UNIVERSITY OF HOUSTON LAW CENTER

BANKRUPTCY TAX

Professor Paul H. Asofsky

Class 1 – Introduction to Bankruptcy Tax

Tuesday, August 25, 2015 5:30 PM

Assignment

Assigned reading—All

1. FOREWORD TO CLASS 1
   2. Bankruptcy Code §§ 541(a), 541(d), 547(b)
   3. Internal Revenue Code §§ 6672(a), 6672(d), 7501, 7512

Optional Reading

1. Corporate Bankruptcy, sections 1A-D, IIA-C (approximately ten pages)
   2. Quattrone Accountants, Inc. v. IRS, 895 F.2d 921 (3d Cir. 1990)

All assigned cases, required or optional, and all IRS documents, are reproduced for you. Some are in excerpted form. You should of course feel free to research and read the entire opinion. s/moo/default

We’ll be discussing the Begier case in detail in class. Read the case and the statutory provisions carefully. While reading this case, please ask yourself:

In Begier, whose taxes were at issue? If the corporation had failed to remit the withheld or collected taxes to the IRS, would the government be able to collect them from the employees or the passengers? Why are these taxes called “trust fund” taxes?

At the conclusion of the class, I’ll give a brief overview of the different characteristics of chapters 7, 11 and 13 to give you a context for the Class 2 assignment.
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FOREWORD TO CLASS 1

Welcome to Bankruptcy Tax. This class is somewhat unique. In other tax courses you take, you will be looking at all or a specialized piece of the Internal Revenue Code and Regulations. You won’t have to look outside the tax system for tax rules, and rarely look elsewhere for policies underlying those rules. This class is different. In the area of bankruptcy tax, we have two systems – the tax system and the bankruptcy system. Both are creatures of federal law, but they operate in separate legal spheres. The authorization for a federal bankruptcy system is found in Article I, Section 8, Clause 4 of the Constitution (“The Congress shall have the power… To establish…uniform Laws on the subject of Bankruptcies throughout the United States”), and finds its legislative expression in title 11 of the United States Code (the “Bankruptcy Code”). The federal income tax is authorized by the Sixteenth Amendment (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration”), and its substance is found in title 26 of the United States Code (the “Internal Revenue Code”). Although the Bankruptcy Code and many of the relevant provisions of the Internal Revenue Code were enacted in the same legislative process, the provisions of the Bankruptcy Code were vetted and marked up by the Judiciary Committees of the House and Senate, whereas the tax laws came through the House Ways and Means Committee and Senate Finance Committee.

Each system and the code regulating it has its own economic goals. Among the goals of the bankruptcy system is to give a distressed debtor a discharge of excessive debt and a fresh start. On the creditor side, the Bankruptcy Code seeks to prevent a race to the courthouse and assure an equitable distribution of the debtor’s assets by imposing a stay of proceedings against the debtor, and generally requires a proof of claim to be filed by each creditor in the bankruptcy court, where it will be resolved and satisfied in a manner prescribed by the Bankruptcy Code and Rules.

Among the goals of the tax system are to raise revenue for the continued operation of the government and to spread the tax burden equitably among taxpayers generally. The Internal Revenue Code strictly prescribes the procedures under which the Internal Revenue Service may assess and collect taxes, and the procedures under which a taxpayer may contest his liabilities, and generally forecloses other avenues of relief, such as injunctions and declaratory judgments, to determine tax liabilities. The Internal Revenue Code defines gross income to include most accessions to wealth, including those arising from debt relief.

It is readily apparent that the goals of the two systems may conflict when addressing the tax obligations of debtors in bankruptcy. Sometimes, the Internal Revenue Code recognizes the bankruptcy interest directly. For example, under section 108(a)(1)(A), income from discharge of
indebtedness is excluded in bankruptcy. Instead, a different regime, called “attribute reduction,”
is put in place. We’ll take this up in a subsequent class. The reason for this is that taxing
discharge of indebtedness in bankruptcy would frustrate the purpose the bankruptcy system,
which is designed to afford debt relief. As another example, changes of ownership of
corporations generally result in diminution of loss carryovers and other tax attributes,
implementing a policy against selling tax losses. We’ll take this up in detail. However, in
bankruptcy, changes in ownership may arise from satisfaction of debt with the corporate debtor’s
stock, with creditors supplanting stockholders. It seems clear that the losses were funded with
the creditors’ money, raising the question of whether a true economic ownership change has
occurred, and so the harsh consequences of ownership changes should be mitigated. Sections
382(l)(5) and 382(l)(6) of the Internal Revenue Code attempt to do so.

The Bankruptcy Code contains its own concessions to the tax system. Recognizing the
centrality of revenues to the functioning of government, section 507(a)(8) of the Bankruptcy
Code gives a priority to most tax claims over the claims of other “general” unsecured creditors.

Sometimes, each code asserts its own primacy. The Internal Revenue Code may give
bankruptcy relief to discharge of indebtedness, but gains on the disposition of the debtor’s assets
in bankruptcy are fully recognized, even if made to pay claims, and returns must continue to be
timely filed, even in the case of deeply insolvent debtors. The Bankruptcy Code pulls almost all
tax disputes within the jurisdiction of the Bankruptcy Court, shunting aside the Tax Court, which
otherwise disposes of 95% of all litigated income tax cases.

On occasion, the Bankruptcy Code will intrude on the Internal Revenue Code in
unexpected ways. Here are a few of many examples:

Under section 382(g)(4) of the Internal Revenue Code, when a majority shareholder
claims a worthless stock deduction, he is treated as selling that stock for nothing, a result that
would wipe out the corporation’s loss carryovers. In the Prudential Lines case, which we’ll read
in a subsequent class, a court enjoined such a stockholder (who was not a debtor before the
bankruptcy court) from claiming a worthless stock deduction to which it was otherwise entitled
because that action would have exercised control over “property” of the bankruptcy estate in
violation of section 362(a)(3) of the Bankruptcy Code.

In the Feiler case, which we’ll read for the next class, and a number of other cases, the
court used the fraudulent conveyance provisions of the Bankruptcy Code to set aside an election
made by the debtor under section 172(b)(3) of the Internal Revenue Code to forego a net
operating loss carryback, notwithstanding that the tax provision said that once made, such an
election is irrevocable.

Begier v. IRS, which you are reading for this class, is another illustration of this collision.
In that case, the corporate debtor collected airline excise taxes from its passengers and paid after-
tax wages to its employees, effectively withholding the taxes. After being delinquent for some
time in remitting these taxes to the Internal Revenue Service, the corporation paid them in on the
evolve of bankruptcy. The taxes were due and owing. Had the debtor filed a claim for refund and
thereafter brought suit, there would be no basis in the tax law to get back this money. However,
the corporation went into bankruptcy, and its trustee attempted to recover these payments as a
voidable preference. We’ll see in class why he didn’t succeed. What is important is that the result is driven by the principles of the bankruptcy law and not the tax law.

During the course, we will be looking at specific tax rules and procedures as they play out in the context of bankruptcy. Though as tax advisors it is critical to learn the rules, as participants in the policy debate it is important in each case to ask how far the tax law should go in accommodating the bankruptcy system without compromising its own integrity.

Now let’s get into the trust fund issues presented by Begier. It’s always nice to have tax lawyers thoughtfully examine each proposed transaction before it’s implemented. Through carelessness or lack of time, that doesn’t always happen, even in large commercial transactions. It is less likely to happen in the period leading up to a bankruptcy filing, as the debtor’s fortunes may be spinning out of control. But you need to educate your partners and clients. Failure to face some tax issues up front may cause pain.

Take the following situations. A retailer has been selling goods to customers in the ordinary course of business, collecting sales taxes as required by law. It goes out of business without having remitted the taxes to the taxing authority. May the taxing authority go after the consumer, claiming that the government didn’t receive the sales taxes, so the consumer is still liable? What if the same retailer had been paying its employees every payday the net amount of wages, after taxes, to which they were entitled, but it failed to remit the withheld taxes to the taxing authority? Will the innocent employee be required to pay the taxes (that he assumed had been withheld and paid over) with his return with only a worthless claim against the employer?

These are real life situations and they happen all the time. There’s good news and there’s bad news. The good news is that the consumer and the employee are protected. Every state and local sales tax law provides that once the tax is collected by the retailer, the taxes are deemed to be held in trust for the taxing authority. That means the consumer has effectively paid the government and it can no longer pursue the consumer. Same for the wages. The employer is holding the withheld taxes in trust for the government (IRC § 7501) and the employee can claim them as a credit on his income tax return notwithstanding that they haven’t actually been remitted.

What’s the bad news? The particular individuals who had the responsibility for seeing that the taxes were accounted for and paid over incur a personal liability. See, e.g., IRC § 6672. It can be devastating. Therefore, an employer should make certain that these taxes are paid over within the time required by law (sometimes only a few days after the retail sale or the payment of wages) or a range of people in the company may be incurring personal liability.

Now take this example. Some of these “trust fund” taxes may be sitting around long unpaid at the time the retailer/employer decides it must file for bankruptcy. Once it files, it cannot pay any pre-bankruptcy obligations (known as prepetition debts) without Bankruptcy Court approval, perhaps not before the end of the case. If that happens, the taxing authority may soon be at the doorstep of the president, the treasurer and even the bookkeeper looking for the money out of their own personal assets. In anticipation of this dilemma can these individuals raid the corporate treasury and denude the debtor of cash to pay the taxes on the eve of bankruptcy to save their own hides? Now read Begier and we’ll discuss.
SOME BASIC BANKRUPTCY LAW ISSUES FOR TAX LAWYERS

NEW YORK UNIVERSITY LAW SCHOOL

BANKRUPTCY TAX

AUGUST 25, 2015

PAUL H. ASOFSKY
SOME BASIC BANKRUPTCY LAW ISSUES FOR TAX LAWYERS
(Bankruptcy Code Provisions Designated “Section”)
(Internal Revenue Code provisions designated “IRC§”)

I. Effect of filing petition.

A. Creates a bankruptcy “estate.” Section 541.

1. Property of debtor becomes property of the estate.
   Section 541(a)(1).

2. In a chapter 7 (liquidation) case, the court must appoint a trustee.
   a. In a chapter 11 (reorganization) case, debtor-in-possession
      has powers of trustee. Section 1107.
   b. Court may appoint trustee in chapter 11 for cause,
      including fraud, incompetency, gross mismanagement.
      Section 1104.

B. No tax consequences when a corporation files.

1. No new taxable entity created. IRC § 1399. Section 346(a).

2. Taxable year does not close. Compare IRC § 1398(d)(2), giving
   an individual an election to close his taxable year as of the day
   before commencement of the case.

3. No short year return required.

4. Consolidated group unaffected.
   a. Treas. Reg. § 1.1502-75(c).
   c. Ltr. Ruls 8713005 (12/10/86), 8555063 (7/31/84).

5. No change in ownership under IRC § 382.

6. REIT, RIC or S Corporation status unaffected, but ability to make
   distributions is generally impaired.

C. All tax returns must be filed in the normal course. Section 346(b);
   28 USC § 960; IRC §§ 6012(b)(3), 1399.

D. Payment of taxes.
1. Pre-petition taxes, like other pre-petition debts, cannot be paid without court order. Section 549.

2. Post-petition taxes must be paid in the ordinary course of business. 28 USC § 960; Section 346(b); cf. Section 503(b)(1)(B).

3. Straddle year no longer bifurcated. Compare Section 507(a)(8)(A) with United States v. Hillsborough Holdings Corp, 116 F.3d 1391 (11th Cir. 1997); In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (9th Cir. 1995); In re L.J. O’Neill Shoe Co., 64 F.3d 1146 (8th Cir. 1995), all decided prior to amendment of that section, holding that tax liability for the straddle year is divided into a pre-petition component and an administrative component.

4. Debtor often seeks “first day orders” permitting payment of pre-petition employment, sales and use, property, franchise and perhaps other taxes. See VI, below.

II. Automatic stay. Section 362.

A. Acts prohibited. Section 362(a).

1. the commencement or continuation of a judicial, administrative or other action or proceeding against the debtor to recover a claim against the debtor that arose before the commencement of the case. Section 362(a)(1).

2. the enforcement against the debtor or against property of the estate of a judgment. Section 362(a)(2).

3. an act to obtain possession of property of the estate or property from the estate or to exercise control over property of the estate. Section 362(a)(3).

4. any act to create, perfect or enforce any lien against property of the estate. Section 362(a)(4).

5. any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case. Section 362(a)(6).

6. the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor. Section 362(a)(8).

B. Acts specifically permitted. Section 362(b).
1. an audit by a governmental unit to determine tax liability. Section 362(b)(9)(A).

2. the issuance by a governmental unit to the debtor of a notice of tax deficiency. Section 362(b)(9)(B).

3. an assessment of tax. Section 362(b)(9)(D).

4. statutory lien for ad valorem property taxes. Section 362(b)(18).

5. certain set-offs of prepetition liabilities against prepetition refunds. Section 362(b)(26).

C. On motion of a party in interest, the court may grant relief from stay. Section 362(d).

D. Does not stay actions against officers and directors for "trust fund" and other personal liability taxes. United States v. Prescription Home Health Care (In re Prescription Home Health Care, Inc.), 316 F.3d 542 (5th Cir. 2002).

III. Trust fund taxes.

A. Taxes collected or withheld from others for remittance to taxing authority. See, e.g., IRC§ 7501(a).

B. Examples:

1. income tax withholding;

2. employee’s share of FICA taxes;

3. sales taxes collected from customers. See N.Y. Tax Law § 1132; and

4. other excise taxes.

C. Failure to account for and pay over tax to taxing authority may result in personal liability for responsible individuals.

1. IRC§ 6672.

2. New York Tax Law § 1132; Texas Tax Code § 111.016

3. Employee or customer absolved of further responsibility.

D. Withheld amounts not property of the debtor.
1. IRS may require separate bank account.

2. Creating separate bank account will establish deposited funds as belonging to the government, not the taxpayer/debtor.


E. Pre-bankruptcy strategies for dealing with trust fund taxes.

1. File early return and pay.

2. Include in motion for first day orders.

IV. Priority of Taxes, Interest and Penalties.

A. Most pre-petition taxes accorded priority. Section 507.

1. Examples.

   a. income and income based taxes. Section 507(a)(8)(A);

   b. property taxes. Section 507(a)(8)(B); and

   c. sales and use taxes. Sections 507(a)(8)(C),(E).

2. Interest.

   a. has the same priority as the tax to which it relates.

   b. does not accrue after petition filing if tax is unsecured. Section 502(b)(2). Will become payable if the estate is solvent at the end of the case. Section 726(a)(5).

3. Penalty.

   a. has no priority if it is for a nonpecuniary loss, Section 507(a)(8)(G), giving it the status of a general unsecured claim.


B. Post-petition taxes are administrative expenses. Section 503(b)(1)(B).
1. Paid in the ordinary course.

2. Have priority over prepetition taxes. Section 507(a)(2).

3. Interest and penalties are administrative expenses.

C. Secured taxes.

1. Are paid in full if property value is equal to or greater than the amount of the claim.


3. Do not accrue post-petition penalties on prepetition federal tax claims. United States v. Ron Pair Enterprises, supra; In re Gift, 469 B.R. 800 (Bankr. M.D. Tenn. 2012) holds that notwithstanding 2005 amendments to Section 506(b), penalties on prepetition state tax claims don’t accrue either.

4. Interest rates under state law for delinquent property taxes are generally high, significantly above market. For that reason, it is usually wise to pay them promptly to stop the running of interest.

V. Process for tax claims.

A. Debtor corporation will file a schedule of liabilities, which will indicate which liabilities, if any, are disputed, contingent or unliquidated.

B. Any creditor (including tax authority) may file proof of claim. Section 1111(a). Federal Rules of Bankruptcy Procedure ("Rule") 3002(a).

C. Debtor is authorized to file proof of claim in the name of a creditor, within 30 days after deadline for creditor to file. Section 501(a); Rule 3004.

D. Bar date.

1. Court sets date by which claim must be filed if it’s to be allowed. Rule 3003(c).

2. Tax authority given 180 days minimum regardless of general bar date. Rule 3002(c)(1).

E. Amendment of proof of claim
F. Bloated proof of claim. A creditor may file a protective or inflated proof of claim to comply with bar date and amend afterwards (e.g., where a taxing authority still needs to audit, or state taxing authority is piggybacking on a yet undetermined federal tax claim). In certain instances, the debtor may be willing to agree to an extension.

VI. Role of first day orders

A. Automatic stay generally prohibits payment of pre-petition debts except

1. by court order

2. pursuant to a plan of reorganization

B. Most prepetition tax claims have priority over claims of general unsecured creditors. Section 507(a)(8).

C. Nonpayment of some prepetition tax claim poses unique problems:

1. withheld federal income and FICA taxes—responsible officer personal liability under IRC § 6672 (“trust funds”)

2. collected sale and use taxes—generally treated as trust funds involving personal liability under state law

3. sales and use taxes on debtor’s purchases, even those that are not trust funds, may give rise to personal liability under some state laws.

4. some real (and some personal) property taxes—accrue above market rates of interest once delinquent.

5. franchise taxes—may result in forfeiture of right to do business.

D. Debtor often seeks court approval for payment of these taxes

1. May occur upon filing petition (hence “first day orders”)

2. creditors would not be adverse, unless debtor is squeezed for cash, since these taxes are likely to have a priority.

E. Orders restricting trading in debtor’s stock and debt.

1. To protect against IRC § 382 ownership changes prior to confirmation.

2. To preserve eligibility for IRC § 382(l)(5).
VII. Bankruptcy court jurisdiction

A. Prepetition claim

1. Adversary proceeding under Section 505(a).
   a. Broad jurisdiction to determine debtor’s pre-petition taxes. Section 505(a)(1).
   b. Not if previously contested and adjudicated. Section 505(a)(2)(A).
   c. In the case of ad valorem property taxes, only if period for contesting under local law has not expired.

2. Claims objection procedure.
   a. Claim allowed unless objection is filed. Section 502(a).
   b. If objection is filed, Bankruptcy Court determines the extent to which it is allowable. Section 502(b).
   c. Often not determined until after confirmation.
   d. Settlements generally require court approval.

B. Administrative claims. Section 505(b).

1. Trustee may request prompt determination of administrative period tax liability by the tax authority by filing request with the tax authority. Section 505(b)(2).
   a. return final if tax authority does not select it for examination within 60 days. Section 505(b)(2)(A)(i).
   b. return final if tax authority does not complete examination within 180 days. Section 505(b)(2)(A)(ii).
   c. court determines liability if there is a dispute.

2. Tax authority may provide method of notice and other requirements. Section 505(b)(1); Rev. Proc. 2006-24, 2006-1 C.B. 94.

C. Sovereign immunity.

1. Eleventh Amendment to U.S. Constitution generally prevents States (but not local governments such as cities, counties and
school districts from being sued in federal courts without their consent.

2. Section 106(a) attempts to abrogate sovereign immunity, but can’t sweepingly wipe out states’ Eleventh Amendment protections.


3. Issues.

a. Can bankruptcy court discharge a tax debt if State doesn’t appear?

b. Can bankruptcy court determine an over-payment and order a refund of state tax?
APPENDIX

Selected Bankruptcy Code Provisions

28 USC § 960

Selected Bankruptcy Rules Provisions
TITLE 11, UNITED STATES CODE (BANKRUPTCY)

11 USC § 346. Special provisions related to the treatment of State and local taxes

(a) Whenever the Internal Revenue Code of 1986 provides that a separate taxable estate or entity is created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of such estate shall be taxed to or claimed by the estate, a separate taxable estate is also created for purposes of any State and local law imposing a tax on or measured by income and such income, gain, loss, deductions, and credits shall be taxed to or claimed by the estate and may not be taxed to or claimed by the debtor. The preceding sentence shall not apply if the case is dismissed. The trustee shall make tax returns of income required under any such State or local law.

(b) Whenever the Internal Revenue Code of 1986 provides that no separate taxable estate shall be created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of an estate shall be taxed to or claimed by the debtor, such income, gain, loss, deductions, and credits shall be taxed to or claimed by the debtor under a State or local law imposing a tax on or measured by income and may not be taxed to or claimed by the estate. The trustee shall make such tax returns of income of corporations and of partnerships as are required under any State or local law, but with respect to partnerships, shall make such returns only to the extent such returns are also required to be made under such Code. The estate shall be liable for any tax imposed on such corporation or partnership, but not for any tax imposed on partners or members.

11 USC § 362. Automatic stay

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of--

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;
(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay--

(9) under subsection (a), of--

(A) an audit by a governmental unit to determine tax liability;

(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(C) a demand for tax returns; or

(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment (but any tax lien that would otherwise attach to property of the estate by reason of such an assessment shall not take effect unless such tax is a debt of the debtor that will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor).

(18) under subsection (a) of the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition;

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if--

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization;
(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that—

(i) may, in the debtor's sole discretion, notwithstanding section 363(3)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or

(4) with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a scheme to delay, hinder, and defraud creditors that involved either—

(A) transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or

(B) multiple bankruptcy filings affecting such real property.

If recorded in compliance with applicable State laws governing notices of interests or liens in real property, an order entered under paragraph (4) shall be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording.

11 U.S.C. § 502. Allowance of claims or interests

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine
the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(2) such claim is for unmatured interest;

11 USC § 503. Allowance of administrative expenses

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

(1)

(B) any tax—

(i) incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title; or

(ii) attributable to an excessive allowance of a tentative carryback adjustment that the estate received, whether the taxable year to which such adjustment relates ended before or after the commencement of the case;

11 USC § 505. Determination of tax liability

(a)

(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

(2) The court may not so determine—

(A) the amount or legality of a tax, fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title;

(B) any right of the estate to a tax refund, before the earlier of—

(i) 120 days after the trustee properly requests such refund from the governmental unit from which such refund is claimed; or

(ii) a determination by such governmental unit of such request
(C) the amount or legality of any amount arising in connection with an ad valorem tax on real or personal property of the estate, if the applicable period for contesting or redetermining that amount under any law (other than a bankruptcy law) has expired.

(b)  

(1)  

(A) The clerk shall maintain a list under which a Federal, State, or local governmental unit responsible for the collection of taxes within the district may--

(i) designate an address for service of requests under this subsection; and

(ii) describe where further information concerning additional requirements for filing such requests may be found.

(B) If such governmental unit does not designate an address and provide such address to the clerk under subparagraph (A), any request made under this subsection may be served at the address for the filing of a tax return or protest with the appropriate taxing authority of such governmental unit.

(2) A trustee may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination of such tax at the address and in the manner designated in paragraph (1). Unless such return is fraudulent, or contains a material misrepresentation, the estate, the trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax--

(A) upon payment of the tax shown on such return, if--

(i) such governmental unit does not notify the trustee, within 60 days after such request, that such return has been selected for examination; or

(ii) such governmental unit does not complete such an examination and notify the trustee of any tax due, within 180 days after such request or within such additional time as the court, for cause, permits;

(B) upon payment of the tax determined by the court, after notice and a hearing, after completion by such governmental unit of such examination; or

(C) upon payment of the tax determined by such governmental unit to be due.
11 USC §506. Determination of secured status

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

11 USC § 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) First:

(A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.

(B) Subject to claims under subparagraph (A), allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless such obligation is assigned voluntarily by the spouse, former spouse, child, parent, legal guardian, or responsible relative of the child for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition be applied and distributed in accordance with applicable nonbankruptcy law.

(C) If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202 or 1302, the administrative expenses of the trustee allowed under paragraphs (1)(A), (2), and (6) of section 503(b) before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims.

(2) Second, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.
(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for--

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition--

(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days before the date of the filing of the petition, exclusive of--

(I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and

(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days.

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

11 USC § 510. Subordination

(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 claim to all or part of another allowed claim or 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 USC § 541. Property of the estate

(a) The commencement of a case under section 301, 302, and 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor’s spouse in community property as of the commencement of the case that is—
(A) under the sole, equal, or joint management and control of the
debtor; or

(B) liable for an allowable claim against the debtor, or for both an
allowable claim against the debtor and an allowable claim against
the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b),
363(n), 543, 550, 553 or 723 off this title.

(4) Any interest in property preserved for the benefit of or ordered
transferred to the estate under section 510© or 551 of this title.

(5) Any interest in property that would have been property of the estate if
such interest had been an interest of the debtor on the date of the filing of
the petition, and that the debtor acquires or becomes entitled to acquire
within 180 days after such date--

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's
spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit
plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the
estate, except such as are earnings from services performed by an
individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the
commencement of the case.

(b) Property of the estate does not include--

(1) any power that the debtor may exercise solely for the benefit of an
entity other than the debtor;

(2) any interest of the debtor as a lessee under a lease of nonresidential
real property that has terminated at the expiration of the stated term of
such lease before the commencement of the case under this title, and
ceases to include any interest of the debtor as a lessee under a lease of
nonresidential real property that has terminated at the expiration of the
stated term of such lease during the case;

(3) any eligibility of the debtor to participate in programs authorized under
et seq), or any accreditation status or State licensure of the debtor as an
educational institution;

(4) any interest of the debtor in liquid or gaseous hydrocarbons to the
extent that--

(A)
cover) from the Internal Revenue Service (IRS) payments of certain withholding and
excise taxes that the debtor made before it
filed for bankruptcy. We hold that the funds
paid here were not the property of the debtor
prior to payment; instead, they were held
in trust by the debtor for the IRS. We
accordingly conclude that the trustee may
not recover the funds.

I

American International Airways, Inc.

(AIA), was a commercial airline. As an em-
ployer, AIA was required to withhold federal
income taxes and to collect Federal Insur-
ance Contributions Act (FICA) taxes from its
employees' wages. 26 U.S.C. § 3402(a) (In-
come taxes); § 3102(a) (FICA taxes). As an
airline, it was required to collect excise taxes
from its customers for payment to the IRS.
§ 4291. Because the amount of these taxes is "held to be a special fund in trust for the
United States," § 7601, they are often called
"trust-fund taxes." See, e.g., Slodov v.
1778, 1782, 56 L.Ed.2d 261 (1978). By early
1984, AIA had fallen behind in its payments
of its trust-fund taxes to the Government.
In February of that year, the IRS ordered
AIA to deposit all trust-fund taxes it collect-
ed thereafter into a separate bank account.
AIA established the account, but did not
deposit funds sufficient to cover the entire
amount of its trust-fund tax obligations. It
nevertheless remained current on these obli-
gations through June 1984, paying the IRS
$696,000 from the separate bank account and
$946,434 from its general operating funds.
AIA and the IRS agreed that all of these
payments would be allocated to specific trust-
fund tax obligations.

On July 19, 1984, AIA petitioned for relief
from its creditors under Chapter 11 of the
(1982 ed.). AIA unsuccessfully operated as a
debtor in possession for three months. Ac-
cordingly, on September 19, the Bankruptcy
Court appointed petitioner Harry P. Begler, Jr., trustee, and a plan of liquidation in Chapter 11 was confirmed. Among the powers of a trustee is the power under § 547(b) to avoid certain payments made by the debtor that would "enabl[e] a creditor to receive payment of a greater percentage of his claim against the debtor than he would have received if the transfer had not been made and he had participated in the distribution of the assets of the bankrupt estate." H.R.Rep. No. 96-688, p. 177 (1979), U.S.Code Cong. & Admin. News 1978, pp. 8787, 6138.

Seeking to exercise his avoidance power, Begler filed an adversary action against the Government to recover the entire amount that AIA had paid the IRS for trust-fund taxes during the 90 days before the bankruptcy filing.

The Bankruptcy Court found for the Government in part and for the trustee in part. In re American International Airways, Inc., 88 B.R. 324 (ED Pa.1988). It refused to permit the trustee to recover any of the money AIA had paid out of the separate account on the theory that AIA had held that money in trust for the IRS. Id., at 327. It allowed the trustee to avoid most of the payments that AIA had made out of its general accounts, however, holding that "only where a tax trust fund is actually established by the debtor and the taxing authority is able to trace funds segregated by the debtor in a trust account established for the purpose of paying the taxes in question we would conclude that such funds are not property of the debtor's estate." Id., at 329. The District Court affirmed. App. to Pet. for Cert. A-22-A-26. On appeal by the Government, the Third Circuit reversed, holding that any prepetition payment of trust-fund taxes is a payment of funds that are not the debtor's property and that such a payment is therefore not an avoidable preference. 878 F.2d 760 (1989). We granted certiorari, 493 U.S. 1017, 110 S.Ct. 714, 107 L.Ed.2d 794 (1990), and we now affirm.

A.

Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal

1. This case is governed by 11 U.S.C. § 547(b) (1982 ed.), which reads:

"Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—

"(1) to or for the benefit of a creditor;

"(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

"(3) made while the debtor was insolvent;

"(4) made—

"(A) on or within 90 days before the date of the filing of the petition; or

"(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—

"(i) was an insider; and

"(ii) had reasonable cause to believe the debtor or was insolvent at the time of such transfer; and

"(5) that enables such creditor to receive more than such creditor would receive if—

"(A) the case were a case under chapter 7 of this title;

"(B) the transfer had not been made; and

"(C) such creditor received payment of such debt to the extent provided by the provisions of this title."

2. No other Court of Appeals has decided a case that presents the precise issue we decide here. The Ninth and District of Columbia Circuits have, however, resolved against the taxing authorities cases presenting related issues. See In re 3 A Roofing Structures & Commercial Framing, Inc., 887 F.2d 981, 987 (CA9 1989) (rejecting the Government's argument that assets the IRS seized from a debtor to satisfy a trust-fund tax obligation before the debtor filed its bankruptcy petition were assets held in trust for the Government under 26 U.S.C. § 7501, and therefore deciding that the transfer effected by the seizure involved "property of the debtor" and was not exempt from avoidance); Dunham v. District of Columbia, 263 U.S.App. D.C. 122, 125, 824 F.2d 1102, 1105 (1987) (reaching a similar conclusion with respect to a voluntary payment of withheld District of Columbia employees income taxes in a case governed by a provision of local law that "essentially mirror[ed]" § 7501).
priority should receive pro rata shares of the debtor's property. See, e.g., 11 U.S.C. § 726(b) (1982 ed.); H.R.Rep. No. 95-685, supra, at 177–178. Section 547(b) further this policy by permitting a trustee in bankruptcy to avoid certain preferential payments made before the debtor files for bankruptcy. This mechanism prevents the debtor from favoring one creditor over others by transferring property shortly before filing for bankruptcy. Of course, if the debtor transfers property that would not have been available for distribution to his creditors in a bankruptcy proceeding, the policy behind the avoidance power is not implicated. The reach of § 547(b)'s avoidance power is therefore limited to transfers of "property of the debtor."

[1] The Bankruptcy Code does not define "property of the debtor." Because the purpose of the avoidance provision is to preserve the property includable within the bankruptcy estate—the property available for distribution to creditors—"property of the debtor" subject to the preferential transfer provision, is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings. For guidance, then, we must turn to § 541, which delineates the scope of "property of the estate" and serves as the postpetition analog to § 547(b)'s "property of the debtor."§

[2] Section 541(a)(1) provides that the "property of the estate" includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Section 541(d) provides:

"Property in which the debtor holds, as of the commencement of the case, only legal

3. To the extent the 1984 amendments to § 547(b) are relevant, they confirm our view that § 541 guides our analysis of what property is "property of the debtor" for purposes of § 547(b). Among the changes was the substitution of an "interest of the debtor in property" for "property of the debtor." 11 U.S.C. § 541(b) (1988 ed.). Section 547(b) thus now mirrors § 541's definition of "property of the estate" as certain "interests of the debtor in property." 11 U.S.C. § 541(a)(1) title and not an equitable interest ... becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."

Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not "property of the estate." Nor is such an equitable interest "property of the debtor" for purposes of § 547(b). As the parties agree, then, the issue in this case is whether the money AIA transferred from its general operating accounts to the IRS was property that AIA had held in trust for the IRS.

[3] We begin with the language of 26 U.S.C. § 7601, the Internal Revenue Code's trust-fund tax provision: "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States." The statutory trust extends, then, only to "the amount of tax so collected or withheld." Begier argues that a trust-fund tax is not "collected or withheld" until specific funds are either sent to the IRS with the relevant return or placed in a segregated fund. AIA neither put the funds paid from its general operating accounts in a separate account nor paid them to the IRS before the beginning of the preference period. Begier therefore contends that no trust was ever created with respect to

(1988 ed.). The Senate Report introducing a predecessor to the bill that amended § 547(b) described the new language as a "clarifying change." S.Rep. No. 98-65, p. 81 (1983). We therefore read, both the older language ("property of the debtor") and the current language ("an interest of the debtor in property") as consistent with "interests of the debtor in property" as that term is used in 11 U.S.C. § 541(a)(1) (1988 ed.).
those funds and that the funds paid to the IRS were therefore property of the debtor.

We disagree. The Internal Revenue Code directs "every person receiving any payment for facilities or services" subject to excise taxes to "collect the amount of the tax from the person making such payment." § 4511. It also requires that an employer "collects" FICA taxes from its employees "by deducting the amount of the tax from the wages as and when paid." § 3121(a) (emphasis added). Both provisions make clear that the act of "collecting" occurs at the time of payment—the recipient's payment for the service in the case of excise taxes and the employer's payment of wages in the case of FICA taxes. The mere fact that AIA neither placed the taxes it collected in a segregated fund nor paid them to the IRS does not somehow mean that AIA never collected the taxes in the first place.

[4] The same analysis applies to taxes the Internal Revenue Code requires that employers "withhold." Section 3402(a)(1) requires that "every employer making payment of wages shall deduct and withhold upon such wages (the employee's federal income tax)." (Emphasis added.) Withholding thus occurs at the time of payment to the employee of his net wages. S.Rep. No. 26-1106, p. 38 (1978) ("[A]ssume that a debtor owes an employee $100 for salary on which there is required withholding of $20. If the debtor paid the employee $80, there has been withholding of $20 which is not property of the debtor's estate in bankruptcy"). See Slodov, 498 U.S. at 243, 98 S.Ct. at 1783 (stating that "There is no general requirement that the withheld sums be segregated from the employer's general funds," and thereby necessarily implying that the sums are "withheld" whether or not segregated). The common meaning of "withholding" supports our interpretation. See Webster's Third New International Dictionary 2627 (1981) (defining "withholding" to mean "the act or procedure of deducting a tax payment from income at the source") (emphasis added).

Our reading of § 7601 is reinforced by § 7512, which permits the IRS, upon proper notice, to require a taxpayer who has failed timely "to collect, truthfully account for, or pay over [trust-fund taxes]," or who has failed timely "to make deposits, payments, or returns of such tax," § 7512(a)(1), to "deposit such amount in a separate account in a bank ... and ... keep the amount of such taxes in such account until payment over to the United States," § 7512(b). If we were to read § 7601 to mandate segregation as a prerequisite to the creation of the trust, § 7512's requirement that funds be segregated in special and limited circumstances would become superfluous. Moreover, petitioner's suggestion that we read a segregation requirement into § 7601 would mean that an employer could avoid the creation of a trust simply by refusing to segregate. Nothing in § 7601 indicates, however, that Congress wanted the IRS to be prodded only insofar as dictated by the debtor's whim. We conclude, therefore, that AIA created a trust within the meaning of § 7601 at the moment the relevant payments (from customers to AIA for excise taxes and from AIA to its employees for FICA and income taxes) were made.

C

[5] Our holding that a trust for the benefit of the IRS existed is not alone sufficient to answer the question presented by this case: whether the particular dollars that AIA paid to the IRS from its general operating accounts were "property of the debtor." Only if those particular funds were held in trust for the IRS do they escape characterization as "property of the debtor." All § 7601 reveals is that AIA at one point created a trust for the IRS; that section provides no rule by which we can decide whether the assets AIA used to pay the IRS were assets belonging to that trust.
[6, 7] In the absence of specific statutory guidance on how we are to determine whether the assets transferred to the IRS were trust property, we might naturally begin with the common-law rules that have been created to answer such questions about other varieties of trusts. Unfortunately, such rules are of limited utility in the context of the trust created by § 7501. Under common-law principles, a trust is created in property; a trust therefore does not come into existence until the settlor identifies an ascertainable interest in property to be the trust res. G. Bogert, Law of Trusts and Trustees § 111 (rev.3d ed.1984); 1A W. Fratcher, Scott on Trusts § 78 (4th ed.1987). A § 7501 trust is radically different from the common-law paradigm, however. That provision states that "the amount of (trust-fund) tax ... collected or withheld shall be held to be a special fund in trust for the United States." (Emphasis added.) Unlike a common-law trust, in which the settlor sets aside particular property as the trust res, § 7501 creates a trust in an abstract "amount"—a dollar figure not tied to any particular assets—rather than in the actual dollars withheld. Common-law trust law, designed for a system in which particular property is identified as the trust res, are thus unhelpful in this special context.

Federal law delineating the nature of the relationship between the § 7501 trust and preferential transfer rules is limited. The only case in which we have explored that topic at any length is United States v. Randall, 401 U.S. 513, 91 S.Ct. 991, 28 L.Ed.2d 278 (1971), a case dealing with a postpetition transfer of property to discharge trust-fund tax obligations that the debtor had accrued prepetition. There, a court had ordered a debtor in possession to maintain a separate account for its withheld federal income and FICA taxes, but the debtor did not comply. When the debtor was subsequently adjudicated a bankrupt, the United States

sought to recover from the debtor's general assets the amount of withheld taxes ahead of the expenses of the bankruptcy proceeding. The Government argued that the debtor held the amount of taxes due in trust for the IRS and that this amount could be traced to the funds the debtor had in its accounts when the bankruptcy petition was filed. The trustees maintained that no trust had been created because the debtor had not segregated the funds. The Court declined directly to address either of these contentions. Id., at 615, 91 S.Ct., at 991. Rather, the Court simply refused to permit the IRS to recover the taxes ahead of administrative expenses, stating that "the statutory policy of subordinating taxes to costs and expenses of administration would not be served by creating or enforcing trusts which eat up an estate, leaving little or nothing for creditors and court officers whose goods and services created the assets." Id., at 617, 91 S.Ct., at 994.

In 1978, Congress fundamentally restructured bankruptcy law by passing the new Bankruptcy Code. Among the changes Congress decided to make was a modification of the rule this Court had enunciated in Randall under the old Bankruptcy Act. The Senate bill attacked Randall directly, providing in § 541 that trust-fund taxes withheld or collected, prior to the filing of the bankruptcy petition, were not "property of the estate." See S.Rep. No. 95-1106, at 83. See also id., at 85. ("These amounts will not be property of the estate regardless of whether such amounts have been segregated from other assets of the debtor by way of a special account, fund, or otherwise, or are deemed to be a special fund in trust pursuant to provisions of applicable tax law") (footnote omitted). The House bill did not deal explicitly with the problem of trust-fund taxes, but the House Report stated that "property of the estate" would not include property held in trust for another. See H.R.Rep. No. 95-598, creation of a trust in the "amount" of withheld taxes. The common law of trusts is not binding on Congress.
at 868, U.S.Code Cong. & Admin. News 1978, p. 6924. Congress was unable to hold a
conference, so the Senate and House floor
managers met to reach compromises on the
differences between the two bills. See 124
Cong.Rec. 32392 (1978) (remarks of Rep. Ed-
wards); Klee, Legislative History of the New
Bankruptcy Law, 23 DePaul L.Rev. 941, 958-
964 (1979). The compromise reached with
respect to the relevant portion of § 541,
which applies to postpetition transfers, was
embodied in the eventually enacted House
amendment and explicitly provided that "in
the case of property held in trust, the prop-
erty of the estate includes the legal title, but
not the beneficial interest in the property."
Edwards). Cf. id., at 32393 (text of House
amendment). Accordingly, the Senate lan-
guage specifying that withheld or collected
trust-fund taxes are not part of the bank-
rupcy estate was deleted as "unnecessary
since property of the estate does not include
the beneficial interest in property held by the
debtor as a trustee.
Under [§ 7501], the
amounts of withheld taxes are held to be a
'special fund in trust for the United States.'

Representative Edwards discussed the
effects of the House language on the rule
established by Randall, indicating that the
House amendment would supplant that rule:

"[A] serious problem exists where 'trust
fund taxes' withheld from others are held
to be property of the estate where the
withheld amounts are commingled with
other assets of the debtor. The courts
should permit the use of reasonable as-
sumptions under which the Internal Re-
venue Service, and other tax authorities, can
demonstrate that amounts of withheld tax-

Congress ex-
pected that the IRS would have to show
some connection between the § 7501 trust
and the assets sought to be applied to a
debtor's trust-fund tax obligations. See
United States v. Whiting Pools, Inc., 462
U.S. 198, 205, n. 10, 103 S.Ct. 2309, 2314,
n. 10, 78 L.Ed.2d 615 (1983) (IRS cannot ex-
clude funds from the estate if it cannot trace
them to § 7501 trust property). The ques-
tion in this case is how extensive the re-
quired nexus must be. The Bankruptcy
Code provides no explicit answer, and Rep-
resentative Edwards' admonition that courts
should "permit the use of reasonable assump-
tions" does not add much. The House Re-
port does, however, give sufficient guidance

modesty Futures Trading Comm'n v. Weinbruch,
471 U.S. 343, 351, 105 S.Ct. 1866, 1992, 85
view that remarks of floor manager of the Act
have "the effect of being a conference report").
regarding those assumptions to permit us to conclude that the nexus requirement is satisfied here. That Report states:

"A payment of withholding taxes constitutes a payment of money held in trust under Internal Revenue Code § 7501(a), and thus will not be a preference because the beneficiary of the trust, the taxing authority, is in a separate class with respect to those taxes, if they have been properly held for payment, as they will have been if the debtor is able to make the payments." H.R.Rep. No. 95-695, supra, at 873, U.S. Code Cong. & Admin. News 1978, p. 6829.8

Under a literal reading of the above passage, the bankruptcy trustee could not avoid any voluntary prepetition payment of trust-fund taxes, regardless of the source of the funds. As the House Report expressly states, the limitation that the funds must "have been properly held for payment" is satisfied "if the debtor is able to make the payments." The debtor's act of voluntarily paying its trust-fund tax obligation therefore is alone sufficient to establish the required nexus between the "amount" held in trust and the funds paid.

We adopt this literal reading. In the absence of any suggestion in the Bankruptcy Code about what tracing rules to apply, we are relegated to the legislative history. The courts are directed to apply "reasonable assumptions" to govern the tracing of funds, and the House Report identifies one such assumption to be that any voluntary prepetition payment of trust-fund taxes out of the debtor's assets is not a transfer of the debtor's property. Nothing in the Bankruptcy Code or its legislative history casts doubt on the reasonableness of that assumption. Other rules might be reasonable, too, but the only evidence we have suggests that Con-

gress preferred this one. We see no reason to disregard that evidence.

III

We hold that AIA's payments of trust-fund taxes to the IRS from its general accounts were not transfers of "property of the debtor," but were instead transfers of property held in trust for the Government pursuant to § 7501. Such payments therefore cannot be avoided as preferences. The judgment of the Court of Appeals is

Affirmed.

Justice SCALIA, concurring in the judgment.

Representative Edwards, the House floor manager for the bill that enacted the Bankruptcy Code, said on the floor that "[t]he courts should permit the use of reasonable assumptions" regarding the tracing of tax trust funds. 194 Cong.Rec. 82417 (1978). We do not know that anyone except the presiding officer was present to hear Representative Edwards. Indeed, we do not know for sure that Representative Edwards' words were even uttered on the floor rather than inserted into the Congressional Record afterwards. If Representative Edwards did speak these words, and if there were others present, they must have been surprised to hear them talking about the tracing of 26 U.S.C. § 7501 tax trust funds, inasmuch as the bill under consideration did not relate to the Internal Revenue Code but the Bankruptcy Code, and contained no provision even mentioning trust-fund taxes.
controlling statutory text. Moreover, even applying the lax legislative-history standards of recent years, this Committee Report should not be considered relevant. If a welfare bill conditioned benefits upon a certain maximum level of "income," courts might well (regrettably) regard as authoritative the Committee Report's statement that "income" means "income as computed under the Internal Revenue Code"; but surely they would not regard as authoritative its statement that a particular class of receipt "constitutes income under the Internal Revenue Code.

The Court decides this case by "adopting" a literal reading of the above language. And at 2287, I think it both demeaning and unproductive for us to ponder whether to adopt literal or not-so-literal readings of Committee Reports, as though they were authoritative on the latter sort of point. Is what the Court accepts here. The proposed (and ultimately enacted) provision of law to which this Committee Report pertained was the general provision of the Bankruptcy Code setting forth the five conditions for a voidable preference, reading in part as follows:

"Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—"

"(1) to or for the benefit of a creditor;"

"(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;"

"(3) made while the debtor was insolvent;"

"(4) made . . . on or within 90 days before the date of the filing of the petition . . . ; and"

"(5) that enables such creditor to receive more than such creditor would receive [under a chapter 7 bankruptcy] distribution]."

H.R. 8230, 85th Cong., 2d Sess., § 547(b) (1957); see 11 U.S.C. § 547(b).
If the Court had applied to the text of the statute the standard tools of legal reasoning, instead of scouring the legislative history for some scrap that is on point (and therefore ipso facto relevant, no matter how unlikely a source of congressional reliance or attention), it would have reached the same result it does today, as follows: Section 7601 obviously intends to give the United States the advantages of a trust beneficiary with respect to collected and withheld taxes. Unfortunately, it does not always succeed in doing so. A trust without a res can no more be created by legislative decree than can a pink rock-candy mountain. In the nature of things no trust exists until a res is identified. Ordinarily the res is identified by the settlor of the trust; in the case of § 7601 it is initially identified (if at all) by the statute, subject (as I shall discuss) to later reidentification by the taxpayer. Where the taxes subject to the trust-fund provision of § 7601 are collected taxes, the statute plainly identifies the res: it is the collections. There may be difficulty in tracing them, but there is no doubt that they exist. Where, however, the taxes subject to the trust-fund provision are withheld taxes, the statute provides no clear identification. When I pay a worker $30 there is no clearly identifiable locus of the $10 in withheld taxes that I do not pay him. Indeed, if my total assets at the time of the payment are $30 there is no conceivable locus.

We may have to grapple at some later date with the question whether the lack of immediate identification means that no trust arises, or rather that § 7601 creates some hitherto unheard-of floating trust in an un-

identified portion of the taxpayer's current or later-acquired assets. We do not have to reach that question today, because even though identification was not made by the statute immediately, it was made by the taxpayer when it wrote a check upon a portion of a designated fund to the Government. (It is clear from the statutory scheme that the taxpayer has the power to identify which portion of its assets constitutes the trust fund; indeed, 26 U.S.C. § 7612 permits the Government to compel such identification where it has not been made.) Even if no trust existed before that check was written, it is clear that a trust existed then. See 1 W. Fratcher, Scott on Trusts § 26.5 (4th ed. 1987) (promise to create trust becomes effective when settler transfers or otherwise designates res as trust property).

The designation here, however, occurred within the 90-day preference period. Ordinarily, the debtor's alienation of his equitable interest by declaring a trust would constitute a preference. It seems to me, however, that one must at least give this effect to § 7601's clearly expressed but sometimes ineffectual intent to create an immediate trust: If and when the trust res is identified from otherwise unencumbered assets, the trust should be deemed to have been in existence from the time of the collection or withholding. Thus, the designation of res does not constitute a preference, and the funds paid were not part of the debtor's estate.

For these reasons, I concur in the judgment of the Court.
QUATTRONE ACCOUNTANTS, INC.
and Philip P. Quattrone,
Appellants,
v.
INTERNAL REVENUE SERVICE.
No. 89-3386.
United States Court of Appeals,
Third Circuit.
Submitted Pursuant to Third
Circuit Rule 12(6)
October 26, 1989.

Before HUTCHINSON and
NYGAARD, Circuit Judges, and
DUBOIS, District Judge.*

OPINION OF THE COURT

NYGAARD, Circuit Judge
Debtor, Quattrone Accountants, Inc. (debtor) and Philip P. Quattrone appeal from the order of the district court affirming the bankruptcy court's determination that debtor is a responsible person who willfully failed to pay over federal employment taxes incurred by the United Dairy Farmers Cooperative Association (UDF) under 26 U.S.C. § 6672, and that the bankruptcy court had no jurisdiction to determine Philip Quattrone's tax liability under Section 6672. We will affirm.

I.
Debtor is a corporation that provided professional accounting services. Philip Quattrone is a part owner and principal officer of the debtor. In the late 1960's, UDF, which produced and marketed milk and cheese products, hired debtor to perform all of its accounting and financial activities. These activities included:
1) meeting with the president of UDF, Ernest Hayes, on an almost daily basis to discuss UDF finances;
2) calculating UDF’s payroll and distributing paychecks;
3) receiving directly all of UDF’s bills;
4) paying all of UDF’s standard monthly bills by use of a signature stamp without prior approval;
5) making joint decisions with Hayes to pay debts outside of standard monthly payments;
6) preparing and filing UDF’s federal, state and local tax returns;
7) procuring and managing all of UDF’s loans.

In early 1980, UDF began its financial slide which culminated in filing for bankruptcy. First, the Department of Agriculture required UDF to modify its schedule of payments to suppliers. This change caused many creditors to be paid late. Soon, Pittsburgh National Bank called an $800,000 loan claiming it to be in default. In response, debtor, although assuring UDF that the loan was not in default, suggested that the alleged default could be cured by having UDF’s members lend UDF two-thirds of one month’s milk receipts. UDF and its members accepted this suggestion. Then, as a consequence of the members’ loan to UDF, the Department of Agriculture brought suit against UDF for reasons not germane to this appeal and obtained a $1.2 million judgment.

About this time, the Internal Revenue Service (IRS) began investigating UDF. UDF owed the IRS $500,000 in withholding taxes. To cure the tax deficit, debtor formed a group of investors willing to lend UDF $250,000. The loan was supposed to cure the current liability as well as cover withholding taxes anticipated for the following four quarters. UDF put up $3.5 million in equipment as security. During the course of the following year UDF constantly questioned debtor whether the quarterly tax payments were being made. Debtor assured UDF that the withholding taxes were being paid. In late 1981, UDF told debtor to produce receipts to verify that the withholding taxes were being paid. The receipts did not correspond to the amounts due. In fact, the withholding taxes due for the quarters ending June 30, 1981 and September 9, 1981 were not paid. Consequently, UDF fired debtor.

In October, 1982, UDF filed a Chapter 11 bankruptcy petition. UDF listed withholding taxes due for the periods ending June 30, 1981 and September 9, 1981 as one of its debts. On January 1, 1984, the IRS assessed a 100% penalty against Philip Quattrone pursuant to 26 U.S.C. § 6672. Around March, 1983 the IRS assessed a 100% penalty against debtor pursuant to Section 6672. In September, 1986, debtor filed a Chapter 11 bankruptcy petition. The IRS then filed a proof of claim asserting its claim against debtor for UDF’s unpaid withholding taxes pursuant to Section 6672. Debtor and Philip Quattrone objected; later, both filed a complaint in bankruptcy court requesting the court to determine the Section 6672 tax liability of each.

The bankruptcy court held that debtor was liable under Section 6672 as a responsible person who willfully failed to pay over UDF’s withholding taxes. The court concluded that debtor was a responsible person because debtor operated as UDF’s internal accounting department with the authority to pay bills, distribute payroll, and prepare and file all UDF tax returns all without prior approval of the UDF Board. The court concluded that debtor willfully failed to pay over the withholding taxes because debtor knew of the tax deficiencies, but failed to exercise its considerable influence on the Board of UDF to get them to pay the taxes, and because debtor obtained money specifically to pay withholding taxes, but used the money instead to pay off other creditors. Lastly, the bankruptcy court held that it had no jurisdiction to determine the tax liability of Philip Quattrone. The court examined 11 U.S.C. § 505(a)(1) and concluded that Section 505 permitted it to determine only the tax liabilities of a debtor or the estate, not of non-debtor third parties.

The district court affirmed the order of the bankruptcy court, 100 B.R. 235. The
district court agreed with the bankruptcy court that it had no jurisdiction over Philip Quattrone. The district court examined both 11 U.S.C. § 506(a)(1) and 28 U.S.C. § 1334 and concluded,

Congress did not intend to empower bankruptcy courts to consider any tax whatsoever, on whomever imposed, even though such tax liability might have some conceivable effect on the administration of the bankruptcy estate. To do so would, in effect, burden the bankruptcy courts with tax issues that are better suited for the tax courts.

Slip. op. at 8. The district court concluded that the bankruptcy court’s findings were not clearly erroneous and that those findings supported the bankruptcy court’s conclusion that debtor was liable under Section 6672. Debtor and Philip Quattrone then filed this timely appeal.

III.

Appellant Philip Quattrone argues that the bankruptcy court has jurisdiction over the question of his tax liability under Section 6672 pursuant to 28 U.S.C. § 1334 and 11 U.S.C. § 506.
We conclude that the issue of the bankruptcy court’s jurisdiction is to be determined solely by 28 U.S.C. § 1334. Since we are determining the bankruptcy court’s jurisdiction over a case between two non-debtors, we must examine the “related to” language of Section 1334.

Section 1334 provides, in pertinent part, “Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings related to cases under Title 11.” Under Section 1334, a civil proceeding is “related to” a bankruptcy proceeding when “the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.” Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (6th Cir.1984) (emphasis in original), quoted in In re Bobroff, 766 F.2d 797, 802 (3d Cir.1985). “An action is related to bankruptcy if the outcome could alter the debtor’s rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.” Id. However, “the mere fact that there may be common issues of fact between a civil proceeding and controversy involving the bankruptcy estate does not bring the matter within the scope of Section 1334. Judicial economy itself does not justify general jurisdiction.” Id.

In Pacor, we held that a personal injury suit between Higgins and Pacor was not related to the bankruptcy of John-Manville Corporation (Manville). Higgins filed suit against Pacor claiming personal injuries sustained from exposure to asbestos distributed by Pacor. Pacor then filed a third party claim for indemnification against debtor Manville. The district court ruled that the bankruptcy court had jurisdiction over the Pacor-Manville suit, but not over the Higgins-Pacor suit because it was not

3. 28 U.S.C. § 157 allows the district court to refer to the bankruptcy court, cases over which

a proceeding related to the Manville bankruptcy. We affirmed, reasoning, the outcome of the Higgins-Pacor action would in no way bind Manville, in that it could not determine any rights, liabilities, or course of action of the debtor. Even if the Higgins-Pacor dispute is resolved in favor of Higgins (thereby keeping open the possibility of a third party claim), Manville would still be able to re-litigate any issue, or adopt any position, in response to a subsequent claim by Pacor. Thus, the bankruptcy estate could not be affected in any way until the Pacor-Manville third party action is actually brought and tried.

Pacor, 743 F.2d at 995.

The outcome of the Section 672 liability suit between Philip Quattrone and the IRS, like the suit between Higgins and Pacor, will in no way affect the debtor’s liability to the IRS under Section 672. Section 672 imposes liability on “[a]ny person required to collect, truthfully account for, and pay over” taxes who willfully fails to do so. 26 U.S.C. § 672; United States v. Vespe, 688 F.2d 1328, 1332 (3d Cir.1989). There can be more than one responsible person for a given employer. Vespe, 688 F.2d at 1332. That another person also may be liable under Section 672 does not affect the liability of the person presently subject to suit. Commonwealth National Bank of Dallas v. United States, 655 F.2d 748 (5th Cir.1982). Section 672 “imposes joint and several liability on each responsible person, and each responsible person can be held for the total amount of withholding not paid.” Sinder v. United States, 655 F.2d 729, 732 (6th Cir.1981). Thus, under Section 672, Philip Quattrone’s liability to the IRS is entirely separate and distinct from debtor’s liability to the IRS under Section 672, even though such potential liability stems from the same withholding taxes. Although the policy of the IRS is to not collect more than 100% of the taxes owed, see United States v. Sotelo, 436 U.S. 265, 279–80 n. 12, 98 S.Ct. 1795, 1802–03 n. 12, 56 L.Ed.2d 275 (1978),

the district court has jurisdiction pursuant to Section 1334.
each person responsible under Section 6672 is liable for that 100%. Thus, even if Philip Quattrone is held liable under 6672, the debtor, if found liable, will remain liable for 100% of the taxes owed.4

We conclude that the action between Philip Quattrone and the IRS to determine Philip’s Section 6672 liability to the IRS is not related to debtor’s bankruptcy. Therefore, the bankruptcy court does not have jurisdiction over Philip Quattrone’s claim.

IV.

We next address whether debtor, Quattrone Accountants, is liable under Section 6672 as a responsible person who willfully failed to pay over withholding taxes. We hold that it is.

The question of debtor’s liability under Section 6672 presents two issues: first, whether debtor is a responsible person; second, whether debtor willfully failed to collect or truthfully account for and pay over such tax. George v. United States, 819 F.2d 1008, 1011 (11th Cir.1987). We will first address the responsible person issue.

A.

[3-5] A responsible person is a person required to collect, truthfully account for or pay over any tax. Slodov v. United States, 436 U.S. 238, 98 S.Ct. 1778, 56 L.Ed.2d 261 (1978). Responsibility is a matter of status, duty or authority, not knowledge. Mazo v. United States, 591 F.2d 1151 (5th Cir.1979). The responsible person need not be a corporate officer. Adams v. United States, 504 F.2d 73 (7th Cir.1974). A person is responsible if the person has significant, though not neces-

4. Arguably, because the IRS does not collect more than what it is owed, if Philip Quattrone were found liable under Section 6672 and then actually made payments toward that liability, such payments would decrease the amount debtor actually owed the IRS. However, the fact remains that debtor is jointly and severally liable for the 100% penalty, and, given this fact combined with the highly contingent nature of Philip Quattrone actually paying a portion of UDF’s tax liability, we cannot conclude that a determination of Philip Quattrone’s tax liability

sarily exclusive, control over the employer’s finances. United States v. Vaspe, 668 F.2d 1332, 1332 (3d Cir.1981). A person has significant control if he has the final or significant word over which bills or creditors get paid. Commonwealth National Bank of Dallas v. United States, 665 F.2d 743, 757 (5th Cir.1982). Here, the evidence indicated that debtor had such control over the finances of UDF to become a responsible person.

[6] Debtor argues that the bankruptcy court overlooked the unconstrained testimony of one of the members of UDF’s board of directors who stated the Board made the policy decisions and that President Hayes handled the day-to-day decisions. Debtor asserts that the evidence indicates that debtor’s position consisted of purely bookkeeping functions. We disagree. A review of the record as a whole supports the bankruptcy court’s finding that debtor had significant control over UDF’s finances. Debtor had the authority to pay UDF’s monthly bills without prior approval. Consistent with this authority, debtor had possession of signature stamps of the treasurer and president of UDF. The only limitation on this authority was that each month debtor had to present to the Board of UDF the bills it had paid for the previous month. Further, debtor provided daily financial advice to UDF and obtained loans for UDF. Debtor also prepared and filed UDF’s tax returns. We conclude, therefore, that a person with the amount of control possessed by debtor is a responsible person under Section 6672.

B.

[7,8] We next address whether debtor willfully failed to truthfully account for under Section 6672 would conceivably have any effect on the bankruptcy estate.

5. The act defines person as including “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.” 26 U.S.C. § 6671(b). Debtor has not challenged its status as a “person” under 26 U.S.C. § 6671(b).
and pay over any taxes. Generally, willfully means a voluntary, conscious and intentional decision to prefer other creditors over the Government. *George v. United States*, 819 F.2d 1005, 1011 (11th Cir.1987); *Howard v. United States*, 711 F.2d 729, 736 (6th Cir.1983). A responsible person acts willfully if he pays other creditors in preference to the IRS knowing that taxes are due. *Wall v. United States*, 692 F.2d 154, 163 (3d Cir.1979). A responsible person also can act willfully if he pays other creditors with reckless disregard for whether taxes have been paid. *United States v. Vespe*, 869 F.2d at 1336.

Here, debtor admits knowing that taxes were not being paid; thus, the question is whether debtor made a voluntary, conscious and intentional decision to prefer other creditors over the IRS. The bankruptcy court found that debtor had such influence with the Board of UDF that had it chosen to, it could have paid the taxes and no one on the Board would have questioned it. The bankruptcy court also found that debtor obtained a loan for UDF specifically to pay UDF’s withholding taxes and that while debtor advised the board that the taxes were being paid, debtor used the funds from that loan to pay creditors other than the IRS.6 Debtor argues that President Hayes instructed debtor to prefer other creditors over the IRS, and therefore, its failure to pay the taxes was not willful. The bankruptcy court, however, apparently rejected this testimony by Philip Quattrone as was its prerogative under 28 U.S.C. § 137(b)(2) and Bankruptcy Rule 8013.7 *See In re Megertech Corp.*, 831 F.2d 410 (3d Cir.1987). The findings of the bankruptcy court that debtor had the power to pay over the taxes and failed to do so are not clearly erroneous. Based upon those findings, we hold that the bankruptcy court correctly concluded that debtor “willfully” failed to pay over the taxes.

V.

In summary, we hold that the bankruptcy court does not have jurisdiction to determine Philip Quattrone’s tax liability and that debtor, Quattrone Accountants, is a responsible person who failed to pay over taxes under Section 6672. We will affirm the judgment of the district court.

6. Although these funds were not trust funds within the meaning of 26 U.S.C. § 7501, *Snedov v. United States*, 436 U.S. 238, 98 S.C. 1778, 56 L.Ed.2d 251 (1978) does not require us to conclude that this act was not willful because, “[w]here there has been no change in control ... responsible persons are subject to a duty to apply any available unencumbered funds to reduce[e] accrued withholding tax liability, whether or not those funds are deemed to be trust funds within the meaning of Section 7501.” *Mass v. United States*, 591 F.2d 1151, 1154 (5th Cir. 1979).