

The Third Circuit Concludes that Sales Tax Claims Cannot Be Discharged in Bankruptcy.

When a business owner collects sales taxes from customers, he generally is serving as a collection agent for a state or municipality. If his business fails and he files for bankruptcy, he may face the question whether his sales tax liability can be discharged.

The Bankruptcy Code has two different provisions that arguably apply: Section 507(a)(8)(C) applies to taxes that are “required to be collected and for which the debtor is liable in any capacity,” while Section 507(a)(8)(E) covers “excise taxes” if the liability arose within three years of the date of the bankruptcy petition; taxes that fall within these provisions have a priority in distribution. 11 U.S.C. § 507(a)(8)(C),(E). More important from a debtor’s perspective, priority tax claims are not dischargeable. 11 U.S.C. § 523(a)(1)(A).

So when a business owner collects sales taxes on behalf of a state or municipality, are his tax liabilities trust fund taxes that can never be discharged or excise tax liabilities that can be discharged after three years? The relevant provisions of Section 507(a)(8) arguably both cover this situation.

On July 20, 2012, the Third Circuit addressed this question, ruling that sales taxes collected from customers are trust fund taxes under Section 507(a)(8)(C) that cannot be discharged. *In re Calabrese*, 2012 U.S. App. LEXIS 14897 (3d Cir. July 20, 2012). In reaching this conclusion, the Third Circuit joined three other federal appellate courts that had reached the same conclusion. *See Shank v. Wash. State Dep’t of Revenue, Excise Tax Div.*, 792 F.2d 829, 832 (9th Cir. 1986); *DeChiaro v. N.Y. State Tax Comm’n*, 760 F.2d 432, 435 (2d Cir. 1985); *Rosenow v. State of Ill. Dep’t of Revenue*, 715 F.2d 277, 279 (7th Cir. 1983). While the Third Circuit reached the same result, its reasoning differed from the approaches taken by the Second, Seventh, and Ninth Circuits.

At the outset, the Court determined that the relevant provisions of Section 507(a)(8) were ambiguous, since sales taxes collected from customers arguable fit into both Section 507(a)(8)(C) and Section 507(a)(8)(E). *In re Calabrese*, 2012 U.S. App. LEXIS 14897, slip op. at *5-*6 (3d Cir. July 20, 2012). Since the statute was ambiguous, the Third Circuit then turned to the legislative history. A careful survey of the legislative history, however, did not resolve the issue in the Court’s view. *Id.* at *21-*22. “Faced with an ambiguous statute and an indefinite legislative history,” the Third Circuit then turned to public policy. *Id.* at *22.

While acknowledging that the Bankruptcy Code was intended to provide debtors with a fresh start and to place creditors on an equal footing, the Court concluded that treating sales taxes collected from customers as a dischargeable debt would create “perverse” incentives for those operating a failing business. *Id.* at *22-*23. Given that consideration, along with the fact that sales taxes collected from customers resemble other trust fund taxes, the Third Circuit concluded that sales taxes collected from customers should be treated as non-dischargeable trust fund taxes under the Bankruptcy Code.

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