

## Courts Split on Definition of a “Return” for Tax Discharge

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On October 11, 2016, Martin Smith petitioned the Supreme Court for a writ of certiorari to review a decision by the Ninth Circuit. After Smith failed to file a timely tax return, the IRS assessed a deficiency against him. Smith filed a belated Form 1040, and the IRS determined he owed an additional \$60,000 in taxes. By this time, Smith was unemployed and insolvent, and ultimately filed for bankruptcy. The opportunity for Smith to discharge his tax debt rests exclusively on the interpretation of two terms in the relevant statute.

A two-tiered circuit split currently plagues the U.S. bankruptcy and tax systems. Section 523 of the Bankruptcy Code outlines certain exceptions to discharge (under sections 727, 1141, 1228(a), 1228(b), 1328(b)). If a return is not filed or if the debtor made a fraudulent return or attempted to evade a tax, tax debt is permanently nondischargeable. If the return is filed late, discharge is postponed for two years.

To interpret what constitutes a “return,” courts often use the *Beard* test, developed in *Beard v. Commissioner*. The *Beard* court defines a “return” based on four elements: “First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.” It is the third prong of “honest and reasonable” attempts that has spawned differing interpretations across circuits. The Ninth Circuit, for example, held that Form 1040 cannot be considered a “return” if it is filed so late that the IRS has already assessed a tax liability. *In re Smith*. The Eighth Circuit, however, disregards timeliness, and defines “return” based on the “face of the form itself,” an inquiry which does not look “into the circumstances under which a document was filed.” *In re Colson*.

In addition to the circuit split regarding the interpretation of “honest and reasonable” as it defines a “return,” there is a split on the meaning of a 2005 amendment to the statute, which excludes from the definition of “return” those filed pursuant to Section 6020(b) of the Internal Revenue Code. Returns filed under Section 6020(b) trigger collection procedures, and involve the Secretary of Treasury making the return because the taxpayer committed fraud.

The Ninth Circuit has found that the 2005 amendment does not undermine the *Beard* test. Other circuits, however, find this new language does abrogate the test, because, as Smith notes in his petition, “it defines returns as those that comply with ‘applicable filing requirements.’” A late return cannot, by its very nature, comply with filing requirements if it missed the deadline requirement.

Varying interpretations of the amendment have resulted in three approaches to dischargeability of tax debt for late-filing taxpayers. The Eight Circuit considers post-assessment returns to be late returns, and only postpones discharge by two years; the Ninth, Fourth, Seventh, and Eleventh Circuits treat post-assessment returns as “non-returns,” barring discharge; and the First, Fifth, and Tenth Circuits exclude post-assessment returns from the amendment’s definition of return, thereby triggering discharge. *In re Colsen*; *In re Smith*; *In re Wogoman*; *In re McCoy*; *In re Fahey*; *In re Maroney*; *In re Payne*; *In re Griffith*.

If the Supreme Court grants certiorari, it may resolve two circuit splits on a single statute, and clarify the law for debtors across the country seeking a fresh start.

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