

Details Matter: Tax Refund Claims in Bankruptcy Court.

Federal tax refund claims are generally subject to an exhaustion requirement under Section 7422(a) of the Internal Revenue Code, which requires that a claim for a refund be “duly filed” according to applicable law “and the regulations of the Secretary . . .” While this language would appear to require strict compliance, courts have periodically recognized informal claims to be sufficient to satisfy the exhaustion requirement.

In the bankruptcy context, Section 505(a) of the Bankruptcy Code gives the bankruptcy court the power to address the propriety of taxes owed or paid by the debtor’s estate. That power is subject to certain limits, which include an exception indicating that the court cannot determine a tax refund “before the earlier of 120 days after the trustee properly requests such refund from the governmental unit from which such refund is claimed”; or until the relevant tax authority rules on the request. 11 U.S.C. § 505(a)(2)(B)(i), (ii). A recent decision under this provision highlights the importance of technical compliance with the exhaustion requirement in the bankruptcy context. *In re Enesco Group, Inc.*, 2013 Bankr. LEXIS 3272 (Bankr. N.D. Ill. Aug. 8, 2013).

Enesco involved a Chapter 7 trustee appointed following conversion of a Chapter 11 case. Roughly one year after conversion, the Trustee received notices from the IRS relating to penalty assessments since the debtor had failed to file information returns for its foreign subsidiaries; the trustee paid the penalties. *In re Enesco Group, Inc.*, 2013 Bankr. LEXIS 3272, slip op. at *9. After the trustee’s accountant completed the relevant returns, he wrote to the IRS requesting a waiver of the penalties and outlining the circumstances supporting the trustee’s good faith, but he did not address the debtor’s rationale for its failure to file, which had rested upon advice from its bankruptcy counsel. The accountant’s letter did not formally request a refund and no formal refund request was filed. The IRS denied the request for “waiver of the penalties” on the merits and indicated that the trustee could file a petition for a refund after the penalties were paid. The response did not acknowledge prior payment of the penalties. *Id.* at *10-*11. The IRS then sent another assessment for the subsequent tax year, and the trustee paid that penalty without requesting a “waiver” or filing a refund claim. *Id.* at *11.

In the ensuing refund action, the bankruptcy court concluded that it lacked subject matter jurisdiction; while recognizing that it had subject matter jurisdiction over tax matters generally under 28 U.S.C. § 1334(b), the court concluded that its jurisdiction was limited by Section 505(a)(2)(B) of the Bankruptcy Code. This conclusion rested upon its analysis of the plain language of the statute, which provided that the court “shall not so determine” a tax refund claim that didn’t meet the requirements of Section 505(a)(2)(B), as well as the Supreme Court’s conclusion that the similar exhaustion requirement of Section 7422 of the Internal Revenue Code was jurisdictional. 2013 Bankr. LEXIS 3272, slip op. at *22-*26.

On the merits, the court concluded that it lacked jurisdiction because the letter written by the trustee’s accountant requesting a waiver of the penalties was not a “proper request” for a refund as required by 505(a)(2)(B)(i) of the Bankruptcy Code. 2013 Bankr. LEXIS 3272, slip op. at *27. This portion of the court’s opinion could be read to suggest that informal refund claims will never suffice to satisfy the exhaustion requirement in the bankruptcy context.

The trustee tried to argue that the correspondence with the IRS sufficed to make an informal claim, but the court rejected the argument because the accountant’s letter did not specifically

request a refund. *Id.* at *28. There is probably room for debate here at least for the tax year covered by the accountant's waiver request, but there was never any effort made to exhaust for the second round of penalties.

The bankruptcy court nonetheless refused to dismiss the case because it ruled that the trustee should be permitted to supplement its complaint under Fed. R. Civ. P. 15(d) and Fed. R. Bankr. P. 7015. The trustee had filed formal refund claims for both tax years after filing the refund claim, and the IRS had denied those requests. 2013 Bankr. LEXIS 3272, slip op. at *29-*30. This discretionary call essentially saved the estate's refund claims from dismissal.

The case highlights the importance of exhaustion in tax refund cases, particularly since it can be read to suggest that informal refund claims won't suffice in bankruptcy cases. While I think that such a reading of the statute would ultimately be rejected, it is simpler to just exhaust correctly.

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