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Circumstances in Which a Fee is an Excise Tax Entitled to Priority

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Introduction

Title 11 of the United States Code (the “Bankruptcy Code”) enumerates several categories in which claims are entitled to receive priority.¹ Indeed, Section 507(a)(8)(E) grants governmental units² priority on obligations that are “excise tax[es] on a transaction.” The Bankruptcy Code, however, does not define the universe of circumstances necessary to fall within the excise tax priority category. Governmental units therefore spend considerable efforts litigating to ensure that their claims are granted priority under the Bankruptcy Code. Ultimately, the success of a claim will hinge on how narrowly or broadly a court interprets Section 507(a)(8)(E). Part I of this memorandum explores the different approaches courts use to determine what constitutes an excise tax. Part II discusses the approaches adopted in different jurisdictions to analyze an excise tax for bankruptcy purposes. Last, Part III addresses what constitutes a transaction as required for priority under the Bankruptcy Code.

¹ See 11 U.S.C. § 507.

² See 11 U.S.C. § 101. (“The term ‘governmental unit’ means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States [but not a United States trustee while serving as a trustee in a case under this title], a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.”).

I. Courts Have Discretion in Deciding What Constitutes an Excise Tax Under Section 507.

A. An Excise Tax Must Meet the “Functionality Test.”

Generally, an obligation is a tax only if it is a “pecuniary burden laid upon individuals or property for the purpose of supporting the government.”³ Moreover, a tax is as an excise tax if it: (1) satisfies the general description of a tax; and (2) operates as a “‘tax’ (as distinct from a debt or penalty) for the purpose of setting the priority of a claim under the bankruptcy laws.”⁴

The Supreme Court established the functionality test in *CF&I* to analyze the second prong of the excise tax standard.⁵ Under the functionality test, a courts will determine if an obligation is a tax by balancing its tax factors against its non-tax factors.⁶ Furthermore, an analysis should be “flexible enough to allow for consideration of any relevant factor.”⁷ Some factors courts consider include how the obligation is paid, applied, and reimbursed.⁸

B. Courts Must Look Beyond a Statutory Label.

Fees and penalties are not accorded priority under the Bankruptcy Code, even if a statute labels them as excise taxes. “Many types of excise taxes are similar to fees and many are described in the statutes creating them as fees, thus making it necessary for courts to distinguish between obligations that are truly excise taxes and those that are considered to be fees.”⁹

Additionally, a fee is generally incurred to receive a benefit that is not evenly distributed or shared with other members of society. It is the result of a voluntary act, unlike taxes, which

³ See *New Jersey v. Anderson*, 203 U.S. 483, 492 (1906).

⁴ *U.S. v. Reorganized CF&I Fabricators of Utah, Inc.*, (“CF&I”), 518 U.S. 213, 220 (1996).

⁵ See *id.* at 224.

⁶ See *id.* at 224-26.

⁷ *Id.* at 255.

⁸ See *In re United Healthcare System, Inc.*, 396 F.3d 247, 255 – 258 (3d Cir. 2005).

⁹ 4 COLLIER ON BANKRUPTCY, § 507.11 (Richard Levin & Henry J. Sommer eds., 16th ed. 2018); see also *In re Cassidy*, 983 F.2d 161, 161-62 (10th Cir. 1992) (holding an exaction was a penalty despite being labeled as a tax in the Internal Revenue Code); *In re Marcucci*, 256 B.R. 685, 695 (Bankr. D.N.J. 2000) (holding a DMV surcharge was not a tax even though it had tax-like characteristics because its purpose was to penalize poor driving); *In re Chesteen*, No. 17-11472, 2018 WL 878847, at *3 (E.D.L.A. 2018) (holding the Affordable Care Act individual mandate was a penalty because it had more non-tax factors designed to expand healthcare coverage).

are involuntary.¹⁰ In general, “a ‘fee’ connotes a ‘benefit’” for the debtor whereas a tax can be imposed arbitrarily and in “disregard [of] benefits bestowed by the Government” as a function of the legislature’s constitutional grant of tax power.¹¹ Penalties are also the result of a voluntary, albeit unlawful, act.¹²

C. Excise Taxes Must Serve a Public Purpose.

Ultimately, “the chief distinction is that a tax is an exaction for public purposes while a fee relates to an individual privilege or benefit to the payer.”¹³ Fees are meant to defray the cost of government, whereas taxes are meant to *support* the government.¹⁴ The *River Coal* court illustrated how excise taxes serve a public purpose by describing the difference between a professional license and a reclamation fee.¹⁵ Licensing charges incurred in connection with a professional license to practice medicine or a permit to conduct a broadcast station are fees because they do not serve a public purpose; they instead benefit the license or permit holder by allowing the holder to engage in particular conduct.¹⁶ A mine reclamation fee, in contrast, is a tax because it is involuntarily imposed for the public purpose of restoring land resources damaged by mining activity, and is imposed on top of the permits that mine operators already own in order to conduct mining activity.¹⁷

Analyzing an obligation’s functional public purpose unearths complications when the obligation is imposed on public sector organizations, such as hospitals. It begets the question of whether a debtor satisfies the public purpose of an excise tax analysis by virtue of operating in the public sector. For instance, *Boston Regional* exemplifies the broad scope of what courts

¹⁰ See *National Cable Television Ass’n v. United States*, 415 U.S. 336, 370 (1974).

¹¹ *Id.* at 340-41.

¹² See *CF&I*, 518 U.S. at 226.

¹³ *United States v. River Coal Co.*, 748 F.2d 1103, 1106 (6th Cir. 1984).

¹⁴ See *id.* at 1106.

¹⁵ See *id.*

¹⁶ See *id.*

¹⁷ See *id.*

consider public purposes for excise taxes under the Bankruptcy Code.¹⁸ The hospital in *Boston Regional* argued that an obligation mandated under Massachusetts law was not an excise tax, but rather a regulatory fee, because the hospital voluntarily chose to operate as an acute hospital for its own benefit.¹⁹ The court, however, held that the fee was a tax because it served the ultimate public purpose of paying for uninsured, low-income residents.²⁰

II. Jurisdictions Vary in what Factors to use in an Excise Tax Analysis.

A. Courts Have Discretion on What Standards to Apply.

Courts have significant discretion to determine what constitutes a “public purpose,” and in turn the discretion to determine what constitutes an excise tax.²¹ Such discretion, however, makes excise tax classification one of “the most frequently litigated issue[s] under section 507(a)(8)(E).”²² Indeed, how broadly Section 507(a)(8)(E) excise taxes are interpreted impacts the availability of funds to other creditors.²³

In the Ninth Circuit, “a five-part test has emerged [to determine] what constitutes a § 507(a)(8)(E) priority excise tax” in what is known as the “*Lorber*” standard.²⁴ The *Lorber* standard provides: (1) the fee is an involuntary pecuniary burden, regardless of name, laid upon an individual or property; (2) the fee is imposed by or under the authority of the legislature; (3) the fee is for public purposes; (4) the fee is imposed under the police or taxing power of the state; and (5) whether a private creditor similarly situated to the government can be hypothesized under the relevant statute.²⁵

¹⁸ See *Boston Regional Medical Center, Inc. v. Massachusetts Div. of Health Care Finance and Policy*, 365 F.3d 51, 60 (1st Cir. 2004).

¹⁹ See *id.* at 56.

²⁰ See *id.* at 60-61.

²¹ See *In re Intern. Tobacco Partners, Ltd.*, 468 B.R. 582, 596-597 (Bankr. E.D.N.Y. 2012).

²² 4 COLLIER ON BANKRUPTCY, § 507.11.

²³ See *Suburban II*, 36 F.3d 484, 487 (6th Cir. 1994).

²⁴ *In re Carpenter*, 540 B.R. 691, 699 (B.A.P. 9th Cir. 2015).

²⁵ See *In re Lorber Indus. of California*, 564 F.3d 1098, 1102 (9th Cir. 2009).

The Sixth Circuit added two more factors to the *Lorber* standard to narrow the scope of the public purpose prong: (1) whether the exaction is universally applied to all similarly situated entities; and (2) whether the granting of priority status to a governmental claimant would prejudice private creditors with like claims.²⁶

In contrast to the *Lorber* standard, many other courts have simply adopted the *Black's Law Dictionary* definition of the term “excise tax.”²⁷ *Black's Law Dictionary* defines “excise tax” as follows:

A tax imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege. A tax on the manufacture, sale, or use of goods or on the carrying on of an occupation or activity, or a tax on the transfer of property. In current usage the term has been extended to include various license fees and practically every internal revenue tax except the income tax.²⁸

B. There Are Similarities Among the Different Standards.

The courts generally agree as to certain factors that should be considered regardless of the standard ultimately applied. For instance, courts uniformly consider whether an obligation is involuntary applied.²⁹ Also, considerable deference is given to whether an obligation has a public purpose.³⁰ The public purpose does not even have to be the primary purpose of the obligation. Indeed, an obligation can still be considered an excise tax so long as it furthers the public purpose to some extent.³¹

²⁶ See *In re Suburban Motor Freight, Inc.*, 36 F.3d 484, 488-89 (6th Cir. 1994).

²⁷ *In re National Steel Corp.*, 321 B.R. 901, 908 (Bankr. N.D. Ill. 2005); *In re Trism, Inc.*, 311 B.R. 509, 516 (B.A.P. 8th Cir. 2004); *In re Voightman*, 236 B.R. 878, 881-82 (Bankr. D.N.D. 1999); *In re Chateaugay Corp.*, 153 B.R. 632, 638 (Bankr. S.D.N.Y. 1993).

²⁸ *Black's Law Dictionary* 563 (6th ed. 1990).

²⁹ See *Lorber*, 564 F.3d at 1067.

³⁰ See *id.*

³¹ See *In re Ludlow Hosp. Soc., Inc.*, 126 B.R. 312, 323 (Bankr. D. Mass. 1997) (holding assessments against the Chapter 7 hospital were excise taxes because they furthered the public interest despite being enacted to primarily offset regulatory costs).

Additionally, legislative intent behind a statutorily imposed obligation is commonly analyzed.³² If the legislative intent is determined to further the public interest, courts are more likely to consider the obligation an excise tax because promoting the public interest is understood to be “the purpose of Congress in providing for priorities in bankruptcy.”³³

III. An Excise Tax is Only Given Priority Status if it is a Tax on a Discrete Transaction.

Not all excise taxes are entitled to priority status. The excise tax must also be leveraged on a discrete transaction.³⁴ The Bankruptcy Code, however, does not define “discrete transaction.” Thus, courts analyze the case law for guidance.³⁵ In interpreting precedent, courts embrace either a broad or narrow perspective.³⁶

Courts that adopt a broad interpretation of Section 507 do not limit transactions to “separate and distinct acts or specific taxable events.”³⁷ They hold that a “broad construction [of a transaction] is consistent with the legislative intent in providing priorities under § 507.”³⁸ Indeed, the legislative underpinning of the excise tax priority is to compensate taxing authorities for being involuntarily creditors.³⁹ Therefore, a wide variety of activities are held to be discrete transactions, such as operating an automobile, executing a contract, driving a truck on a public highway, and employing a worker.⁴⁰

³² See *In re Ridgecrest Healthcare, Inc.*, 571 B.R. 838, 843 (Bankr. C.D. Cal. 2017) (holding the statutorily labeled fees were excise taxes because they supported California’s Medicaid program, but only after analyzing the legislative history of the applicable state law).

³³ *New Neighborhoods, Inc. v. West Virginia Workers’ Compensation Fund*, 886 F.2d 714, 720 (4th Cir. 1989).

³⁴ See § 507(a)(8)(e)(ii).

³⁵ See *In re National Steel Corp.* 321 B.R. at 911.

³⁶ See *In re Ridgecrest Healthcare, Inc.*, 571 B.R. at 845 (holding that the Ninth Circuit case law suggests adopting a narrow view of a “discrete transaction” after considering broader interpretations adopted by some other circuits).

³⁷ *In re National Steel Corp.*, 321 B.R. at 911.

³⁸ *Id.* at 909; see also *In re Groetken*, 843 F.2d 1007, 1014 (7th Cir. 1988).

³⁹ See 4 COLLIER ON BANKRUPTCY, § 507.11.

⁴⁰ See *In re National Steel Corp.*, 321 B.R. at 911 (collecting cases).

Moreover, courts in jurisdictions that adopt a broad interpretation may even hold “discrete transaction” to include multiple transactions.⁴¹ In effect, affording flexibility to courts in deciding how many transactions can comprise a “discrete transaction” helps the government recover on excise claims in more circumstances.⁴²

Finally, many other courts have adopted a narrow interpretation of the term “transaction” by using the plain meaning of the Bankruptcy Code. Driving the notion of a strict statutory interpretation and limited grant of priority is that “every such claim reduces the fund available to general creditors.”⁴³ For example, the *In re Albion Health Services* court determined that unemployment and wage related taxes fall within the ambit of Section 507 because Congress specifically drafted that category into the statute.⁴⁴ A strict statutory interpretation of “discrete transaction” can be further strengthened when the transaction at issue is explicitly addressed in another related statute.⁴⁵ In effect, creditors who reference a specific provision in the Bankruptcy Code in jurisdictions that interpret Section 507 narrowly, such as the Ninth Circuit, will be more likely to succeed on priority claims.⁴⁶

Conclusion

An obligation that is an excise tax on a discrete transaction is entitled to priority under the Bankruptcy Code. However, the Bankruptcy Code does not define the circumstances that give rise to an excise tax or discrete transaction. Courts accordingly have broad discretion to determine how to define those terms. Nevertheless, legislative intent and public policy play a

⁴¹ See *In re Rizzo*, 741 F.3d 703, 706 (6th Cir. 2014); see also *In re National Steel Corp.*, 321 B.R. at 909.

⁴² See *In re Perry*, 521 B.R. 370, 379 (holding multiple transactions in a medical practice, from treating patients to paying employees, to collectively be a “transaction”); see also *Quiroz v. Michigan, Dept. of Treasury*, 472 B.R. 434, 439 (holding a bundle of financial transactions to be a “transaction” since the legislature acknowledged that business necessarily covers a series of transactions).

⁴³ *Suburban II*, 36 F.3d 484, 487 (6th Cir. 1994).

⁴⁴ See *In re Albion Health Services*, 339 B.R. 171, 179 (Bankr. W.D. Mich. 2006).

⁴⁵ See *id.* (holding that the obligation was an excise tax under the Bankruptcy Code because language in the Federal Unemployment Tax Act corroborated that designation).

⁴⁶ See *In re Ridgecrest Healthcare* 571 B.R. at 845.

substantial role in all excise tax analyses. The ability of governmental entities to receive priority, and the funds that remain available for other creditors, will continue to hinge on how broadly a court interprets Section 507(a)(8) of the Bankruptcy Code.