

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF IOWA**

In the Matter of:

David William Brown,

Debtors

David William Brown,

Plaintiff

Case No. 10-03083-als7

Chapter 7

Adv. Pro. 10-30088-als

v.

Iowa Department of Revenue,

Defendants

**MEMORANDUM OF DECISION  
(date entered on docket: August 29, 2011)**

COURSE OF PROCEEDING

David Brown (“Plaintiff” or “Brown”) filed a complaint seeking to discharge 1040 income taxes, penalties and interest owing to the Iowa Department of Revenue (“IDR”) for tax years 1986 through 2007 pursuant to 11 U.S.C. sections 523(a)(1)(B)(ii) and 507(a)(8) (2011). In response the IDR affirmatively asserts that its tax lien filed prior to the Plaintiff’s bankruptcy remains effective; that Plaintiff attempted to willfully evade or defeat his income tax liabilities; and that Plaintiff owes restitution to the IDR resulting from a state court criminal proceeding. The Court has jurisdiction of this proceeding pursuant to 11 U.S.C. sections 157 and 1334.

Prior to trial the parties agreed to the following:

1. The income taxes, interest and penalty owing to the IDR for tax years 1998 and prior years are discharged by operation of entry of the general discharge order in the Debtor's underlying bankruptcy case.
2. Only the penalties for tax year 2006 and prior years are discharged by operation of entry of the discharge order in the Debtor's underlying bankruptcy case.
3. Penalties owing for tax years 2007, 2008 and 2009 are not discharged.
4. Iowa income tax liabilities for tax years 2005, 2006, 2007 and 2008 are not excepted from discharge pursuant to 11 U.S.C. sections 523(a)(1)(A) and (B)(ii).
5. Payment owing under the restitution order entered by the Iowa District Court is not subject to discharge.
6. The statutory tax lien filed by the IDR for unpaid taxes for tax years 1999 through 2008 remains valid and continues to attach to any property the Plaintiff owned prior to June 6, 2010, the filing date of his chapter 7 bankruptcy proceeding.

As a result of these stipulations, the only disputed issue is limited to whether the Plaintiff's income tax liabilities for tax years 1999 through 2004 are subject to discharge. For the reasons stated herein the Plaintiff's income tax liability is not discharged pursuant to 11 U.S.C. section 523(a)(1)(C) (2011).

### FACTS

The Plaintiff has earned his living as a self-employed siding installer for various sales companies on new construction and remodeling jobs. Compensation is based upon the amount of square footage and trim work involved for a specific contract. Payment is made by check from the sales company directly to Brown in his personal name. Upon receiving payment for a job, he would go to the payer's bank to obtain cash. As required, the sales companies provided annual 1099 forms to the Plaintiff which reflected the compensation paid.

Brown did not routinely file tax returns. His practice was to wait several years and file numerous returns simultaneously. His 1999, 2000, 2001, 2002, 2003 and 2004

Iowa tax returns were all filed on March 18, 2005. These returns all reflect an outstanding tax liability which the Plaintiff has not paid. Tax payments owing for calendar years 1999-2004 total \$30,703, plus \$6,036 in penalties and interest which continue to accrue.

In the early years of his work, the Plaintiff traveled to job sites within Iowa and in surrounding states. He stated that during this time period he would claim his motel expenses as business deductions on his tax returns. For the tax years in question his jobs were local and primarily involved new construction. The Plaintiff argues that the 1099 forms did not take into account his out of pocket expenses including employee wages, tool replacement and vehicle maintenance. Because he did not maintain any record of these expenses, he could not claim these deductions on his tax returns. The Plaintiff claims that after payment of his undocumented business expenses that his income was reduced to the point where he did not believe he was in a position to meet his living expenses *and* make payment on his outstanding tax obligations.

On August 4, 2010, Brown pled guilty in the Iowa District Court to one count of Fraudulent Practice in the First Degree, a Class C Felony. His sentence ordered restitution to be paid to the IDR in the amount of \$47,056. Conditions of probation include monthly payments of restitution, the timely filing of tax returns, and timely payment of quarterly estimates and tax obligations.

#### DISCUSSION

The Plaintiff has met his initial burden by showing that the taxes owed for years 1999 through 2004 qualify for discharge based upon the time requirements set forth at 11 U.S.C. section 523(a)(1)(A) (2011). The sole issue for determination arises under 11

U.S.C. section 523(a)(1)(C) which provides that taxes are not discharged if a debtor “made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.” (2011). The IDR bears the burden of proof under this provision by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991).

The plain language of the statute requires a finding of both conduct (that the debtor sought “in any manner to evade or defeat” his tax liability) and intent (that the debtor did so “willfully”). These two components are independent, but may overlap and share common elements. Fliss v. Iowa Dep’t of Revenue (In re Fliss), 339 B.R. 481, 486 (Bankr. N.D. Iowa 2006) (citing Schlesinger v. United States (In re Schlesinger), 290 B.R. 529, 537 n.5 (Bankr. E.D. Pa. 2002)). There is no requirement to prove a bad motive or malice under the statute. See United States v. Fegeley (In re Fegeley), 118 F.3d 979, 984 (3d Cir. 1997); United States v. Ryan (In re Ryan), 286 B.R. 141, 148 (Bankr. W.D. Mo. 2002). It is sufficient to show that the debtor's attempts to avoid or evade tax liability were done knowingly, voluntarily and intentionally. See Toti v. United States (In re Toti), 24 F.3d 806, 809 (6th Cir. 1994). Acts of either commission or omission may be used to prove the conduct element but the mere nonpayment of taxes is insufficient evidence. See United States v. Carnes (In re Carnes), 244 B.R. 435, 447 (Bankr. W.D. Mo. 2000). Intent may be proven through circumstantial evidence and inferred through a pattern of conduct. United States v. Ryan (In re Ryan), 286 B.R. at 148.

A number of factors have been identified by the courts to assist in the evaluation of whether there has been a willful evasion of taxes under the statute, including, but not limited to the: failure to file tax returns; filing of late returns; failure to file adequate

returns; failure to make tax payments; failure to maintain usual records to document transactions; dealing in cash; frustration of collection efforts; implausible or inconsistent behavior by the taxpayer; and election to divert substantial income to uses other than paying lawful taxes.<sup>1</sup> A final determination is based upon the totality of the circumstances because no one factor is dispositive. Roper v. Barclay (In re Roper), 294 B.R. 301, 306 (B.A.P. 8th Cir. 2003).

The only timely filed return for the tax years at issue occurred for tax year 2004. By his own admission, the Plaintiff has consistently and historically failed to file timely tax returns. There is no evidence that these late returns were caused by “mistake, inadvertence or an honest misunderstanding” which would militate against a finding of willful intent. Mills v. United States (In re Mills), 337 B.R. 691, 699 (Bankr. D. Kan. 2005). Plaintiff’s decision to not file timely tax returns appears to be intentional. Additionally, the filed returns were not always accurate. Brown claimed deductions for federal taxes on his state returns for 2005, 2006, 2007 and 2008 which he had not in fact paid.<sup>2</sup> These facts establish a voluntary and knowing pattern of conduct by the Plaintiff in failing to file timely and accurate returns.

Brown argues that his net income was substantially less than the amount shown on his tax returns, primarily due to wage payments he made to individuals that assisted

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<sup>1</sup> United States v. Mitchell (In re Mitchell), 633 F.3d 1319, 1326-30 (11th Cir. 2011); United States v. Fretz (In re Fretz), 244 F.3d 1323, 1329 (11th Cir. 2001); United States v. Fegeley (In re Fegeley), 118 F.3d 979, 984 (3d Cir. 1997); May v. Mo. Dep’t of Revenue (In re May), 251 B.R. 714, 718 (8th Cir. B.A.P. 2000), aff’d, 2 Fed. Appx. 681 (8th Cir. 2001); United States v. Beninati 438 B.R. 755, 758 (D. Mass. 2010); Hamm v. United States (In re Hamm), 356 B.R. 263, 286 (Bankr. S.D. Fla. 2006); Fliiss v. Iowa Dep’t of Rev. (In re Fliiss), 339 B.R. 481, 486-87 (Bankr. N.D. Iowa 2006); Mills v. United States (In re Mills), 337 B.R. 691, 700 (Bankr. D. Kan. 2005); Hamer v. IRS (In re Hamer), 328 B.R. 825, 834 (Bankr. N.D. Ala. 2005); United States v. Carey (In re Carey), 326 B.R. 816, 823-24 (Bankr. E.D. Cal. 2005); Hassan v. United States, (In re Hassan), 301 B.R. 614, 622 (S.D. Fla. 2003); United States v. Ryan (In re Ryan), 286 B.R. at 148; United States v. Spiwak (In re Spiwak), 285 B.R. 744, 751 (S.D. Fla. 2002).

<sup>2</sup> Plaintiff’s Exhibit 3.

him in his business. He stated that he employed friends or day laborers on bigger installation jobs. These individuals were paid daily in cash, and records for these payments were never maintained. Due to this lack of documentation, deductions for payment of wages were not included on Plaintiff's income tax returns. By way of explanation, Brown suggests that he was only following his accountant's advice in not including expenses for which he did not have adequate records. He contends that at the "end of the day, this [his inability to take business expense deductions] resulted in a larger taxable income and more tax owed on [his] returns."<sup>3</sup> While this may be true, after being informed of this requirement, Brown took no action to remedy his record keeping to avoid the consequence of higher tax obligations. Again, the evidence indicates that although the solution to his problem of owing higher taxes was solely within his control, the Plaintiff made the election to continue his practice of not maintaining any form of wage records. It is difficult, if not impossible, to accept Brown's position that because his complete lack of record keeping resulted in substantial tax obligations being owed, he was somehow justified in his failure to pay the amounts due.

Although the Plaintiff was aware from his prior tax returns that he generally owed taxes due to his business income, it is undisputed that he never made any estimated tax payments. Brown states that he never had the ability to write a check for the full amount owing. He "did not feel" that he could pay his monthly expenses and pay his taxes. Even if he had cash left over at the end of a month Brown stated it was insufficient "to get started on anything," which is apparently a reference to the substantial amount of his outstanding tax balance. This explanation is not persuasive. In 1994 the Debtor and IDR agreed to a payment plan of \$50 monthly. The Plaintiff only paid \$600 over the course of

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<sup>3</sup> Plaintiff's Trial Brief.

eighteen months under this arrangement.<sup>4</sup> These facts support a conclusion that the Plaintiff demonstrated a failure to cooperate in reducing his tax obligation by refusing to pay even the small amount negotiated under this payment plan.

Brown asserts that he voluntarily cooperated with the IDR in providing information about his tax obligations and that this proves that he did not attempt to frustrate collection efforts. This position is contrary to the weight of the evidence. The Plaintiff made a conscious decision to not pay his taxes through estimated payments or payment at the time his returns were filed. Moreover, after paying only a nominal amount, Brown discontinued the monthly payments he agreed to with the IDR. No basis for this action was provided. Under the circumstances, it is reasonable to conclude that Brown's conduct represents both a willful failure to pay and a frustration of collection efforts under the payment plan.

The Plaintiff points to his schedules as evidence of the fact that he has not accumulated extensive property and that he has not led a lavish lifestyle. He maintains no bank accounts, has no credit cards, has minimal assets and deals only in cash. He has never owned real estate. He does not own a vehicle despite needing one for his work. During the years of 1999 through 2004 Brown earned total gross income of approximately \$460,000. In three of these five years, his annual gross income exceeded \$100,000. No explanation is provided as to the disposition of his income, other than the general allegation that it was all utilized for business and living expenses. Living expenses set forth on Schedule J of his filing indicate total monthly expenditures of \$1,760.<sup>5</sup> Using these amounts his annual living expenses total \$21,120. Based upon

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<sup>4</sup> Plaintiff's Exhibit 2; Defendant's Exhibit J.

<sup>5</sup> That includes a duplicate entry for toiletries and personal hygiene in the amount of \$100.

the record, it is not plausible to conclude that in every tax year from 1999 through 2004 Brown was unable to pay even a portion of his tax obligations.

On April 6, 2010 the Debtor was charged under Iowa law with Fraudulent Practice in the First Degree related to his tax obligations for 2005 through 2008. According to the trial information, the Plaintiff “is a person or withholding agent required to supply information to pay tax or to make, sign, or file a deposit form or return required and who willfully failed to pay the tax at the time or times required by law.”<sup>6</sup> The Debtor pled guilty to this charge, and was sentenced to a short prison term. Pursuant to the terms of his probation and the restitution order, the Plaintiff is required to timely file returns, make timely payment of current tax obligations and pay a monthly amount towards his outstanding tax balance. Brown testified that he is in compliance with these conditions. Over the past 23 years, Brown has only consistently filed returns and made payments on his taxes due to the criminal charge.

In this Circuit: “[i]f a debtor is aware of the duty to pay his taxes, has the wherewithal to pay the taxes and takes steps to avoid paying them, there is a willful attempt to evade or defeat the tax.” May v. Mo. Dep’t of Revenue (In re May), 251 B.R. 714, 718 (8th Cir. B.A.P. 2000), aff’d, 2 Fed. Appx. 681 (8th Cir. 2001). Under the totality of the circumstances, the IDR has met its burden under 11 U.S.C. section 523(a)(1)(C) (2011) to preclude discharge of the tax obligations owing for 1999-2004.

Based upon the foregoing it is hereby ORDERED that:

1. The tax obligations owing for 1999, 2000, 2001, 2002, 2003 and 2004 are not discharged;

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<sup>6</sup> Defendant’s Exhibit L.

2. The remaining tax obligations are governed by the parties' stipulation made part of the trial record.
3. Each party shall bear their own costs.

/s/ Anita L. Shodeen  
Anita L. Shodeen  
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:  
Electronic Filers in this Adversary Proceeding