appears that in creating an exception for section 6020(a), the drafters made clear (desiring a belt and suspenders) that they were not including its companion section 6020(b)."); *In re McCoy*, 666 F.3d at 931 ("Even leaving aside that the I.R.S. notice is focused on federal and not state taxes, both of the concerns it raises are misplaced in this case. First, the second sentence of § 523(a)(\*) is not superfluous if plainly read as an explanation of what kinds of tax filings qualify as 'returns.' Section 523(a)(\*) defines a return for discharge purposes as a 'return the [sic] satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements).' Since filings under § 6020 of the Internal Revenue Code are not returns that satisfy 'applicable filing requirements,' this second sentence simply explains that returns filed pursuant to § 6020(a) do qualify as returns for discharge purposes, while those filed pursuant to § 6020(b) do not. In other words, this second sentence in § 523(a)(\*) carves out a narrow exception to the definition of 'return' for § 6020(a) returns, while explaining that § 6020(b) returns, in contrast, do not qualify as returns for discharge purposes. Such a reading conforms with the plain language of the text and leaves no portion of § 523(a)(\*) superfluous." (citation omitted)).

100. 11 U.S.C. § 523 (emphasis added).

101. *Saharovich*, *supra* note 8, at 239–40.

102. *In re Fahey*, 779 F.3d at 18 (Thompson, J., dissenting); see I.R.C. § 6020(b).

6020(a) returns are prepared at the discretion of the IRS, meaning that the dischargeability of a debtor's debts may ultimately be determined by the actions of the IRS rather than the debtor.<sup>103</sup> Given the IRS's limited resources, the practical ability of taxpayers to take advantage of section 6020(a) is suspect.

Fundamentally, the one-day-late rule harms the basic principle that bankruptcy exists to give debtors a fresh start. President George W. Bush reiterated his commitment to providing a fresh start even while signing BAPCA into law.<sup>104</sup> Undoubtedly, Congress intended BAPCPA to crack down on abuse and close loopholes,<sup>105</sup> but this purpose is not easy to reconcile with the reality of the one-day-late rule. There are any number of reasons—from lack of legal sophistication to personal tragedy—why an honest taxpayer may need to file a tax return late.<sup>106</sup> The one-day-late rule casts a wide net and catches many honest debtors, along with possibly a few cheaters.

The fact that the BAPCPA failed to dissipate confusion in the courts is concerning, considering that Congress's intent in enacting a statutory definition of "return" was likely to clarify that very issue.<sup>107</sup> The fact that some courts incorporate the *Beard* test as part of "applicable nonbankruptcy law" means that the pre-BAPCPA split over how to apply *Beard* remains very much alive. The hanging paragraph has only exacerbated the problem by introducing a new divide over the one-day-late rule. Seemingly, the only thing that the hanging paragraph accomplishes is clarifying that returns under section 6020(a) are dischargeable, while those under section 6020(b) are excepted.

### B. PREVIOUSLY PROPOSED LEGISLATIVE SOLUTIONS

Observers have unanimously and severely denounced the hanging paragraph. Responding to the obvious problems faced by federal courts on this issue, legal commentators have widely condemned the one-day-late rule as a flawed policy burdened by interpretive contradictions. Commentators

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103. See I.R.C. § 6020(a).

104. Remarks on Signing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 41 WEEKLY COMP. PRES. DOC. 641, 642, reprinted in 2005 U.S.C.C.A.N. S7, S7.

105. H.R. REP. NO. 109-31, at 3-5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 90-92.

106. *In re Fahey*, 779 F.3d at 18 (Thompson, J., dissenting) ("[T]he Massachusetts taxing authority acknowledges that someone may miss the filing deadline for a 'reasonable cause.' Yet under the majority's formulation, even people who have a good-faith reason for filing late—and are then excused by the state taxing authority for doing so—are mere 'delinquent taxpayers,' shunned from receiving a bankruptcy discharge. While the 2005 reforms certainly sought to avert abuses that had been occurring in the bankruptcy system, I find it presumptuous to conclude that well intentioned people who file their taxes one day late—with no way to anticipate that bankruptcy would be coming down the pipeline a whole two years later—are the people trying to 'commit fraud' or 'game the system.'"); Todd, *supra* note 82, at 435.

107. See *In re Fahey*, 779 F.3d at 16 (Thompson, J., dissenting) ("Presumably aware of this confusion that was ensuing in the courts, in 2005, Congress added the hanging paragraph . . .").

have advocated for various solutions to the problems posed by the hanging paragraph. As of yet, Congress declines to act.

In 2014, the American Bar Association Section of Taxation submitted a proposed amendment to § 523(a) to four chairmen and ranking members of two congressional committees.<sup>108</sup> The proposal only amended the first sentence of the hanging paragraph. The group proposed inserting the phrase “other than timeliness” into the parenthetical, so that the first sentence would read: “For purposes of this subsection, the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements other than timeliness).”<sup>109</sup>

Academic commentators have also focused their attention on the first sentence of the hanging paragraph, which is the textual source of the one-day-late rule. One commentator has suggested altering the parenthetical so that the first sentence would read: “For purposes of this subsection, the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including an honest and reasonable attempt to satisfy the requirements of the tax law).”<sup>110</sup> This proposal is expressly designed to eliminate the one-day-late rule while codifying the *Beard* test. Another observer has suggested simply deleting the parenthetical and leaving “applicable nonbankruptcy law,” or else amending the text to read:

[T]he term “return” means a return that satisfies the requirements of applicable nonbankruptcy law (including returns prepared pursuant to section 6020(a) of the Internal Revenue Code, or similar State or local law, but not including a return filed on behalf of a taxpayer pursuant to section 6020(b) of the Internal Revenue Code, or similar State or local law).<sup>111</sup>

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108. Letter from Michael Hirschfeld, Chair, Am. Bar Ass’n Section of Taxation, to the Honorable Ron Wyden et al., Chairman, Senate Comm. on Fin. (July 29, 2014). It should be noted that the American Bar Association Section of Taxation’s proposal was not approved by the House of Delegates or the Board of Governors of the American Bar Association and did not represent the official opinion of the American Bar Association itself. *Id.*

109. *Id.* at 8.

110. See Saharovich, *supra* note 8, at 263–65; see also 11 U.S.C. § 523(a) (2012) (listing exceptions to discharge).

111. “The first—and simplest—option is to strike the parenthetical entirely and replace it with nothing. This would likely not be an elegant solution because it would effectively restore the pre-BAPCPA status quo, including the ambiguity surrounding section 6020 substitute returns.” Todd, *supra* note 82, at 456.

[Another] solution would be to amend the parenthetical to provide that the phrase ‘applicable filing requirements’ does not include timeliness. Naturally, this approach raises a concern that debtors could game the system by timing the filing of their late returns. This concern, however, is mitigated by the general provisions of section 523 related to tax discharges. For example, section 523 already polices—and precludes—a discharge for tax returns filed on the eve of bankruptcy. If Congress has concerns about strategic, tax-driven bankruptcy timing, it should

Lastly, one commentator noted that Congress could redraft the statute to clarify “that that subsection neither alters § 523(a)(1)(B)(ii), nor means that an untimely-filed tax return can never be considered a return for discharge purposes.”<sup>112</sup>

These proposals all squarely address the one-day-late rule, but they also share an obvious downside: None of the above proposals clarifies whether the *Beard* test has been preempted or is applied as “applicable nonbankruptcy law.” Assuming the *Beard* test does still apply, these proposals do not address how to resolve the controversy that existed prior to BAPCPA over how to apply the test. Indeed, some commentators freely admit their proposals will likely invite a continuation of the circuit split.<sup>113</sup> To their credit, these proposals would eliminate the harshness of the one-day-late rule that courts and commentators have criticized at length. However, a more satisfying resolution would go beyond correcting the one-day-late rule and would provide a more suitable answer to the underlying problem of how to define “return” for the purpose of § 523.

#### IV. A NEW APPROACH TO DEFINING “RETURN”: STATUTORILY ELIMINATING ALL TIMELINESS REQUIREMENTS

This Part proposes a new solution to the problem of discharging delinquent tax debt. First, it discusses the original context of *Beard v. Commissioner* and examines how later courts have misapplied that case. Better understanding the underlying principles of *Beard* helps clarify how to approach the present controversy. This Part then proposes that Congress should redraft its statutory definition of “return” in accordance with the principles derived from *Beard*.

##### A. REEXAMINING BEARD V. COMMISSIONER

Regrettably, courts applying the *Beard* test have given very little thought to the actual context in which *Beard v. Commissioner* was decided. This is particularly ironic considering the *Beard* decision’s admonition that “[i]t is important to consider the factual circumstances under which this test has

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expressly address those concerns in the timing subsections, not by implication in a general hanging paragraph.

*Id.* (footnote omitted).

112. Mills, *supra* note 6, at 493.

113. See Todd, *supra* note 82, at 457 (“The concern would be that, even if the parenthetical were fixed legislatively to remove the applicable filing requirement language, which has been read to include timeliness, the IRS (or the courts) might nevertheless read the same timeliness requirement into the earlier phrase ‘a return that satisfies *applicable nonbankruptcy law*.’ It would not be a stretch to assert that applicable nonbankruptcy law contains a timing element, or at a minimum, reinvigorates the fourth element of the *Beard* test. Thus, any amendment would need to be clear on this point: Tax debt that is related to a tardy tax return can be discharged, as long as it complies with the general tax timing requirements of section 523. This could be achieved by expressly excepting the date a tax return is due from the hanging paragraph.”).

been applied.”<sup>114</sup> There is more to be learned from *Beard* than a recitation of its four-prong test. Understanding the context and reasoning of *Beard* can inform how to properly apply its test consistent with its underlying rationale.

The *Beard* case arose when a taxpayer filed a Treasury Form 1040—the required standardized income tax return form—which he tampered with to list his wages as not subject to tax.<sup>115</sup> Despite the fact that his tampering “may not be readily apparent to a casual reader,” the IRS identified the problem.<sup>116</sup> The court’s anger with *Beard*, a *pro se* defendant, was readily apparent in its opinion.<sup>117</sup> Likely contributing to the court’s frustration was the fact that *Beard* was just one of 23 similar cases in what the court called “a coordinated protest effort.”<sup>118</sup> The issue before the court was whether *Beard*’s tampered-with form was a “return.”<sup>119</sup> If not, *Beard* was subject to a penalty for failing to file.<sup>120</sup>

The *Beard* court derived its test from three Supreme Court cases: *Florsheim Bros. Drygoods Co. v. United States*,<sup>121</sup> *Zellerbach Paper Co. v. Helvering*,<sup>122</sup> and *Germantown Trust Co. v. Commissioner*.<sup>123</sup> Looking to the face of the document itself, the Tax Court held that *Beard*’s actions in submitting a tampered-with return as part of a tax protest were not honest and reasonable.<sup>124</sup> The court concluded that *Beard*’s return “in fact makes a mockery of the requirements for a tax return, both as to form and content. Whether or not the form contains sufficient information to permit a tax to be calculated is not altogether clear.”<sup>125</sup> At the same time, the court also considered the broader implications of how *Beard*’s tax protest and manipulation could harm the tax system itself.<sup>126</sup> In a brief concurrence, Judge Nims expressed his extreme

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114. *Beard v. Comm’r*, 82 T.C. 766, 777 (1984), *aff’d*, 793 F.2d 139 (6th Cir. 1986).

115. *Id.* at 768–72.

116. *Id.* at 769.

117. The opinion called *Beard*’s theory as to why wages should not be subject to income tax “frivolous and utterly without merit.” *Id.* at 770. *Beard* was found to have instituted the proceeding for delay. *Id.* at 781. The court said the purpose of *Beard*’s actions was “to drain further the limited resources of this Court with these frivolous contentions.” *Id.* at 771. In a concurring opinion, Judge Nims accused Mr. *Beard* of filing a “travesty tax return.” *Id.* at 783 (Nims, J., concurring).

118. *Id.* at 770–71.

119. *Id.* at 774.

120. *Id.*

121. *Florsheim Bros. Drygoods Co. v. United States*, 280 U.S. 453 (1930).

122. *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934).

123. *Germantown Tr. Co. v. Comm’r*, 309 U.S. 304 (1940).

124. *Beard*, 82 T.C. at 779–80.

125. *Id.* at 779.

126. *See id.*

In the tax protestor cases, it is obvious that there is no “honest and genuine” attempt to meet the requirements of the code. In our self-reporting tax system the government should not be forced to accept as a return a document which plainly is not intended to give the required information.

frustration with Beard, “whose so-called returns *on their face* make clear a concerted effort to disrupt the tax system.”<sup>127</sup>

Judge Chabot dissented in *Beard*, writing that he would have found the tampered-with return to be valid, even though the IRS refused to accept it.<sup>128</sup> Judge Chabot reasoned that the forms “appeared on their faces to constitute endeavors to satisfy the law.”<sup>129</sup> He articulated his standard for analyzing honesty and reasonableness as “a document which on its face plausibly purports to be in compliance, and which is signed by the taxpayer, is a return despite its inaccuracies.”<sup>130</sup> To the majority, he warned that “this Court should not confuse the law as to what is a tax return, just to punish a particular individual or even a class of individuals. The Congress has given the courts more effective tools.”<sup>131</sup>

#### B. HOW BEARD SHOULD HAVE BEEN APPLIED IN POSTASSESSMENT CASES

The rationale illuminated by the debate in *Beard* is entirely relevant in applying the test to the problem of late-filed returns. When *Beard* articulated the “honesty and reasonableness” prong, it contemplated the need to preserve the self-reporting function of the tax system, but this concern arose in the context of a tampered form that could be seen to be invalid from the face of the document itself.<sup>132</sup> In an even more permissive analysis, Judge Chabot’s dissenting opinion looked exclusively at the face of the document and applied a deferential “plausibility” standard, which did not even take accuracy into consideration as a part of honesty and reasonableness.<sup>133</sup>

Contrasting the opinion in *Beard* with *In re Hindenlang* and the other pre-BAPCPA majority cases reveals how substantially the latter cases differ from the original understanding of the *Beard* test. Every opinion in the *Beard* case grounded its analysis in the form and substance of the return.<sup>134</sup> By contrast, none of the cases in the vein of *In re Hindenlang* discussed the content of the postassessment returns to any meaningful degree, presumably because the purported returns were correct and accurate. Instead, the pre-BAPCPA majority cases reached their conclusion exclusively on the basis that

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*Id.* (quoting *United States v. Moore*, 627 F.2d 830, 835 (7th Cir. 1980)). “The purpose [of the self-assessment system] is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.” *Id.* at 775 (emphasis omitted) (quoting *Comm’r v. Lane-Wells Co.*, 321 U.S. 219, 223 (1944)).

127. *Id.* at 783–84 (Nims, J., concurring) (emphasis added).

128. *Id.* at 784–87 (Chabot, J., concurring in part and dissenting in part).

129. *Id.* at 784–85 (quoting *Badaracco v. Comm’r*, 464 U.S. 386, 396–97 (1984)).

130. *Id.* at 784 (quoting *Badaracco*, 464 U.S. at 396–97).

131. *Id.* at 786.

132. *Id.* at 778–79.

133. *Id.* at 784–85 (Chabot, J., dissenting).

134. See *id.* at 779; *id.* at 783–84 (Nims, J., concurring); *id.* at 784–85 (Chabot, J., concurring in part and dissenting in part).

postassessment returns could not be honest and reasonable because the timing of the filings defied the tax system's purpose of self-reporting.<sup>135</sup> In incorporating the *Beard* test into the bankruptcy context, these courts subtly changed its rationale. Whereas, the *Beard* Court was concerned with requiring taxpayers to self-report accurate and sufficient data,<sup>136</sup> later cases required taxpayers to comply with the IRC in a way that facilitated collection.<sup>137</sup>

When courts began incorporating the *Beard* test to postassessment return cases, they made a second subtle change that should be noted: They started to use bankruptcy procedures to enforce the IRC. This is notable because refusing to discharge a tax return does nothing make the bankruptcy process more efficient. Instead, the rationale is entirely to penalize noncompliance with the IRC.

The forgoing discussion strongly suggests that Judge Easterbrook's dissent in *In re Payne* was correct in two important arguments. First, his criticism of the majority opinion for conflating collection with information gathering is well-supported by *Beard's* treatment of self-reporting in the tax system.<sup>138</sup> Second, Judge Easterbrook's admonition that "[t]here is no general equitable override to the Bankruptcy Code" appears particularly pertinent when the bankruptcy proceeding is being used to police the separate system of taxation.<sup>139</sup>

### C. A NEW PROPOSAL TO REDRAFT THE HANGING PARAGRAPH

This Note proposes that Congress draft a new definition of "return" that entirely eliminates timeliness as a component of the definition.<sup>140</sup> This proposal is intended to both repeal the one-day-late approach and to resolve the original circuit split pertaining to the application of the *Beard* test. To accomplish this, I propose that the text of the hanging paragraph be redrafted to read:

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135. See, e.g., *Moroney v. United States (In re Moroney)*, 352 F.3d 902, 906 (4th Cir. 2003) (discussing the importance of self-reporting in the tax system).

136. *Beard*, 82 T.C. at 779.

137. *In re Payne*, 431 F.3d 1055, 1057-58 (7th Cir. 2005).

138. See *id.* at 1060-61 (Easterbrook, J., dissenting); *Beard*, 82 T.C. at 779. Additionally, Judge Easterbrook's belief that information in postassessment returns has value to the IRS appears to be well-grounded. *In re Payne*, 431 F.3d at 1060-61 (Easterbrook, J., dissenting); see *Smith v. IRS (In re Smith)*, 828 F.3d 1094, 1096 (9th Cir. 2016) (describing how taxpayer's postassessment return increased his tax liability).

139. *In re Payne*, 431 F.3d at 1061-63 (Easterbrook, J., dissenting) ("Judges should not fiddle with the definition of 'return' so that one word covers *all* important steps in a system of self-assessment."); *Beard*, 82 T.C. at 786 (Chabot, J., concurring in part and dissenting in part) ("[T]his Court should not confuse the law as to what is a tax return, just to punish a particular individual or even a class of individuals.").

140. This approach would be consistent with the principle that "exceptions to discharge are to be strictly construed in favor of the debtor." *United States v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1034 (6th Cir. 1999) (quoting *United States v. Fegeley (In re Fegeley)*, 118 F.3d 979, 983 (3d Cir. 1997)).

For purposes of this subsection, the term “return” means a purported return that, on its face, satisfies applicable content, acknowledgement and attestation requirements with reasonable accuracy. Such term shall not exclude a return for delinquency.

This proposal is intended to align with the original understanding of the *Beard* test by assessing the validity of a “return” based on the face of the document. The first three prongs of the *Beard* test—that a tax return purport to be a return, be signed under penalty of perjury, and contain information sufficient to determine tax liability—are incorporated into the first sentence of my proposal. Retaining these elements is sensible because they are necessary as the basic requirements to achieve the form and substance of a return. By requiring that a “return” be evaluated exclusively on the face of the document, this expressly adopts the view of Judge Easterbrook and the Eighth Circuit, which most closely aligns with the rationale in *Beard*. By specifying that the requirements must be met by reasonable accuracy, this proposal declines to codify the overly permissive view of Judge Chabot, who would evaluate returns without regard to the accuracy of their contents. The self-reporting function of the tax system justifies an examination of the contents of a return to determine whether it provides sufficient accurate information to realistically function as a return.

Eliminating the more demanding requirement of honesty and reasonableness is justified in order to reconcile the pre-BAPCPA circuit split. This proposal settles that matter in favor of taking timeliness out of the definition. Nothing would prevent a postassessment return from being defined as a return, so long as the return is sufficient on its face. My proposal achieves what the *Beard* test was originally designed to do—ensure that a return satisfies basic requirements and is not being misused to harm the tax system itself.

An advantage of my proposal is that its bright-line approach is easy to apply and will bring uniformity to the currently split jurisdictions. Additionally, my proposal expansively effectuates the purpose of the Bankruptcy Code to provide a “fresh start” for the unfortunate debtor. To achieve a discharge under my proposal, a debtor need only to submit a tax return that, on its face, satisfies the requirements of a tax return.

While it could be argued that this proposal does not do enough to ensure that bankruptcy is limited to honest debtors, I believe that the courts’ experience with the *Beard* test has shown that a punitive measure should not be shoehorned into a definitional section. Nothing in this proposal prohibits Congress from including a separate provision prohibiting postassessment tax returns.<sup>141</sup> Rather than a definitional provision, the appropriate place for such a provision would be under § 523(a)(1)(B), which establishes requirements

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141. This Note takes no stance whether such a provision is advisable. The scope of this Note is strictly limited to the proper definition of “return.”

for dischargeability.<sup>142</sup> Additionally, protections against fraud already exist. The Bankruptcy Code already penalizes outright fraud on the part of the debtor under § 523(a)(1)(C).<sup>143</sup> Furthermore, § 523(a)(1)(B)(ii) provides a two-year window prior to declaring bankruptcy in which a late-filed tax return is nondischargeable.<sup>144</sup> This provision prevents extreme abuse by a debtor rushing to file tax returns immediately before filing for bankruptcy so as to get a discharge.<sup>145</sup> This proposal will allow the Bankruptcy Code to better effectuate the principle of providing a fresh start.

## V. CONCLUSION

The purposes of the bankruptcy and taxation systems will always compete for priority. Congress should clarify how these conflicting purposes are to be balanced. Such a balance will inevitably require a complicated defining of terms. However, it cannot be denied that the current statutory definition of tax “return” found in the hanging paragraph is unsuitable; it lends itself to a harsh extreme not justified by any theory of bankruptcy or taxation. This Note proposes redrafting the hanging paragraph to clarify and improve this doctrine. Resolving issues in favor of the debtor will best effectuate the Bankruptcy Code’s purpose—giving the honest debtor a fresh start.

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142. 11 U.S.C. § 523(a)(1)(C) (2012).

143. *Id.* § 523(a)(1)(C); *Fahey v. Mass. Dep’t of Revenue (In re Fahey)*, 779 F.3d 1, 10 (1st Cir. 2015) (“Against this background, it is more plausible that Congress intended to settle the dispute over late filed tax returns against the debtor (who both fails to pay taxes and fails to file a return as required by law) than it is that Congress sought to preserve some version of the unsettled four-pronged *Beard* test by using language that has no reference to that case law and that certainly suggests no four-pronged definition. Particularly noteworthy is the fact that Congress’s chosen test called for satisfying the filing requirements of applicable law, not merely making an ‘honest attempt’ to do so.”); *In re Nunez*, 232 B.R. 778, 783 (B.A.P. 9th Cir. 1999); *see also Colsen v. United States (In re Colsen)*, 446 F.3d 836, 840 (8th Cir. 2006) (“[T]he fourth *Beard* criterion contains no mention of timeliness or the filer’s intent. We have been offered no persuasive reason to create a more subjective definition of ‘return’ that is dependent on the facts and circumstances of a taxpayer’s filing. We think that to do so would increase the difficulty of administration and introduce an inconsistency into the terminology of the tax laws. We therefore hold 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. The filer’s subjective intent is irrelevant.”).

144. 11 U.S.C. § 523(a)(1)(B)(ii).

145. *In re Hindenlang*, 164 F.3d at 1032 (“[T]he requirement of a two-year waiting period after filing a late return but before seeking discharge prevents a debtor who has ignored the filing requirements of the Internal Revenue Code from waiting until the eve of bankruptcy, filing a delayed but standard tax return form, and seeking discharge the next day.”).