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INTRODUCTION

Congress enacted the Internal Revenue Code (the "Code") to raise revenue and implement social and economic policy.[1] Where the Code contains ambiguous or underinclusive language, the courts must interpret its meaning and, at times, its policy objectives. As with most statutes enacted by Congress, many sections of the Code are open to numerous interpretations.[2] The Tenth Circuit Court of Appeals heard and decided several cases in which the court had to interpret the Code's language during the 1995-96 survey period.[3] This Survey begins by providing a general background of taxation and the Internal Revenue Code in Part I. Part II discusses *United States v. Reorganized CF&I Fabricators.*[4] In *CF&I*, the Supreme Court affirmed the Tenth Circuit's decision which held that the Code's funding-deficiency tax[5] is not an excise tax for priority purposes under federal bankruptcy law,[6] but reversed the Tenth Circuit's categorical subordination of the Internal Revenue Service's (the "Service") tax claim.[7] The Supreme Court looked beyond the Code's language to determine the nature of § 4971(a) assessments, but limited courts' ability to expand equitable subordination beyond the confines of statutory language.[8]

The Survey concludes with Part III, which examines the Tenth Circuit's interpretation, in two cases, of the Code provision which places a 100% penalty on responsible persons who fail to pay over to the government withheld employment taxes.[9]

I. GENERAL BACKGROUND

Taxes are a vital component of organized society.[10] Ancient societies imposed taxes and developed methods to ensure their collection.[11] Taxes pro-

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1. JOSEPH A. PECHMAN, FEDERAL TAX POLICY 5 (1987).

2. JOHN C. CHOMMIE, THE LAW OF FEDERAL INCOME TAXATION 10 (2d ed. 1973).

3. The survey period includes decisions of the Tenth Circuit between September 1, 1995, and August 31, 1996.

4. 53 F.3d 1155 (10th Cir. 1995).

5. 26 U.S.C. § 4971 (1994).

6. 26 U.S.C. § 507(a)(8) (1994 & Supp. 1997) (interpreting the original 26 U.S.C. § 507(a)(7) which has since been amended to § 507(a)(8)).

7. United States v. Reorganized CF&I Fabricators, 116 S. Ct. 2106, 2115 (1996).

8. *Id.*

9. 26 U.S.C. § 6672 (1994); Bradshaw v. United States, 83 F.3d 1175 (10th Cir. 1995); Taylor v. IRS, 69 F.3d 411 (10th Cir. 1995).

10. DANIEL Q. POSIN, FEDERAL INCOME TAXATION OF INDIVIDUALS 33 (2d ed. 1993). "Our Founding Fathers believed that the power to tax was quintessential for the proper governance of our country." David Laro, *The Evolution of the Tax Court as an Independent Tribunal*, 1995 U. ILL. L. REV. 17, 19 (1995).

11. POSIN, *supra* note 10, at 33. In ancient Sumer, the first organized society of record, the payment of taxes was ensured by religious sanction. *Id.* at 33-34. In ancient Greece, taxes were imposed upon the Athenian upper classes to finance the coups d'etat of 411 and 404 B.C. *Id.*

vide for government administration and military defense,[12] and attempt to achieve social and economic change.[13]

The Constitution gives Congress the "Power To lay and collect Taxes."[14] Tax bills begin in the House and then transfer to the Senate.[15] The legislators compromise between competing social and economic interests before promulgating tax legislation.[16] Today's tax system evolved from legislation present at the country's inception.[17] The Internal Revenue Code of 1986 is used today.[18] Protest against taxation has an interesting history in the United States. From the Boston Tea Party[19] to the Montana Freemen,[20] citizens have implemented violent measures to avoid tax payment. Today, when a conflict between the taxpayer and government arises, several legal avenues are open to settle the dispute. The taxpayer can pay the deficiency, and in turn sue for a refund in a District Court; or the taxpayer may petition the United States Tax Court for a trial.[21] The taxpayer or Service may appeal to the proper Court of Appeals.[22]

The Code has grown from a document of sixteen pages to a mass of complex regulations.[23] The complexity of tax law results from the sheer size of

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12. *Id.* at 33. Taxation provided resources which allowed the United States to become a world power. CHOMMIE, *supra* note 2, at 1.

13. PECHMAN, *supra* note 1, at 5. Taxes shift resources to the public sector, apportion governmental costs among people based upon their economic situation, and facilitate "economic growth, stability, and efficiency." *Id.* High taxes coupled with low government spending combats inflation by constricting private demand. Low taxes coupled with high expenditures combat recession by increasing private demand. *Id.* at 8. Taxes allow the government to influence national economic and social institutions. CHOMMIE, *supra* note 2, at 1.

14. U.S. CONST. art. I, § 8, cl. 1.

15. PECHMAN, *supra* note 1, at 44. "All Bills for raising Revenue shall originate in the House of Representatives." U.S. CONST. art I, § 7. Tax proposals begin in the Treasury and other federal agencies. The President makes recommendations to Congress, where they are reviewed by two tax committees and sent to the House and Senate. PECHMAN, *supra* note 1, at 44-53. Taxation is assigned to a joint congressional committee. The Joint Committee on Taxation contains five members of the House Ways and Means Committee and five members of the Senate Finance Committee, three each from the majority party and two each from the minority party. *Id.* at 38-39. For a more detailed description of the taxation legislation process, *see* CHOMMIE, *supra* note 2, at 8-10.

16. PECHMAN, *supra* note 1, at 38-39. Political, economic, and social groups attempt to pressure the Treasury, the tax committees, and the President to gain an advantage in taxation legislation. *Id.* at 38.

17. *Id.* at 39.

18. *Id.* The 1986 Code is comprised of the 1954 Code as amended by the Tax Reform Act of 1986. Internal Revenue Code of 1986, Pub. L. No. 99-514, 100 Stat. 2095 (codified as amended at 26 U.S.C. §§ 1-9722 (1994)).

19. In 1773, men boarded ships of the British East India Company and tossed tea overboard to protest the tea tax imposed by British Parliament. POSIN, *supra* note 10, at 34-35.

20. FBI agents surrounded a Freemen compound in Montana for 81 days attempting to apprehend the Freemen for committing various crimes, including tax evasion. Carey Goldberg, *The Freemen Sought Refuge in an Ideology That Kept the Law, and Reality, at Bay*, N.Y. TIMES, June 16, 1996, at 14.

21. CHOMMIE, *supra* note 2, at 14-15. The Tax Court does not provide for a jury trial. *Id.* at 15.

22. *Id.* The case may continue on to the United States Supreme Court. *Id.*

23. *Id.* at 10. The current Code consists of 800 pages which contain over 250,000 words. *Id.* Difficult provisions treating corporations as separate entities, increasing rates on ordinary income, giving privileges to certain economic classes, and closing loopholes have increased the complexity of the Code. *Id.* at 10-11.

the regulations which govern it and the large number of people it directly effects.[24] Taxation effects the lives of more Americans than perhaps any other area of the law.[25]

II. TAX CLAIMS IN BANKRUPTCY

A. *Background*

The Bankruptcy Code contains rules, called priorities, which determine the order in which to pay creditors from the bankrupt's limited pool of resources.[26] Unsecured compensatory excise tax claims of the government receive eighth priority.[27] A penalty claim, however, receives priority only if it is a pecuniary loss penalty.[28] A § 726(a)(4) noncompensatory penalty is subordinated to all general, unsecured claims.[29] Taxpayers have heavily litigated the Service's assessments to determine whether they are punitive or compensatory.[30]

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24. POSIN, *supra* note 10, at 39-40. In the early 1990's, over 90 million tax returns were filed annually in the United States. *Id.* The Service employed 120,000 in 1990. Laro, *supra* note 10, at 21.

25. Dobson v. Commissioner, 320 U.S. 489, 494-95 (1943). "No other branch of the law touches human activities at so many points" as tax law. *Id.* at 494-95.

26. Lee A. Sheppard, *Bankruptcy Tax Policy: How Far Should Equitable Subordination Go?*, 8 TAX PRAC. 356, 357 (1995). Secured claims come before unsecured claims. *Id.* Claims arising out of the bankruptcy administration receive first priority. *Id.*

27. 11 U.S.C. § 507(a)(8) (1993 & Supp. 1997). Section 507 of the Bankruptcy Code provides:

> (a) [t]he following expenses and claims have priority in the following order:
> . . . .
> (8) Eighth, allowed unsecured claims of the governmental units, only to the extent that such claims are for . . .
> . . . .
> (E) an Excise Tax on—
> (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or
> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition.

Id.

28. 11 U.S.C. § 507(a)(8)(G) (1993 & Supp. 1997).

29. 11 U.S.C. § 726(a)(4) (1994). Section 726(a) provides:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed
> (1) first, in payment of claims of the kind specified in, and in the order specified in section 507 of this title, ...
> (2) second, in payment of any allowed unsecured claim
> . . . .
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages . . . to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim
> . . . .
> (6) sixth, to the debtor.

Id.

30. Sheppard, *supra* note 26, at 357. Several courts have addressed whether a tax labeled as an excise tax should be granted priority under § 507(a)(8)(E) of the Bankruptcy Code or subordi-

An example of a contentious category of assessments are those levied against pension plans. The Code requires that employers meet funding requirements for pension plans qualified under Code §§ 401(a) and 403(a).[31] The Code places an excise tax on employers who fail to fund pension plans as required.[32] The assessment is located in a subsection entitled "Miscellaneous Excise Taxes." If the language of this title defines the nature of the assessment for purposes of the Bankruptcy Code, the government would receive eighth priority. If, however, the assessment is a penalty, it would not receive priority under the Bankruptcy Code because it does not compensate for pecuniary loss. The legislative history of this section suggests Congress intended this excise tax be punitive in nature.[33] Commentators, however, have found the history vague and inconclusive.[34]

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nated as a penalty, if the true nature of the exaction is a penalty under § 726(a)(4). *See generally* United States v. Mansfield Tire & Rubber Co., 942 F.2d 1055 (6th Cir. 1991); Unified Control Systems Inc. v. IRS, 586 F.2d 1036 (5th Cir. 1978); Kline v. Feinblatt, 403 F. Supp. 974 (D. Md. 1975).

31. 26 U.S.C. § 412 (1994). Section 412 provides:

> (a) General rule. Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan—
>
> (1) such plan included a trust which qualified (or was determined by the Secretary to have qualified) under section 401(a), or
>
> (2) such plan satisfied (or was determined by the Secretary to have satisfied) the requirements of section 403(a).
>
> A plan to which this section applies shall have satisfied the minimum funding standard for such plan year if, as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term "accumulated funding deficiency" means for any plan, the excess of the total charges over the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years. In any plan year in which a multiemployer plan is in reorganization, the accumulated funding deficiency of the plan shall be determined under section 418B.

Id.

32. 26 U.S.C. § 4971 (1994). Section 4971 provides for taxes on those who fail to meet minimum funding standards:

> (a) Initial tax. For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year. (b) Additional tax. In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

Id.

33. The legislative history describes the statute's purpose:

> The [committee] bill also provides new and more effective penalties where employers fail to meet the funding standards. In the past, an attempt has been made to enforce the relatively weak funding standards existing under present law by providing for immediate vesting of the employees' rights, to the extent funded, under plans which do not meet these standards. This procedure, however, has proved to be defective since it does not directly penalize those responsible for the underfunding. For this reason, the bill places the obligation for funding and the penalty for underfunding on the person on whom it belongs—namely the employer. This is achieved by imposing an excise tax where the employer fails to meet the funding standards.

S. REP. NO. 93-406, pt. I (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4909-10.

34. *See* Laurie F. Humphrey, Comment, In re Mansfield Tire & Rubber Company: *A Penalty*

The Sixth Circuit, in *United States v. Mansfield Tire & Rubber Co.*,[35] became the first, and remains the only circuit to hold that a tax under § 507(a)(7)(E)—now § 507(a)(8)(E)—receives priority against unsecured claims. Relying upon the statutory construction method used by the United States Supreme Court in *United States v. Ron Pair Enterprises, Inc.*,[36] the *Mansfield* court found that because Congress gave priority to excise taxes, courts should conclude that Congress knowingly used the terms and should grant these taxes priority.[37]

In *Unified Control Systems v. IRS*,[38] the Fifth Circuit stated that "the label placed upon an imposition in a revenue measure is [not] decisive in determining its character [as a tax or penalty]."[39] The court found that § 4941 excise taxes were penalties and not allowed as claims.[40]

In *Cassidy v. Dumler*,[41] the Tenth Circuit held that a § 72(t) tax is punitive in nature and may be equitably subordinated.[42] Thus, the *Cassidy* court rejected the Sixth Circuit's analysis on this issue, relying instead on the Fifth Circuit's reasoning.[43]

Bankruptcy courts may deviate from congressionally established distribution rules.[44] The Bankruptcy Code provides for equitable subordination.[45] Courts now apply equitable subordination in cases where a claim holder acts in good faith.[46]

By Any Other Name Is Not a Penalty, 42 CASE W. RES. L. REV. 1069, 1081 (1992) (stating that "the legislative history of section 507 is inconclusive at best"). *But see* David L. Kwass, Note, *Excise Taxes in Bankruptcy:* United States v. Mansfield Tire & Rubber Co. *Holds Congress to Its Word*, 12 VA. TAX REV. 513, 521 n.40 (1993) (suggesting two grounds with which to attack the legislative history argument).

35. 942 F.2d 1055 (6th Cir. 1991).

36. 489 U.S. 235 (1989).

37. *Mansfield Tire & Rubber Co.*, 942 F.2d at 1059. The Sixth Circuit said, "[w]here Congress has exercised its constitutional power and deemed an exaction an 'excise tax', the question has been answered." *Id.* at 1059.

38. 586 F.2d 1036 (5th Cir. 1978).

39. *Unified Control Sys.*, 586 F.2d at 1037.

40. *Id.* at 1039 (holding that granting priority to excise taxes "would thwart the congressional purpose to honor such assessments over the claims of entirely innocent creditors, except insofar as the government can show pecuniary loss").

41. 983 F.2d 161 (10th Cir. 1992).

42. *Cassidy*, 983 F.2d at 165. The Tenth Circuit relied upon Supreme Court decisions in which the Court held that the name given to an exaction by the state legislature is not conclusive. *Id.* at 163. The Court rejected appellant's contention that these cases did not apply to federal exactions. *Id.*

43. 983 F.2d at 162.

44. Sheppard, *supra* note 26, at 357.

45. *See Id.* Section 510(c) provides:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may—
>
> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed interest to all or part of another allowed interest; or
>
> (2) order that any lien securing such a subordinated claim be transferred to the estate.

11 U.S.C. § 510(c) (1994).

46. Sheppard, *supra* note 26, at 357.

In *In re Virtual Network Services Corp*,[47] the Seventh Circuit expanded equitable subordination. As courts were invoking equitable subordination at the time of ratification, the court found that Congress ratified subordination when it enacted the Bankruptcy Code of 1978.[48] Other circuits have also held that they may equitably subordinate pre-petition tax penalties to other creditor's claims.[49]

B. United States v. Reorganized CF&I Fabricators[50]

1. Facts

CF&I Fabricators sponsored two qualified pension plans which they did not adequately fund as required by Code § 412.[51] CF&I later filed for Bankruptcy under Chapter 11.[52] The Service filed proofs of claim, and assessed a ten percent tax under § 4971 on the funding deficiency.[53] The Service sought priority treatment in post-bankruptcy distributions under § 507(a)(7)(E)—now § 507(a)(8)(E).[54] The Bankruptcy Court found that the tax liability was not an excise tax under § 507,[55] and accepted CF&I's reorganization plan which placed the government in the lowest priority.[56] Upon the government's appeal, the District Court for the District of Utah affirmed.[57]

2. Tenth Circuit Decision

Declaring the analysis set forth in *Cassidy* as binding precedent, the Tenth Circuit found that the Bankruptcy Court correctly looked beyond the statutory

47. 902 F.2d 1246 (7th Cir. 1990).

48. *In re Virtual Network Serv. Corp.*, 902 F.2d at 1249-50. The Seventh Circuit went on to find "that § 510(c)(1) authorizes courts to equitably subordinate claims to other claims on a case-by-case basis without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors." *Id.* at 1250.

49. *See* Burden v. United States, 917 F.2d 115, 119 (3d Cir. 1990) (holding that § 510(c) permits this subordination); Schultz Broadway Inn v. United States, 912 F.2d 230 (8th Cir. 1990) (using legislative history of § 510(c) to support subordination of government tax claims).

50. 53 F.3d 1155 (10th Cir. 1995).

51. *Reorganized CF&I Fabricators*, 53 F.3d at 1156 [*CF&I Fabricators*]. In September of 1990, CF&I failed to contribute a required $12.4 million to the plans for the taxable year ending December 31, 1989. *Id.*

52. United States v. Reorganized CF&I Fabricators, 116 S. Ct. 2106, 2109 (1996) [*Reorganized CF&I Fabricators*]. CF&I filed in its attempt to reorganize, largely because of an inability to meet the funding requirements of 29 U.S.C. § 1001. *Id.*

53. *Id.*

54. *Id.* In the alternative, the Government sought to prioritize its claim as a tax penalty in compensation for pecuniary loss under § 507(a). *Id.*

55. *Id.* The bankruptcy court read § 4971 as creating a noncompensatory penalty. *Id.*

56. *Id.* at 2109-10.

57. *Id.* at 2110. CF&I created a reorganization plan placing the § 4971 claim in a special class for "nonpecuniary loss penalties" before the appeal was heard. *Id.* The District Court affirmed the court's decision to look beyond the words of the statute and the subordination. *Id.*

label.[58] The court then turned to equitable subordination.[59] The court said that other courts apply equitable subordination only when a creditor has committed a wrongdoing,[60] but followed the Seventh Circuit's contrary reasoning.[61] The Tenth Circuit held that "§ 510(c)(1) does not require a finding of claimant misconduct to subordinate nonpecuniary loss tax penalty claims."[62]

3. United States Supreme Court Decision[63]

The Court relied upon the congressional purpose in creating § 4971. Looking beyond the statutory language, the Court found that Congress intended § 4971 as a penalty and not an excise tax.[64] Because the language of § 4971 does not contain the term "excise"[65] and because "characterizations in the Internal Revenue' Code are not dispositive in the bankruptcy context,"[66] the Court found the Service's unsecured claim should not receive priority.[67]

Relying upon the its recent decision in *U.S. v. Noland*,[68] the Court reversed the Tenth Circuit's equitable subordination of the Service's claim.[69] Dissenting, Justice Thomas agreed that the Tenth Circuit improperly subordinated the Service's claim, but thought every excise tax should be given § 507(a)(8)(E) status.[70]

C. *Analysis*

Because the language in § 4971 does not label its assessment as an excise tax,[71] the *CF&I* Court could have relied upon its decision in *United States v.*

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58. *CF&I Fabricators*, 53 F.3d at 1158. In *Cassidy*, the Tenth Circuit held that "Congress' labeling of [an] exaction as a tax is not determinative of its status for priority in bankruptcy . . . ." *Cassidy*, 983 F.2d at 163. The *CF&I* court concluded that the bankruptcy court correctly refused to treat the Internal Revenue Code's label as determinative for priority in bankruptcy purposes. *CF&I Fabricators*, 53 F.3d at 1158.

59. *See CF&I Fabricators*, 53 F.3d at 1158.

60. *Id.*

61. *Id.* at 1159. The Seventh Circuit relied upon legislative history to determine that Congress intended courts to develop the equitable subordination doctrine. *In re Virtual Network Servs. Corp.*, 902 F.2d at 1249-50.

62. *CF&I Fabricators*, 53 F.3d at 1159.

63. The Supreme Court granted certiorari "to resolve a conflict among the circuits over whether § 4971(a) claims are excise taxes within the meaning of § 507(a)(7)(E) [now § 507(a)(8)(E)], and whether such claims are categorically subject to equitable subordination under § 510(c)." *Reorganized CF&I Fabricators*, 116 S. Ct. at 2110.

64. *Id.* at 2114.

65. *Id.* at 2112. The only reference to the term "excise" is in the title of the chapter in which § 4971 is located. *Id.*

66. *Id.* at 2113.

67. *Id.* at 2114.

68. 116 S. Ct. 1524 (1996) (concluding that categorical reordering of priorities that take place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c)).

69. *Reorganized CF&I Fabricators*, 116 S. Ct. at 2115.

70. *Id.* at 2116 (Thomas, J., dissenting). Justice Thomas thought it was "not appropriate . . . for federal courts to perform a similar inquiry into valid taxes passed by Congress, and the majority cites no case in which this Court has denied bankruptcy priority to a congressionally enacted tax." *Id.* (Thomas, J., dissenting).

71. *See supra* note 65 and accompanying text. "No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any par-

Ron Pair Enterprises, Inc.[72] In *Ron Pair*, the Court held that where the language of the Bankruptcy Code is plain, "'the sole function of the courts is to enforce it according to its terms.'"[73] The *CF&I* Court incorrectly relied[74] on *United States v. New York*[75] and *United States v. Sotelo.*[76] In these cases, the Court refused to rely on the terminology used in relevant tax and bankruptcy provisions and, instead, followed a functional analysis. The Court could have used an analysis under *Ron Pair*, which mandates decisions based on statutory language, to arrive at the same conclusion and maintain consistency with precedent.[77] Instead, the Court relied upon cases which are inconsistent with the precedent established by *Ron Pair* and other Supreme Court cases.[78]

The Court properly limited equitable subordination. The results may harshly punish innocent creditors who take subject to prioritized government claims.[79] Congress, however, decided claim priority in the Bankruptcy Code,

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ticular section or provision or portion of this title . . . ." 26 U.S.C. § 7806(b) (1994).

72. 489 U.S. 235, 241 (1989) (holding that "as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute").

73. *Ron Pair*, 489 U.S. at 241 (quoting Caminetti v. United States, 242 U.S. 470 (1917)).

74. *See Reorganized CF&I Fabricators*, 116 S. Ct. at 2111.

75. 315 U.S. 510 (1942). The Court placed no weight on the tax label, looking instead to the actual effects of the exaction. *Id.*

76. 436 U.S. 268, 275 (1978) (stating that "[w]e . . . cannot agree with the Court of Appeals that the penalty language of Internal Revenue Code § 6672 is dispositive of the status of respondent's debt under Bankruptcy Act § 17(a)(1)(e)"); *see* Kwass, *supra* note 34, at 527 ("*Sotelo*, however, no longer appears to be good law. Justice Rehnquist wrote the dissent in *Sotelo* and endorsed the approach later adopted in *Ron Pair*.").

77. *See* Humphrey, *supra* note 34, at 1082 (approving of the Sixth Circuit's reliance on *Ron Pair* in *Mansfield Tire*); Kwass, *supra* note 34, at 530 (stating that "the appropriate Supreme Court standard is derived from the plain meaning rule in *United States v. Ron Pair*"). "After *Ron Pair* . . . courts should rarely look beyond relevant statutory history to interpret what Congress intended by enacting a statute." Jeffrey H. Paravano, *Postpetition Interest on Oversecured Tax Liens—Abandonment of the "Nonconsensual" Distinction in Bankruptcy Proceedings:* United States v. Ron Pair Enterprises, Inc., 42 TAX LAW. 475, 487 (1989).

78. *See* Humphrey, *supra* note 34, 1077 n.60 (quoting Dewsnup v. Timm, 502 U.S. 410, 419-20 (1992) (construing amendments of the bankruptcy laws as not affecting prior law absent legislative history to the contrary and declaring that "silence in the legislative history to the contrary cannot be controlling" where the statute is unambiguous)); Ardestani v. INS, 502 U.S. 129, 135-36 (1991) (starting with the language of a statute, presuming plain language expresses intent, and allowing only conclusive legislative history to counter the presumption); Demarest v. Manspeaker, 498 U.S. 184, 190 (1991) (stating that "[w]hen . . . the terms of a statue [are] unambiguous, judicial inquiry is complete except in rare and exceptional circumstances"); Freytag v. Commissioner, 501 U.S. 868, 873 (1991) (finding that when language is unambiguous, judicial inquiry ends). The Supreme Court has been inconsistent interpreting the Code. *See* Kenneth N. Klee & Frank A. Merola, *Ignoring Congressional Intent: Eight Years of Judicial Legislation*, 62 AM. BANKR. L.J. 1, 2 (1988) (criticizing courts for ignoring statutory language); Jeffrey W. Shaw, Note, *Discharging Tax Penalties in Bankruptcy Liquidation: No Relief for the Dishonest Debtor*, 10 VA. TAX REV. 801, 803 n.10 (1991) (arguing that the Supreme Court has been inconsistent when interpreting the Bankruptcy Code). *But see* Nicholas S. Zeppos, *Legislative History and the Interpretation of Statutes: Toward a Fact-Finding Model of Statutory Interpretation*, 76 VA. L. REV. 1295 (1990) (arguing statutory interpretation is moving toward textualism).

79. United States v. Nolan, 48 F.3d 210 (6th Cir. 1995). The *Nolan* Court stated:

> We do not see the fairness or the justice in permitting the Commissioner's claim for tax penalties, which are not being assessed because of pecuniary losses to the Internal Revenue Service, to enjoy an equal or higher priority with claims based on the extension of value to the debtor, whether secured or not.

Id.

and that decision should be respected by the courts.[80] Bankruptcy judges will no longer disrupt tax collection by imposing their own visions of fairness in place of congressionally mandated priorities.

III. FAILURE TO PAY OVER TAX

A. *Background*

The Code places a 100% penalty tax on responsible persons who fail to pay over to the government withheld employee taxes.[81] The employer's failure to follow the requirements of §§ 3102(a)[82] and 3402(a)[83] triggers the

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80. *See* Humphrey, *supra* note 34, at 1082. Humphrey notes:

> While the temptation exists to define congressional policy under the Bankruptcy Code as a broad mandate to protect innocent creditors, the same Code also evidences a policy to protect government revenues of almost every nature . . . . [W]hether Congress provides a vehicle by which debtors in bankruptcy can be relieved of certain debt is entirely up to them.

Id. (citation omitted). *But see* Stephen W. Sather, *Tax Issues in Bankruptcy*, 25 ST. MARY'S L.J. 1363, 1375 (1994) ("Generally, courts should allow subordination of tax penalties in a Chapter 11 plan when a failure to subordinate would dilute the distribution to unsecured creditors. Allowing the government to receive a penalty before creditors with compensatory claims are paid in full is not equitable.").

81. 26 U.S.C. § 6672 (1994). This penalty statute provides in part:

> (a) Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 . . . for any offense to which this section is applicable.

Id.

82. 26 U.S.C. § 3102(a) (1994). Section 3102 sets forth the requirements for deductions of taxes from wages, providing in part that "[t]he tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid." *Id.*

83. 26 U.S.C. § 3402(a) (1994). Section 3402 provides requirements for withholdings, stating in part:

> (a) Requirement of withholding.
>
> (1) In general. Except as otherwise provided in this section, every employer making payments of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—
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> (A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and
>
> (B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of Chapter 1 applicable to such periods.
>
> (2) Amount of wages. For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one personal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under

penalty. The term "person" includes "an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."[84]

Following the example set by other circuits, the Tenth Circuit very willingly finds persons responsible under § 6672.[85] "A person is responsible within the meaning of the statute if that person is required to collect, truthfully account for or pay over any taxes withheld from the wages of a company's employees."[86] A managing officer or employee is generally a responsible person.[87] Holding office, controlling financial matters, having authority to spend funds, owning stock, and hiring and firing employees all indicate responsibility.[88] A corporate officer retains responsibility even if superiors threaten to fire the officer if he pays the government.[89]

If a responsible person intentionally prefers other creditors to the Service, she meets the willfulness requirement under § 6672.[90] "Willfulness is present whenever a responsible person 'acts or fails to act consciously and voluntarily and with knowledge or intent that as a result of his action or inaction trust funds belonging to the government will not be paid over but will be used for other purposes.'"[91]

Because of varied fact patterns and levels of control held by employees, courts experience difficulty in developing a bright line test to determine responsibility.[92] Responsible person status poses a question for the trier of fact—determined on a case-by-case basis.[93] Courts willingly uphold the provisions of § 6672. In doing so, the courts protect government funds, even when the result harshly imposes a penalty on those with little practical control

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this section.

Id.

84. 26 U.S.C. § 6671(b) (1994).

85. Denbo v. United States, 988 F.2d 1029, 1032 (10th Cir. 1993).

86. *Id.*

87. *Id. See also* Muck v. United States, 3 F.3d 1378, 1380 (10th Cir. 1993) (stating that "[t]he existence of [significant authority], irrespective of whether that authority is actually exercised, is determinative").

88. *Denbo*, 988 F.2d at 1032. "Among other things, therefore, a corporate officer or employee is responsible if he or she has significant, though not necessarily exclusive, authority in the 'general management and fiscal decision making of the corporation.'" *Id.* (quoting Kissier v. United States, 598 F.2d 1128, 1132 (8th Cir. 1979)).

89. *See* Howard v. United States, 711 F.2d 729, 734 (5th Cir. 1983).

90. *Denbo*, 988 F.2d at 1033. In *Denbo*, the Tenth Circuit stated:

> Although negligence does not give rise to § 6672 liability, the willfulness requirement is . . . met if the responsible officer shows 'a reckless disregard of a known or obvious risk that funds may not be remitted to the government.' A responsible person's failure to investigate or to correct mismanagement after being notified that withholding taxes have not been paid satisfies the § 6672 willfulness requirement.

Id. (quoting Smith v. United States, 894 F.2d 1549, 1554 n.5 (11th Cir. 1990) (quoting Thibodeau v. United States, 828 F.2d 1499, 1503 (11th Cir. 1987))).

91. *Muck*, 3 F.3d at 1381. (quoting Olsen v. United States, 952 F.2d 236, 240 (8th Cir. 1991) (quoting Hartman v. United States, 538 F.2d 1336, 1341 (8th Cir. 1976))).

92. Mary A. Bedikian, *The Pernicious Reach of 26 U.S.C. Section 6672*, 13 VA. TAX REV. 225, 240 (1993).

93. *See* Jay v. United States, 865 F.2d 1175 (10th Cir. 1989).

over the payment of creditors.[94] Responsible persons[95] include sureties,[96] accountants,[97] and attorneys.[98]

The burden of proof falls on the responsible person.[99] Assessments against responsible persons are presumed correct, making it difficult for the responsible person to meet the burden.[100] Section 6672 tax imposes joint and several liability.[101] In addition, § 6672 does not grant a right to contribution.[102]

B. *Tenth Circuit Decisions*

1. *Taylor v. Internal Revenue Service*[103]

a. *Facts*

Oscar and Donald Taylor incorporated Delta Cattle Corporation in 1981, with business offices in Tulsa and ranches in eastern Oklahoma.[104] Donald Taylor was the vice president, and served on the board of directors.[105] He owned no stock, but he had authorization to write checks, borrow funds, and hire and fire employees with Oscar's approval.[106] Taylor's primary responsibility was that of a "cowboy": he did not prepare corporate payrolls, ensure that taxes were withheld, file quarterly returns, or make quarterly deposits.

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94. Bedikian, *supra* note 92, at 246. Bedikian observed:

> [Section 6672] is harsh and far reaching, intended to protect the government when responsible persons dip into the "trust fund" and deliberately allocate money for uses other than payment of the tax liability. Regardless of the amount of money involved, which can be virtually inconsequential, the act itself constitutes a preference over the government, thus triggering the assessment. Once the assessment is generated, the taxpayer faces an extraordinary maze of presumptions and burdens . . . .

Id. Taxpayers have been successful in only 23 of 270 federal and claims court cases. *Id.* at 270 n.19.

95. The Service chooses, with complete discretion, against whom it will assert the penalty. Neier v. United States, 127 B.R. 669, 680 (D. Kan. 1991) (finding that the Service need not seek collection first from officer who had primary control over payment of trust fund taxes).

96. Pacific Nat'l Ins. Co. v. United Sates, 422 F.2d 26, 31 (9th Cir. 1970).

97. *See* Quattrone Accountants, Inc. v. IRS, 895 F.2d 921, 927 (3d Cir. 1990) (finding that an accounting firm, which was responsible for the payment of a corporate client's bills, was a "responsible person" although it was required to present client with copy of bills each month).

98. *See* IRS v. Blais, 612 F. Supp. 700, 707 (D. Mass. 1985) (finding that a lawyer, who operated a car dealership under a power of attorney from the owner, was liable for 100% penalty tax).

99. *See* Bedikian, *supra* note 92, at 246. McDermitt v. United States, 954 F.2d 1245, 1251 (6th Cir. 1992); Collins v. United States, 848 F.2d 740, 742 (6th Cir. 1988); Ruth v. United States, 823 F.2d 1091, 1093 (7th Cir. 1987); Caldrone v. United States, 799 F.2d 254, 258 (6th Cir. 1986); Sinder v. United States, 655 F.2d 729, 731 (6th Cir. 1981).

100. Bedikian, *supra* note 92, at 246.

101. *See* Conley v. United States, 773 F. Supp. 1176, 1176-77 (S.D. Ind. 1991); Cline v. United States, No. 89-73312, 1993 U.S. App. WL 272516 (6th Cir. Jul. 21, 1993). *But see* Reid v. United States, 558 F. Supp. 686, 688-89 (N.D. Miss. 1983) (finding federal common law right of action for contribution or indemnification under section 6672).

102. Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 645 (1980) (finding common law fails to create the rule of contribution in antitrust).

103. 69 F.3d 411 (10th Cir. 1995).

104. *Taylor*, 69 F.3d at 413. Delta conducted ranching activities for investors. *Id.*

105. *Id.*

106. *Id.*

Taylor did, however, sign one 1984 tax return.[107] In March of 1984, Delta filed for bankruptcy under Chapter 11.[108] In February of 1985, the IRS sent Taylor a Notice of Proposed Assessment of 100 Percent Penalty which identified the quarters of unpaid taxes, the amount of unpaid taxes, and the penalty amount.[109] In March of 1995, the IRS assessed the § 6672 penalty against Taylor.[110] The bankruptcy court found that Taylor was not a responsible person.[111] The district court reversed and found that Taylor was a responsible person.[112] The district court held that Taylor had acted willfully,[113] and rejected Taylor's contention that the assessment was void because the IRS assessed it in a lump sum instead of assessing it against Taylor for each quarter.[114]

b. *Decision*

The Tenth Circuit stated that "the bankruptcy court's ultimate determination whether an individual constitutes a 'responsible person' . . . involves an application of law to fact, which is subject to de novo review by the district court."[115] The Tenth Circuit applied the test for responsible persons established in *Denbo*, agreeing with the district court that Taylor had sufficient control over operations to qualify as a responsible person.[116] The court found that the District Court should not have determined the willfulness issue as a matter of law and remanded for findings of fact.[117]

The court found that the assessment against Taylor was valid and rejected Taylor's contention that *Stallard v. United States*,[118] a Fifth Circuit decision, prohibited such an assessment.[119] The court stated, "[t]he Stallard court acknowledged . . . that an aggregate, lump sum assessment of § 6672 penalties is permissible as long as the IRS identifies the particular tax period for which the taxpayer is liable . . . ."[120]

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107. *Id.* Oscar Taylor, Donald Taylor's brother, was the president; he managed the business and owned all the stock, making all corporate decisions and determining which checks to write and which creditors to pay. *Id.*

108. *Id.* at 414.

109. *Id.*

110. *Id.*

111. *Id.* "The Bankruptcy Court explained that a responsible person 'is the person who within the corporate structure has the job to see that the withheld taxes are paid.' . . . " *Id.* (quoting 26 U.S.C. § 6672). The Bankruptcy Court found that Oscar Taylor, Donald Taylor's brother, was the responsible person. *Id.*

112. *Id.* at 415.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 416. The court pointed out that Taylor managed the daily operations in the business office when his brother was not there, and had "the effective power to pay taxes." *Id.*

117. *Id.* at 417.

118. 12 F.3d 489 (5th Cir. 1994).

119. *Taylor*, 69 F.3d at 418.

120. *Id.*

2. *Bradshaw v. United States*[121]

a. *Facts*

In portions of 1985 and 1986, Larry Bradshaw acted as the president of Heritage Building Products ("Heritage").[122] On May 10, 1985, Bradshaw entered into a credit agreement with Zion First National Bank granting the bank a lien on Heritage's assets and the right to freeze Heritage's bank accounts if Heritage went into default.[123] On March 15, 1986, Zion determined that Heritage defaulted and so Zion froze the Heritage accounts.[124] Thus, Heritage needed Zion's approval for the future use of funds.[125] Zion refused approval for payment of withholding taxes with funds from the frozen accounts, despite Bradshaw's request for the funds.[126] Heritage failed to pay federal withholding taxes to the IRS for the first three quarters of 1986, and the penalty assessed for late payment in 1985.[127] The Internal Revenue Service assessed a 100% penalty against Bradshaw as a "responsible person" under § 6672.[128] The district court found that Bradshaw lacked the power to distribute funds and therefore was not a responsible person.[129]

b. *Decision*

The Tenth Circuit relied primarily upon the Second Circuit's decision in *Kalb v. United States*,[130] and declared Bradshaw a responsible person under § 6672.[131] The court said that a corporate officer "may not escape liability as a 'responsible person' under § 6672 by voluntarily entering into agreements which permit preferring other creditors to the government."[132] Noting that Bradshaw granted the bank power to prefer other creditors to the government,[133] the court found he could not avoid responsibility by ceding financial control.[134] The Tenth Circuit agreed with the Ninth,[135] Fifth,[136] and Second[137] Circuits, which had arrived at similar conclusions.[138] The court said the only way Bradshaw could have avoided liability was to resign or refuse to

121. 83 F.3d 1175 (10th Cir. 1995).
122. *Bradshaw*, 83 F.3d at 1177. Bradshaw owned thirteen percent of Heritage stock. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. 505 F.2d 506 (2d Cir. 1974).
131. *Bradshaw*, 83 F.3d at 1182.
132. *Id.* at 1180.
133. *Id.*
134. *Id.*
135. Rykoff v. United States, 40 F.3d 305, 308 (9th Cir. 1994) ("The fact that a bank exercises significant control over payments to creditors does not necessarily absolve the corporate officer of liability under § 6672.").
136. Gustin v. United States, 876 F.2d 485, 491-92 (5th Cir. 1989) (stating that "[o]ne does not cease to be a responsible person merely by delegating that responsibility to others").
137. *Kalb*, 505 F.2d at 510; *see* Botta v. Scanlon, 314 F.2d 392, 393 (2d Cir. 1963).
138. *Bradshaw*, 83 F.3d at 1181.

sign the checks, thereby shutting down the company.[139]

C. *Analysis*

One commentator suggested that Congress intended to induce employers to comply with their duty to pay taxes by imposing severe penalties on the officials responsible for the employers' decisions.[140] By extending the responsible person designation to an officer with no practical control over the employer's payment to creditors, the Tenth Circuit imposes harsh consequences on those unable to avoid them—several commentators would say too harsh.[141] The Tenth Circuit may however, intend to protect innocent employees and the government from the abuse of corporate officers and shareholders.[142]

D. *Other Circuits*

Several other circuit courts of appeals ruled on the scope of the responsible person designation in the past year. In most of the cases, the circuit courts found the taxpayer a responsible person under § 6672.[143] A divided Ninth

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139. *Id.*

140. James E. Hungerford, Howard v. United States*: Who Should Be Responsible for the 100 Percent Penalty?*, 1989 U. PUGET SOUND L. REV. 451, 453.

141. *See* Stephen J. Vasek, *The Hidden Tax Trap of I.R.C. Section 6672*, 67 KY. L.J. 27, 73 (1978) (stating that the "[a]pplications of section 6672, as currently interpreted, often imposes a harsh penalty on morally innocent and unsuspecting business managers"); Hungerford, *supra* note 140, at 470 (stating that "[i]t is certainly not fair to saddle an individual corporate employee who is not responsible for the problem with a staggering corporate debt just to provide an alternate means of collection"); Bedikian, *supra* note 92, at 238 (stating that "the consequences of extending the responsible person definition are unjustified and places persons . . . in a virtual catch-22: not following his superior's directive would have subjected him to termination while following the directive would have subjected him to enormous penalties").

142. *See* Wright v. United States, 809 F.2d 425, 428 (7th Cir. 1987); Bedikian, *supra* note 92, at 231. Bedikian notes:

> [S]ection 6672 is intended to be a powerful deterrent against the promiscuous or deliberate use of money which rightfully belongs to the government. It is only when courts construe the statute mechanically, without regard to the actual control possessed by the responsible person, that section 6672 begins to reveal its most pernicious side.

Id.

143. Gadoury v. IRS, No. 95-1872, 1996 WL 83894 (1st Cir. Feb. 26, 1996) (unpublished disposition) (finding a company controller had sufficient control over disbursement of company funds, admitted that he knew the taxes were not paid, and failed to take remedial steps); Donelan Phelps & Co. v. United States, 876 F.2d 1373 (8th Cir. 1996) (finding the managers of company in reorganization were responsible persons under § 6672); Keller v. United States, 46 F.3d 851 (8th Cir. 1995) (affirming a § 6672 penalty against an estate's personal representative who exercised authority over the operation of an inn owned by the estate, and agreeing with the lower court that the representative was a responsible person who had acted willfully); Szego v. Commissioner, No. CA-89-2186-JFM, 1995 WL 678257 (4th Cir. Nov. 15, 1995) (unpublished disposition) (finding a company's majority shareholder and chairman of the board liable for the corporation's unpaid employment taxes under § 6672); Ashby v. United States, No. CV-92-00293-HDM, 1995 WL 635178 (9th Cir. Oct. 27, 1995) (unpublished disposition) (affirming a district court decision holding that a corporation's president was liable as a responsible person under § 6672); United States v. DiMeo, No. CV-89-0617-GLT, 1995 WL 501506 (9th Cir. Aug. 23, 1995) (unpublished disposition) (affirming a district court decision holding a man liable for a company's unpaid employment taxes as a responsible person under § 6672); Snyder v. Talon, No. CV-93-2722, 1993 U.S. Dist. WL 597121 (C.D. Cal. Oct. 29, 1993) (ruling that a bankruptcy court prop-

Circuit ruled that gross negligence sufficed to establish the willfulness requirement of § 6672.[144] The Sixth Circuit held that a company president's failure to remit overdue withholding taxes was not willful, because a state statute encumbered his use of the available funds.[145]

CONCLUSION

The Supreme Court's decision in *CF&I Fabricators* arrives at the correct conclusion, but by the wrong analysis. Instead of simply noting that the term "excise" does not directly fall within § 4971 and by applying a functional analysis, the Court relied upon its decisions in *United States v. New York* and *United States v. Sotelo*. These cases—inconsistent with the Court's decision in *Ron Pair*—open the door for courts to look beyond the direction imposed by Congress to further their own agendas.

Because the Tenth and other Circuits have expanded the responsible person definition, courts may assess huge penalties against unwitting employees with little practical control over company actions. These employees can avoid the penalty only by quitting their jobs when they discover that their employer has failed to pay proper employment taxes. These harsh consequences, however, protect innocent employees and government revenue from abuse by corporate officers and shareholders.

Michael T. Lininger

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erly denied a debtor's motion to reconsider a summary judgment in favor of the IRS, because the debtor's motion did not present any new issues).

144. Phillips v. IRS, 73 F.3d 939, 942 (9th Cir. 1996).

145. Huizinga v. United States, 68 F.3d 139, 144 (6th Cir. 1995).