UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

ERNEST F. KEMPF and ROSETTA J. KEMPF,	Case No. 86-867-C
Debtors,	Adv. No. 86-0154
ERNEST F. KEMPF and ROSETTA J. KEMPF,	Chapter 7
Plaintiffs,	
V.	
UNITED STATES INTERNAL REVENUE SERVICE and IOWA DEPARTMENT OF REVENUE,	
Defendants.	

ORDER - TRIAL ON COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On April 25, 1988, a trial was held on the complaint to determine dischargeability of debt. Thomas P. Schlapkohl appeared on behalf of Plaintiffs and Timothy M. Mulligan appeared on behalf of Defendant Internal Revenue Service (hereinafter "IRS"). At the conclusion of said trial, the Court took the matter under advisement upon a briefing deadline of May 25, 1988. Both parties have submitted proposed findings and conclusions, and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I). The Court, upon review of the pleadings, evidence admitted, arguments of counsel, and briefs submitted, now enters its findings and conclusions pursuant to F.R. Bankr. P. 7052.

FINDINGS OF FACT

1. Debtors (hereinafter "Plaintiffs") filed a Chapter 7 petition on March 31, 1986. They amended their petition on May 7, 1986, to show taxes owing to the IRS in an undetermined amount for the years 1978 through 1981.

2. On July 8, 1986, Plaintiffs filed a complaint to determine dischargeability of debts. Plaintiffs allege in Count I that the income taxes due and owing to the IRS for the years 1978 through 1981 are dischargeable under the three-year rule as provided in 11 U.S.C. 523(a)(l)(A) and 507(a)(7)(A)(i). plaintiffs pray in this count that any amounts of unpaid taxes owing to the IRS be held discharge-able.

3. The complaint in Count II prays that taxes owing to the Iowa Department of Revenue for unpaid taxes for the years 1978 through 1981 be held dischargeable. plaintiffs dismissed this count on April 18, 1988.

4. The IRS filed its answer on August 14, 1986, and made affirmative allegations that 11 U.S.C. §523(a)(1)(C) exempts plaintiffs' taxes for said period from discharge. The IRS was permitted to amend its answer to allege a violation of 11 U.S.C. §523(a)(1)(B)(i).

5. Plaintiffs are husband and wife and reside in Des Moines, Iowa. Mr. Kempf is 60 years of age and is employed as a route salesman for Anderson Erickson Dairy, where he

has held the same position for the past 17 years. His highest level of education is the 8th grade.

6. Mrs. Kempf is 52 years of age and has never been employed outside the home except for some part time baby sitting. Mrs. Kempf has a 9th grade education.

7. In addition to their income from the dairy, Plaintiffs began operating a trash hauling business in about 1977 called Ernie’s Trash Hauling. Said business was operated as a sole proprietorship during the relevant years.

8. Plaintiffs did not have any previous experience in operating a business and did not seek professional or legal counsel in this regard.

9. This trash hauling business was a modest operation. Plaintiffs did not advertise and obtained their customers by word of mouth.

10. During the years 1978 through 1981, Plaintiffs had their federal income tax returns prepared locally by H&R Block. They filed their returns in a timely manner for each of those years. Copies of their 1978-1981 federal tax returns were offered into evidence as Exhibits AA through DD.

11. The returns Plaintiffs filed with the IRS for the years in question contained only a two-page Form 1040 and Schedule A (Itemized Deductions). The total income reported was as follows:

	Total Income
1978	$ 9,989.00
1979	13,941.00
1980	14,633.00
1981	15,050.00

12. Plaintiffs retained an accountant, George Moore, after the 1981 tax year to prepare returns which reflected Plaintiffs' tax liability including their income from the trash hauling business. Those returns reflected gross income and net income from the trash hauling business alone as follows:

	Gross Income	Net Income
1978	$12,243.00	$7,663.00
1979	21,444.00	10,464.00
1980	28,309.00	12,591.00
1981	34,776.00	9,187.00

13. The inclusion of the income from the trash hauling business increased Plaintiffs' total income on line 21 of the Form 1040 as follows:

1978	$17,652.00
1979	24,405.00
1980	27,224.00
1981	24,826.00

14. Mr. Moore testified the returns he prepared were based on all the income and deductions plaintiffs could document, including some undocumented expenses which the examiner of the State of Iowa allowed the Plaintiffs.

15. The returns prepared by Mr. Moore, Exhibits EE through HH, included Forms 1040, Schedules A, B, C, and SE, and Forms 3468, 4562 and 4797 (for the year 1981 only).

16. The returns prepared by Mr. Moore were signed by Plaintiffs but were never filed. Mr. Moore testified the amended returns were not in final form in that they included only those business income and expenses allowed by the Iowa Department of Revenue, and were not prepared with the intention of filing them. Mr. Kempf testified he thought the amended tax returns had been filed.

17. Plaintiffs testified they were not familiar with the specifics of recording and reporting income with respect to a business. They testified they were aware they were making some income from the trash hauling business during the relevant years and they also testified they knew they had a duty to report that income on their tax returns. However, they both testified that although they knew they had business income, this income seemed to be quickly consumed by operational expenses.

18. Plaintiffs kept fairly accurate records as to the income from customers but accurate records were not kept as to the expenses.

19. Mrs. Kempf testified they did not regard the trash hauling business as a money-making business until the commencement of the 1980s. She did inquire of H&R Block as to how to set up a business but did not follow through and obtain any advice on the subject.

20. Mr. Moore was hired by Plaintiffs to attempt to reconstruct their taxable income for the years 1978 through

1981 sometime in 1983 when the Iowa Department of Revenue was conducting an audit of Plaintiffs' financial situation. Mr. Moore testified Plaintiffs' business records were poorly kept.

21. At the close of IRS's case, Plaintiffs moved for a directed verdict concerning the issue of whether they had made a fraudulent return or willfully attempted in any manner to evade or defeat such tax, pursuant to section 523(a) (1) (C). The Court partially granted the motion, finding Plaintiffs had not made a fraudulent return. However, the Court denied Plaintiffs' motion on the issue of whether they had willfully attempted to evade or defeat the tax.

DISCUSSION

The issue in this case is whether Plaintiffs' self-employment income tax from their unreported self-employment income earned from 1978-1981 is excepted from discharge under 11 U.S.C. §523(a)(l). Said section provides in relevant part:

> (a) A discharge under section 727... .of this title does not discharge an individual debtor from any debt-
>
> (1) for a tax or a customs duty-
>
> (A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;
>
> (B) with respect to which a return, if required --

> (i) was not filed; or
>
> (ii) was filed 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; or
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

In determining the dischargeability of Plaintiffs' unpaid self-employment taxes, the Court will consider all three subsections under section 523 (a) (1).

Under section 523 (a) (1) (C), a tax is not discharged if Plaintiffs "made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." Since the Court has already ruled Plaintiffs did not make a fraudulent return, the issue under section 523(a) (1) (C) focuses solely on whether Plaintiffs willfully attempted in any manner to evade or defeat such tax. The Bankruprty Code is silent regarding the meaning of "willfully attempted." Legislative history provides little guidance as to the meaning of "willfully attempted". In addition, the Court has not found any case law interpreting such. However, language nearly identical to section 523(a)(l)(C) "willfully attempted in any manner to evade or defeat such tax" is found at 26 U.S.C. §6672 of the Internal Revenue Code concerning withholding tax penalties.

Under section 6672, willful action refers to a voluntary, conscious and intentional act as opposed to an

accidental evasion of the tax. Monday v. United States, 421 F.2d 1210, 1216 (7th Cir. 1970); Wall v. United States, 592 F.2d 154, 163 (3rd Cir. 1979); Emshwiller v. Unitect States, 565 F.2d 1042, 1045 (8th Cir. 1977). There is no requirement of bad motive or a specific intent to defraud the government or deprive it of revenue. Feist v. United States, 607 F.2d 954, 961 (Fed. Cir. 1979); Sherman v. United States, 490 F.Sup. 747, 754 (D. Mich. 1980); In re Thompson, 37 B.R. 211, 216 (Bankr. M.D. Fla. 1983). Willfulness can be proven by showing the responsible person recklessly disregarded his or her duty to collect, account for, and pay over the tax. Feist, 607 F.2d at 961; see Hildebrand v. United States, 563 F.Supp. 1259, 1263 (D.N.J. 1983). Given the absence of a definition of "willfully attempted" in either the Bankruptcy Code, legislative history, or case law interpreting such, the Court adopts the above standards for purposes of section 523(a) (1) (C).

In the case at bar, Plaintiffs knew they were earning additional income from their trash hauling business. This additional net income increased their total income for the years in question by an average of $9,976.00 per year, which works out to a 75% average annual increase in their incomes. In addition, Plaintiffs knew they had a duty to report that additional income on their tax returns. However, they failed to do so. As a result, the Court concludes Plaintiffs' failure to report their additional income was a

voluntary, conscious and intentional act. Thus, Plaintiffs' self—employment tax is nondischargeable under section 523(a) (1) (C).

Assuming arguendo Plaintiffs did not willfully attempt to evade the tax, the next issue is whether Plaintiffs' failure to report self-employment income violates section 523 (a) (1) (B) (i). Said section provides an exception to discharge for a tax liability with respect to which a return, if required, was not filed. 26 U.S.C. §6017 requires every taxpayer having net earnings from self-employment of $400.00 or more for the taxable year to file a return for selfemployment tax. Treasury regulation §l.6017-l(a)(2) provides that the return required by section 6017 shall be made on Form 1040. Since Plaintiffs did have selfemployment earnings of greater than $400.00 for each taxable year in question, they were required to file a selfemployment tax return on Form 1040.

In the case at bar, Plaintiffs did file Forms 1040 for the years in question. However, said returns did not contain the section 6017 return information concerning their self-employment income. To satisfy the requirements of section 6017, Plaintiffs should have reported their selfemployment income on line 13 of the 1978, 1979 and 1980 Forms 1040, and on line 11 of the 1981 Form 1040, as well as on Schedules C and SE. Since Plaintiffs never filed returns reflecting self-employment income or Schedules C and SE, and

since the returns that were filed did not contain any information concerning their self-employment income, Plaintiffs have not filed a return within the meaning of section 6017. Therefore, under section 523(a)(l)(B)(i), Plaintiffs are not entitled to discharge of the taxes due from their self-employment income because they have not filed self-employment tax returns as required by section 6017. See generally In re Haywood, 62 B.R. 482 (Bankr. N.D. Ill. 1986) (failure to file amended tax returns as required by state statute makes the taxes nondischargeable under §523 (a) (1) (B) (i)

Assuming arguendo Plaintiffs' returns are considered filed under section 523(a)(l)(B)(i), the final issue is whether Plaintiffs' taxes are still assessable under section 523(a)(l)(A). Said section provides that taxes of a kind specified in section 507(a) (7) are excepted from discharge. Section 507 (a) (7) (A) (iii) specifies taxes measured on income, other than a tax specified in section 523(a) (1) (B) or 523(a) (1) (C), not assessed before, but assessable after commencement of the case. Thus, if the tax at issue is not assessed before the commencement of the bankruptcy but is assessable after the commencement of the bankruptcy, it is not dischargeable.

The general rule on the assessment of tax is that "any tax imposed [under the Internal Revenue Code] shall be assessed within 3 years after the return was filed." 26

U.S.C. 6501(a). This rule, however, is subject to the exception that when a taxpayer fails to file a return, "the tax may be assessed...at any time." Id. at section 650l(c)(3). Moreover, "any person made liable for any tax [under the Internal Revenue Code] shall make a return or statement according to the forms and regulation prescribed by the Secretary [of the Treasury]." Id. at §6011(a). Thus, the issue becomes whether Plaintiffs' failure to report their self-employment income on their Forms 1040 tolls the three year statute of limitations.

The statute of limitations barring tax assessments is strictly construed in the government's favor. Badaracco v. Commissioner, 464 U.S. 386, 392 (1984). Case law provides that even if a taxpayer files a return, it does not necessarily commence the running of the statute of limitations. The decisive issue is whether the return contains enough information for the IRS to determine the taxpayer's liability for the tax in question. Commissioner v. Lane-Wells, Co., 321 U.S. 219, 222—23 (1944); Germantown Trust Co. v. Commissioner, 309 U.S. 304, 308 (1940); Atlantic Land & Imp. Co. v. United States, 790 F.2d 853, 858, (11th Cir. 1986). The filing of Form 1040 fully reporting income but not reporting self-employment tax starts the period of limitation for assessment of self employment tax to run. Rev. Rul. 82-185, 1982-44 I.R.B. 8 (emphasis added).

In the case at bar, Plaintiffs failed to report their self-employment income for the years in question. As noted

earlier, said additional net income increased Plaintiffs' total income for the years in question by an average of 75% per year. Because of this large discrepancy between Plaintiffs' reported income and their actual income, the Court concludes Plaintiffs have not filed returns which contain enough information for the IRS to compute their tax. As a result, under section 26 U.S.C. §6501(c)(3), the tax deficiency may still be assessed. Therefore, Plaintiffs' self-employment taxes are excepted from discharge under section 523 (a) (1) (A).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes:

1) Under 11 U.S.C. §523(a) (1) (C), Plaintiffs willfully attempted to evade or defeat their self-employment taxes for the years 1978-1981;

2) Under §523(a)(l)(B)(i), Plaintiffs did not file a return; and

3) Under §523(a)(l)(A), Plaintiffs' self-employment taxes are still assessable.

IT IS ACCORDINGLY ORDERED that Plaintiffs' selfemployment income taxes for the years 1978-1981 are excepted from discharge.

Dated this 23rd day of September, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE