

**Hawkins v. Franchise Tax Board: 9<sup>th</sup> Circuit Requires Government to Show Specific Intent to Evade Taxes for Denial of Discharge**

A September 15, 2014, 9<sup>th</sup> Circuit Court of Appeals decision (*Hawkins v. The Franchise Tax Board of California* (CA-9 September 15, 2014) No. 11-16276), found that the government must show that a debtor acted with the specific intent to evade or defeat taxes in order to except taxes from a debtor's discharge. This heightened standard is in contrast to the findings of a majority of circuits and represents a much needed deviation from recent decisions that have found in the government's favor in regards to the discharge of taxes.

*Hawkins v. The Franchise Tax Board of California* ("Hawkins") involved a wealthy couple (the "debtors") that refused to adjust their spending to match their decreased income and mounting tax debt owed to the Internal Revenue Service ("IRS") and the Franchise Tax Board of California ("FTB").

After the IRS challenged the validity of several of the debtors' tax shelters and performed an audit of four tax years, the debtors found themselves in debt to the IRS in the amount of \$21 million and to the FTB in the amount of \$15.3 million.

Once the taxes met the eligibility requirements for discharge in a bankruptcy case the debtors filed a Chapter 11 bankruptcy case. However, the Bankruptcy Court (and later the District Court in affirming) found that the taxes were excepted from discharge under 11 U.S.C. §523(a)(1)(C) which excepts taxes from discharge if the debtor "willfully attempted in any manner to evade or defeat such tax." In its reasoning the court found that the debtors continued to live a lavish lifestyle even though their income had significantly decreased and they were aware of the substantial tax debts owed to the IRS and FTB. The court estimated that the debtors' personal expenses exceeded their earned income by \$516,000 to \$2.35 million from January, 2004 to September, 2006. However, the debtors did not just ignore the tax debts owed. Prior to filing their bankruptcy case the debtors liquidated their primary residence and paid the entire \$6.5 million proceeds to the IRS. Further, the FTB received \$6 million from the seizure of various financial accounts.

On appeal the 9<sup>th</sup> Circuit concluded that "willful" evasion of taxes required more than just the intentional non-payment of a known tax-debt (the view of the majority of circuits). The 9<sup>th</sup> Circuit Court of Appeals concluded that the government is required to show that the debtors acted with the **specific intent** to evade the taxes owed. While not deciding on the facts of the case, the court concluded to hold that merely living beyond one's means as willful tax evasion would make all taxes ineligible for discharge in every bankruptcy case. To a certain degree every debtor is living beyond their means, and the standard to discharge taxes "must apply equally to the rich and poor alike."

As a practical matter, this is a significant victory for taxpayers and debtors. With the higher standard set by the 9<sup>th</sup> Circuit it will be more difficult for the government to prove the willful evasion of taxes prong to attempt to except tax debt from a bankruptcy discharge. Further, the government will have a large hurdle to cross for those taxpayers

that are proactive and work with the IRS or FTB during the collection period, prior to their bankruptcy case. Simple steps like providing financial information, agreeing to an installment agreement, or attempting an offer in compromise will make it nearly impossible for the IRS or FTB to show the debtor acted with the specific intent to evade their tax debt.

If you owe significant tax debt it is important to speak with an attorney to determine the best course of action. As the *Hawkins* case shows addressing tax debt early on can help avoid potential difficulties later in attempting to discharge tax debt. Completely ignoring the tax liabilities can still be shown as the willful evasion of the tax debt when attempting to discharge your tax debt down the road in a bankruptcy case.

The attorneys at Calone & Harrel Law Group, LLP, offer extensive experience in tax collection issues, Chapter 7 bankruptcy and Chapter 13 bankruptcy and can provide exceptional representation throughout the difficult process. We welcome you to give our office a call to schedule a consultation with one of our experienced attorneys to discuss the best options for you given your factual situation.