

Volume 42 | Issue 3

1992

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Recommended Citation

Laurie F. Humphrey, *In Re Mansfield Tire & Rubber Company: A Penalty by Any Other Name Is Not a Penalty*, 42 Case W. Res. L. Rev. 1069 (1992)

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*IN RE MANSFIELD TIRE
& RUBBER COMPANY: A PENALTY
BY ANY OTHER NAME
IS NOT A PENALTY*

The Bankruptcy Code provides an elaborate set of rules setting priorities for claims against a bankrupt estate.¹ Chapter 7 governs bankruptcies which result in liquidation of the estate.² Chapter 11 governs bankruptcy proceedings in which the debtor plans to reorganize and continue its business.³ In both situations, section 507 priorities obtain.⁴

Under section 507(a)(7)(E) of the Bankruptcy Code, creditors owed excise taxes are among those given priority claims.⁵ Con-

1. The Bankruptcy Code is codified in title 11 of the United States Code. See 11 U.S.C. §§ 1-15,326 (1988 & Supp. II 1990).

2. See *id.* §§ 701-66.

3. See *id.* §§ 1101-74.

4. *Id.* §§ 726 (requiring liquidating distributions under chapter 7 to comply with § 507 priorities), 1129(a)(9) (conditioning approval of a plan on payment of debts given priority under § 507).

5. *Id.* § 507(a)(7)(E). Section 507(a) provides in part:

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

. . . .

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for —

(E) an excise tax on —

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

versely, under section 726(a)(4) of chapter 7, claims for penalties are expressly subordinated to the claims of all other creditors.⁶ While these rules appear clear and easy to apply, certain claims for exactions labeled excise taxes under the Internal Revenue Code (the "Revenue Code") resemble penalties.⁷ The courts have, therefore, addressed whether a tax labeled by Congress as an excise tax in the Revenue Code should be given priority automatically under section 507(a)(7)(E) of the Bankruptcy Code or subordinated as a penalty, if the true nature of the exaction is a penalty, under section 726(a)(4).⁸ Until recently, every court addressing the issue determined whether the true nature of the exaction was more akin to an excise tax or to a penalty.⁹

In *United States v. Mansfield Tire & Rubber Company (In re Mansfield Tire & Rubber Company)*, the United States Court of Appeals for the Sixth Circuit became the first court to hold that an exaction labeled by Congress as an excise tax under the Revenue Code was entitled to priority under section 507(a)(7)(E) of the Bankruptcy Code without regard to its true nature as a penalty.¹⁰ This comment compares the reasoning of the Sixth Circuit with the

Id. § 507(a) (emphasis added). Excise taxes are one of seven types of taxes given priority under the Bankruptcy Code. The others include certain income, property, withholding and employment taxes, certain customs duties and penalties related to any of these governmental claims given priority. *Id.*

6. *Id.* § 726(a)(4). See *infra* notes 41-43 and accompanying text for a brief discussion of whether § 726, which expressly applies only to chapter 7 liquidations, applies to chapter 11 cases by analogy. For purposes of this comment, application of § 726 to a chapter 11 case is assumed.

7. See, e.g., 26 U.S.C. §§ 4911 (tax on excess lobbying expenses incurred by public charities), 4941 (tax on certain persons engaging in self-dealing transactions with a private foundation), 4971 (tax on an employer for failure to properly fund a pension plan), 4980 (tax on an employer upon reversion of pension plan assets). All of the foregoing are expressly labelled by Congress as excise taxes. See 26 U.S.C. §§ 4041-5000 (Subtitle D, "Miscellaneous Excise Taxes").

8. See *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F.2d 1055 (6th Cir. 1991); *United States v. Unsecured Creditors' Committee of C-T of Virginia (In re C-T Virginia, Inc.)*, No. 91-0026-L, 1991 U.S. Dist. LEXIS 16,741 (W.D. Va. Oct. 30, 1991); *Mahon v. United States (In re Unified Control Systems, Inc.)*, 586 F.2d 1036 (5th Cir. 1978); *United Steelworkers of America v. Pension Benefit Guaranty Corp. (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672 (W.D. Pa. 1989); *United States v. Feinblatt (In re Kline)*, 403 F. Supp. 974 (D. Md. 1975), *aff'd. per curiam*, 547 F.2d 823 (4th Cir. 1977). See also *infra* text accompanying notes 11-30.

9. See *C-T Virginia*, 1991 U.S. Dist. LEXIS 16,741; *Unified Control Systems*, 586 F.2d 1036; *Wheeling-Pittsburgh Steel Corp.*, 103 B.R. 672; *Kline*, 403 F. Supp. 974.

10. *Mansfield Tire*, 942 F.2d at 1059. The *Mansfield Tire* court also addressed whether an excise tax should be subordinated under equitable principles. See *id.* at 1061-62. A discussion of this portion of the court's opinion is beyond the scope of this comment.

reasoning of the courts taking a contrary position and argues that the conclusion and reasoning of the Sixth Circuit should prevail. Therefore, courts should not attempt to ascertain the true nature of an excise tax, but they should instead grant priority automatically to claims for the tax under section 507(a)(7)(E) of the Bankruptcy Code.

I. CASES OUTSIDE THE SIXTH CIRCUIT

Only a few courts have addressed the priority status of claims for excise taxes that resemble penalties.¹¹ Except for the Sixth Circuit, however, the courts addressing the issue have held that the penalty-like excise tax claim was subordinated to the claims of all other creditors.¹² This section focuses on the rationale the courts used to support their conclusion.

In *In re Kline*, the United States District Court for the District of Maryland considered whether the taxes imposed by sections 4941 and 4944 of the Revenue Code should be characterized as excise taxes or as penalties for purposes of the Bankruptcy Code.¹³ Sections 4941 and 4944 of the Revenue Code impose excise taxes on certain individuals and on private foundations when the individuals and the private foundations engage in prohibited transactions.¹⁴ The *Kline* court held that although the taxes imposed by sections 4941 and 4944 were labeled excise taxes, the taxes were actually penalties not entitled to priority under the Bankruptcy Code.¹⁵

11. See *supra* note 8.

12. *United States v. Unsecured Creditors' Committee of C-T of Virginia (In re C-T Virginia, Inc.)*, No. 91-0026-L, 1991 U.S. Dist. LEXIS 16,741, at *4 (W.D. Pa. October 30, 1991) (employing the usual test but concluding that 26 U.S.C. § 4980 did not resemble a penalty); *Mahon v. United States (In re Unified Control Systems, Inc.)*, 586 F.2d 1036, 1039 (5th Cir. 1978); *United Steelworkers of America v. Pension Benefit Guaranty Corp. (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672, 694 (W.D. Pa. 1989); *United States v. Feinblatt (In re Kline)*, 403 F. Supp. 974, 978-79 (D. Md. 1975), *aff'd per curiam*, 547 F.2d 823 (4th Cir. 1977).

13. *Kline*, 403 F. Supp. at 976.

14. 26 U.S.C. §§ 4941 (taxing certain individuals), 4944 (taxing private foundation for jeopardizing its tax-exempt status and foundation manager who participates in actions creating such jeopardy).

15. *Kline*, 403 F. Supp. at 978-79. The *Kline* case arose before Congress enacted the Bankruptcy Code in 1978. At the time of the *Kline* decision, the Bankruptcy Act disallowed all claims for penalties against a bankrupt estate. See Act of July 1, 1898, ch. 541, § 57, 30 Stat. 544, 560 (repealed 1978) (reprinted as amended before 1978, 11 U.S.C.A. app. § 93(j) (West 1979)). The act provided priority for a general category of claims termed 'taxes' without specifically stating categories of taxes. See Pub. L. No. 90-157, §

The court set forth a number of arguments for its holding. First, the bankruptcy scheme then in effect gave priority to taxes owed to governmental units, but it also disallowed debts owed to governmental units as penalties, except to the extent the penalties constituted actual pecuniary losses incurred by the governmental unit.¹⁶ Second, adoption of sections 4941 and 4944 of the Revenue Code was intended to correct abuses relating to private foundations.¹⁷ Third, the court stated that the Bankruptcy Act "implement[ed] a broad congressional policy against punishing the innocent creditors of a bankrupt . . . [and] accomplishe[d] this purpose by providing that claims for 'penalties' shall not be allowed against the bankrupt estate."¹⁸

The *Kline* court therefore concluded that the true nature of the tax should be the controlling factor in determining its character for bankruptcy claim purposes. Focusing on congressional purpose in imposing the exactions at issue, the court found that the taxes were imposed to discourage through economic punishment abuses by private foundations.¹⁹ Lack of any evidence that Congress intended the exactions to approximate any actual pecuniary harm to the federal government buttressed the court's decision.²⁰

While Congress had clearly labeled the requisite payments as taxes, the court refused to allow the title given them to be conclusive of the exaction's true nature.²¹ "An enactment which has as its purpose the punishment of conduct perceived as wrongful should be deemed a 'penalty' under [section] 57j [of the Bankruptcy Act] regardless of the terminology employed by the legislature [I]t would fly in the face of [section] 57j of the Bankruptcy Act to give such assessments a priority over the claims of entirely innocent creditors" ²² On appeal, the United States Court of Appeals for the Fourth Circuit adopted the *Kline* court's opinion as its own.²³

1, 81 Stat. 511, 511-12 (1967) (repealed in 1978) (reprinted as amended before repeal, 11 U.S.C.A. app. § 104(a) (West 1979)). The current Bankruptcy Code subordinates, but does not disallow, certain claims for penalties against a bankrupt estate, and grants priority to certain specific taxes. See 11 U.S.C. §§ 507, 726.

16. *Kline*, 403 F. Supp. at 976.

17. *Id.* at 976-77.

18. *Id.* at 977. See also *supra* note 15.

19. *Id.* at 977-78.

20. *Id.* at 978.

21. *Id.*

22. *Id.* at 978-79.

23. *United States v. Feinblatt (In re Kline)*, 547 F.2d 823 (4th Cir. 1977). After the

In *In re Unified Control Systems, Inc.*, the United States Court of Appeals for the Fifth Circuit also addressed the priority status of section 4941 of the Revenue Code.²⁴ Looking to the context of the tax statutes instead of the labels employed by Congress, the court concluded that the exactions imposed by section 4941 were penalties.²⁵ In so doing, the court relied heavily on the *Kline* decision.²⁶

Congress amended the Bankruptcy Code after the disputes addressed in *Kline* and *Unified Control Systems* arose.²⁷ Two changes made by Congress directly relate to the present issue. First, instead of giving priority to a broad category entitled "taxes," section 507 specifies the priority given to certain expressly stated taxes.²⁸ Excise taxes are expressly stated in that section.²⁹ Second, penalties are no longer disallowed, but are subordinated to the claims of other creditors,³⁰ or are granted priority.³¹ Whether the courts' view regarding excise tax priority was to be affected by these changes remained to be seen.

In 1989, the United States District Court for the Western District of Pennsylvania addressed the priority status of a claim based on section 4971 of the Revenue Code.³² Section 4971 of the Revenue Code imposes an excise tax on employers who fail to

Sixth Circuit decided *In re Mansfield Tire*, a district court in the Fourth Circuit affirmed a bankruptcy court's analysis patterned on *Kline*. See *United States v. Unsecured Creditors' Committee of C-T of Virginia (In re C-T Virginia, Inc.)*, 1991 U.S. Dist. LEXIS 16,741 (Oct. 30, 1991). The district court acknowledged the Sixth Circuit's approach in *Mansfield Tire* but noted that inquiry into the purposes of the exactions followed the approach of the Fourth Circuit. *Id.* The district court reversed the bankruptcy court decision because the district court disagreed with the bankruptcy court's conclusion that § 4980 of the Revenue Code was a penalty rather than a tax. *Id.*

24. *Mahon v. United States (In re Unified Control Systems, Inc.)*, 586 F.2d 1036 (5th Cir. 1978).

25. *Id.* at 1039 (relying on "[t]he language of the [Internal Revenue Code], its legislative history, the graduated levels of the sanctions imposed, and the almost confiscatory level of the exaction assessed").

26. See *id.* at 1037-39.

27. See Pub. L. 95-598, 92 Stat. 2583 (1978); Pub. L. 98-353, 98 Stat. 358 (1984) (both laws currently codified in Title 11 of the United States Code).

28. 11 U.S.C. § 507.

29. *Id.* § 507(a)(7)(E). See *supra* note 5 for the text of § 507.

30. *Id.* § 726(a)(4).

31. *Id.* § 507(a)(7)(G). Penalties arising from taxes given priority under § 507 receive priority if related to actual pecuniary loss.

32. *United Steelworkers of America v. Pension Benefit Guaranty Corp. (In re Wheeling-Pittsburgh Steel Corp.)*, 103 B.R. 672 (W.D. Pa. 1989).

fund sufficiently their pension plan.³³ The court reviewed the legislative history of section 4971 and concluded that the tax imposed was clearly a penalty for bankruptcy purposes.³⁴ The court, however, did not hold that section 726 of the Bankruptcy Code therefore dictated subordination of the claim for the excise tax. The court instead held that equitable considerations dictated disallowance of the claim.³⁵ As a result, this case failed to clarify the impact, if any, of the 1978 overhaul of the bankruptcy statutes. The court's inquiry into the exaction's nature, however, resembled old case law. By expressly relying on *Kline* and *Unified Control Systems*, the court suggested that pre-amendment case law continued to govern the issue.

II. *IN RE MANSFIELD TIRE & RUBBER COMPANY*

A. Procedural History

In 1979, The Mansfield Tire & Rubber Company filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Ohio.³⁶ The Internal Revenue Service filed a proof of claim which included a claim for excise taxes due under section 4971 of the Revenue Code imposing an excise tax on employers failing to fund properly their pension plan.³⁷ After reviewing the law under the pre-1978 Bankruptcy Code, the bankruptcy court briefly discussed the 1978 amendments.³⁸ The court stated that "the policy of protecting innocent creditors from the impact of punitive debts was continued [in the 1978 amendments]."³⁹ Citing *Kline* and *Unified Control Systems*, the bankruptcy court also stated that "it is abundantly clear that the mere labeling of an exaction as a tax is not determinative of its character."⁴⁰

After reviewing the language and legislative history of section 4971, the bankruptcy court held that the amounts imposed by sec-

33. 26 U.S.C. § 4971.

34. *Wheeling-Pittsburgh Steel*, 103 B.R. at 694.

35. *Id.* The court did not cite statutory support, but declared "[i]t is inherently unfair to punish the debtor's creditors." *Id.*

36. The facts of the proceedings appear in *In re Mansfield Tire & Rubber Co.*, 80 B.R. 395, 395-96 (Bankr. N.D. Ohio 1987).

37. *Id.* at 396.

38. *Id.* at 397.

39. *Id.*

40. *Id.* at 398.

tion 4971 constituted a penalty and not a tax for bankruptcy purposes.⁴¹ Having thus decided, the bankruptcy court reviewed the appropriate priority of the claim. The options available to the court were subordination under section 726(a)(4) or under section 510(c) of the Bankruptcy Code.⁴² Although section 726 is expressly applicable to chapter 7 liquidation cases only, the court noted that the section has been applied by analogy to chapter 11 cases by some, but not all, courts.⁴³ The court avoided the controversy, however, and subordinated the Service's claims under section 510(c), which allows subordination for equitable considerations.⁴⁴

On appeal, the United States District Court for the Northern District of Ohio affirmed the bankruptcy court's decision.⁴⁵ Again disregarding the label given by Congress, the district court chose to focus on the purpose of section 4971 of the Revenue Code.⁴⁶ The district court concluded that the section 4971 taxes "are penalties for [section] 507(a) purposes."⁴⁷

B. The Sixth Circuit Opinion

The Sixth Circuit analyzed the excise tax-penalty issue presented in *In re Mansfield Tire & Rubber Company* in a manner radically different from previous decisions addressing the issue.⁴⁸ The Sixth Circuit reversed the decision of the district court,⁴⁹ supporting the reversal with arguments focusing on Bankruptcy Code language rather than on intent and purpose under the Revenue Code.

Noting that the term 'excise tax' is not defined in the Bank-

41. *Id.* at 399-400.

42. *Id.* at 400-01.

43. *Id.* at 401. The bankruptcy court cited *Erlin Manor Nursing Home, Inc. v. Rate Setting Commission of Massachusetts (In re Erlin Manor Nursing Home, Inc.)*, 36 B.R. 672 (Bankr. Mass. 1984) and *Compton Corp. v. United States (In re Compton Corp.)*, 40 B.R. 875 (Bankr. N.D. Tex. 1984) as authority for applying § 726 to a chapter 11 case by analogy, and it cited *In re Colin*, 44 B.R. 806 (Bankr. S.D.N.Y. 1984) as one case refusing to apply § 726 by analogy.

44. *Id.* See also 11 U.S.C. § 510(c).

45. *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 120 B.R. 862, 868 (N.D. Ohio 1990).

46. *Id.* at 864-65.

47. *Id.* at 866. The district court also affirmed the bankruptcy court's decision to subordinate the claims under section 510(c). See *id.* at 866-68.

48. *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F.2d 1055 (6th Cir. 1991).

49. *Id.* at 1056.

ruptcy Code, the court concluded that Congress did not intend a meaning peculiar to that Code.⁵⁰ Congress granted priority to excise taxes without reference to their regulatory nature or to pecuniary loss.⁵¹ While many taxes labeled excise taxes discourage conduct deemed wrongful, neither the Bankruptcy Code nor its legislative history indicate that certain excise taxes were to be treated as other than excise taxes.⁵²

As to the policy of protecting innocent creditors, the Sixth Circuit was unsympathetic. Section 4971 was in existence as an excise tax when Congress enacted the current Bankruptcy Code in 1978.⁵³ While 'excise tax' is not defined in the Bankruptcy Code, Congress certainly intended to include those taxes labeled as such in the Revenue Code when Congress enacted the Bankruptcy Code.⁵⁴ In addition, a host of taxes were given priority over "innocent creditors" despite any harm they may suffer as a result thereof.⁵⁵

The Sixth Circuit therefore stated that where Congress gave unqualified priority under the Bankruptcy Code to excise taxes and Congress also titled a specific exaction in the Revenue Code an excise tax, the court would not intervene to recharacterize the exaction as something other than an excise tax.⁵⁶

III. ANALYSIS

This comment concludes that the analysis employed by the Sixth Circuit in the *Mansfield Tire* decision is more appropriate than that employed by other courts. The statutory language of both the Revenue Code and the Bankruptcy Code support the court's analysis. In addition, the legislative history of the Bankruptcy Code does not clearly support the decisions typified by *Kline*. And the legislative history of the tax statutes at issue in these cases show that while the purpose of the statutes may have been punitive in character, Congress consciously labeled such exactions excise taxes.

50. *Id.* at 1058.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.* at 1058-59.

55. *Id.* at 1059.

56. *Id.* The Sixth Circuit also stated that such deference to legislative labels did not extend to legislative entities other than Congress. *Id.* at 1059. The Sixth Circuit also reversed the holding of the district court regarding equitable subordination under § 510(c). *Id.* at 1061-62.

Further, while the *Kline* decision and its progeny relied heavily on the policy of protecting innocent creditors, *Kline* was decided under a bankruptcy structure that was much more ambiguous than the current Bankruptcy Code, and the opinion therefore should carry little or no persuasive weight in cases decided under the current code.

A. Statutory Interpretation

Both the language of section 507 of the Bankruptcy Code and the current judicial formulation of statutory interpretation support a literal reading of section 507. Section 507 expressly sets forth the priority to be granted to excise taxes.⁵⁷ Other than restricting claims by the timeframes during which a claim for excise taxes arose, section 507 does not in any way qualify the priority given excise taxes.⁵⁸ "Where Congress has exercised its constitutional power and deemed an exaction an 'excise tax', the question [of whether a particular exaction is an 'excise tax' within the Bankruptcy Code] has been answered."⁵⁹

In addition, the current United States Supreme Court has repeatedly interpreted statutory language strictly.⁶⁰ Absent a result completely at odds with the purpose of a statute, the plain meaning of the statute controls.⁶¹

While the Bankruptcy Code may evidence some intent to protect innocent creditors from certain penalties resulting from the debtor's conduct, since 1978 the creditors are not completely protected against such penalties. In fact, while claims for some penalties may be subordinated under section 726, section 507 expressly gives priority to penalties related to claims under 507.⁶² While

57. 11 U.S.C. § 507(a)(7)(E). See *supra* note 5 for the complete text of § 507(a).

58. See 11 U.S.C. § 507(a)(7)(E).

59. *Mansfield Tire*, 942 F.2d at 1059.

60. See, e.g., *Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992) (construing amendments of the bankruptcy laws as not affecting prior law absent legislative history to the contrary and declaring that "silence in the legislative history cannot be controlling" where the statute is unambiguous); *Ardestani v. Immigration and Naturalization Service*, 112 S. Ct. 515, 519-521 (1991) (starting with the language of a statute, presuming plain language expresses intent and allowing only conclusive legislative history to counter the presumption); *Demarest v. Manspeaker*, 111 S. Ct. 599, 604 (1991) ("When . . . the terms of a statute [are] unambiguous, judicial inquiry is complete except in rare and exceptional circumstances."); *Freytag v. Commissioner*, 111 S. Ct. 2631, 2636 (1991) (finding that when language is unambiguous, judicial inquiry ends).

61. E.g., *Demarest*, 111 S. Ct. at 604.

62. 11 U.S.C. § 507(a)(7)(G).

priority is limited to penalties for which the government can show pecuniary loss, section 507(a)(7)(G) counters the argument that the Bankruptcy Code evidences a general policy to protect creditors from punitive exactions.⁶³ Therefore, interpreting section 507 as granting priority to excise taxes which resemble penalties is not completely at odds with the purposes of the Bankruptcy Code.⁶⁴

Further, as pointed out by the Sixth Circuit, a host of exactions entitled excise taxes in the Revenue Code resemble penalties.⁶⁵ Most of these taxes were in existence when the Bankruptcy Code was enacted.⁶⁶ When Congress grants an unqualified priority to excise taxes and the Revenue Code contains excise taxes, it appears that Congress wishes to grant priority to taxes by label, rather than by purpose. Even Black's Law Dictionary currently recognizes that the term "excise tax" extends to practically every tax under the Revenue Code other than income taxes.⁶⁷

Finally, consider the status of the excise tax debt if that claim is not granted priority under section 507. The bankruptcy and district courts addressing *Mansfield Tire* concluded that the claim was to be subordinated.⁶⁸ Another possibility exists, however. Section 523 of the Bankruptcy Code exempts certain debts from discharge in bankruptcy.⁶⁹ Among the exemptions from discharge is a debt representing a non-pecuniary loss penalty owed to a governmental unit not specified in section 507(a)(7).⁷⁰ Therefore, it appears that if the claim for an excise tax is not granted priority

63. Note that under the pre-1978 bankruptcy laws, penalties were completely disallowed except to the extent of pecuniary loss. See *supra* note 15 and text accompanying notes 27-31. Not only are penalties now allowed, certain penalties are actually granted priority. See 11 U.S.C. § 507(A)(7)(G).

64. While one may disagree with the Supreme Court's method of statutory interpretation, the Sixth Circuit must defer to that method. Failure to defer would merely result in an expensive and time-consuming appeal which would probably end in a reversal of the decision.

65. *Mansfield Tire*, 942 F.2d at 1058-59. See also *supra* note 7.

66. *Mansfield Tire*, 942 F.2d at 1058.

67. BLACK'S LAW DICTIONARY 563 (6th ed. 1990) (defining "excise tax" as "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 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*" (emphasis added)).

68. *United States v. Mansfield Tire & Rubber Co.* (*In re Mansfield Tire & Rubber Co.*); 120 B.R. 862, 866-68 (N.D. Ohio 1990); *In re Mansfield Tire & Rubber Co.*, 80 B.R. 395, 401 (Bankr. N.D. Ohio 1987).

69. See 11 U.S.C. § 523.

70. *Id.* § 523(a)(7).

under section 507 because of the tax's punitive nature, the debtor should not be granted relief from the indebtedness through subordination of the claim. The court should merely refuse to grant the debtor a discharge from the debt.

B. Legislative History

The legislative history of the Bankruptcy Code and of the specific sections of the Revenue Code at issue are also relevant to whether section 507 should be strictly construed to grant priority to all excise taxes. Unfortunately, the legislative history of section 4971, which is quite clear, is irrelevant if the legislative history of section 507 is ambiguous. If the legislative history of section 507 does not strongly suggest a different reading, the plain language of section 507 will prevail.

The legislative history of section 4971 of the Revenue Code is straightforward. Enacted as part of ERISA,⁷¹ section 4971 was clearly intended to be punitive, but was also clearly intended to be an excise tax. The following language appears verbatim in both the report of the House Committee on Ways and Means and the report of the Senate Committee on Finance:

The bill also provides new and more effective *penalties* where employers fail to meet the funding standards. In the past, an attempt has been made to enforce the relatively weak funding standards existing under present law by providing for immediate vesting of the employees' rights, to the extent funded, under plans which do not meet these standards. This procedure, however, has proved to be defective since it does not directly penalize those responsible for the underfunding. For this reason, the bill places the obligation for funding and the *penalty* for underfunding on the person on whom it belongs — namely, the employer.

This is achieved by imposing *an excise tax* where the

71. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, ch. 43, § 4971, 88 Stat. 829, 920 (1974).

employer fails to meet the funding standards . . . ⁷²

Therefore, both houses of Congress were aware that section 4971 constituted a penalty labeled an excise tax. Section 4971 was intended to be punitive in nature. The texts of the reports also support an intentional codification of section 4971 in the Revenue Code under the excise tax subchapter, instead of under the penalty sections. However, this legislative purpose is relevant only if section 507 gives priority to a select set of excise taxes.

The legislative history of the Bankruptcy Code, though fairly extensive, is ambiguous. Few statements directly relevant to excise tax priority exist. One House Report contains the following statement:

H.R. 8200 modifies current law with respect to the tax priority. The kinds of taxes entitled to priority under H.R. 8200 closely follows the categories granted priority under the Bankruptcy Act, though taxes that are fines or penalties are not entitled to priority, even to the extent of actual pecuniary loss [W]ith respect to other taxes, such as customs, excise, and property taxes, it is easier for a taxing authority to discover a delinquency ⁷³

While this report seems to indicate that no penalties were allowed priority,⁷⁴ the clear language of section 507(a)(7)(G) contradicts the supposed legislative intent, at least to the extent of pecuniary loss.⁷⁵ In addition, a separate statement regarding legislative intent seems directly to contradict the House Report. One legislator was quoted as saying in reference to section 507:

All Federal, State or local taxes generally considered or *expressly* treated as excises are covered by this category, including sales taxes, estate and gift taxes, gasoline and special fuel taxes, and wagering and truck taxes.⁷⁶

72. H. REP. NO. 807, 93d Cong., 2d sess., reprinted in 1974 U.S.C.C.A.N. 4670, 4694-95 (emphasis added); S. REP. NO. 393, 93d Cong., 2d sess., reprinted in 1974 U.S.C.C.A.N. 4890, 4909-10 (emphasis added). The *Wheeling-Pittsburgh Steel* court cited the above language but did not include the second paragraph. See *United Steelworkers of America v. Pension Benefit Guaranty Corp.* (*In re Wheeling-Pittsburgh Steel Corp.*), 103 B.R. 672, 694 (W.D. Pa. 1989).

73. H. REP. NO. 595, 95th Cong., 1st Sess. 90 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6151.

74. The Report is unclear regarding whether prior law or the house bill (or both) disallows penalties.

75. See 11 U.S.C. § 507(A)(7)(G).

76. 124 Congressional Record 32,392, 32,416 (1978) (emphasis added), reprinted in

While the statement of one legislator is not conclusive,⁷⁷ this statement appears more aligned than the statement of the House Report with the express language of section 507. Therefore, the legislative history of section 507 is inconclusive at best. Absent clear contrary intent, the plain meaning of the statute must prevail.⁷⁸

One legislative interpretation argument exists for retaining the inquiry into the true nature of an excise tax. The analysis followed in *Kline* and *Unified Control Systems* was settled law when the current Bankruptcy Code was enacted.⁷⁹ Therefore, the legal analysis should continue to apply absent a clear legislative intent to overrule the analysis.⁸⁰ Since the legislative history is ambiguous, no clear intent to overrule precedent exists and perhaps the *Kline* approach should continue to apply.

The argument, however, is flawed. First, section 507 now expressly grants priority to excise taxes.⁸¹ Therefore, section 507 implicitly overrules *Kline* and similar cases. Second, while most penalties were disallowed and penalties representing pecuniary loss were subordinated under the pre-1978 bankruptcy scheme, such is no longer the case.⁸² "Where the language [of a bankruptcy statute] is unambiguous, silence in the legislative history cannot be controlling."⁸³

C. Policy

While the temptation exists to define congressional policy under the Bankruptcy Code as a broad mandate to protect innocent creditors, the same Code also evidences a policy to protect government revenue of almost every nature. As the Sixth Circuit stated:

1978 U.S.C.C.A.N. 6505, 6567 (statement of Rep. Edwards on presentation to the House of an amendment to Senate's substituted bill).

77. See, e.g., *West Virginia Univ. Hosp. v. Casey*, 111 S. Ct. 1138, 1147 (1991) ("Where [the statutory text] contains a phrase that is unambiguous, . . . we do not permit it to be expanded or contracted by the statements of individual legislators or committees during the course of the enactment process.").

78. See, e.g., *Ardestani v. Immigration and Naturalization Service*, 112 S. Ct. 515, 519-21 (1991).

79. *Kline* was decided in 1975. In hindsight at least, *Kline* was regarded as the landmark case.

80. *Dewsnup v. Timm*, 112 S.Ct. 773, 779 (1992).

81. 11 U.S.C. § 507(a)(7)(E).

82. See *supra* note 15.

83. *Dewsnup*, 112 S.Ct. at 779.

With respect to the trustees' argument that the debtors' innocent creditors will bear the cost of prioritizing the government's claims, we needn't concern ourselves with that policy decision. Congress has already made that choice Whatever general policy against giving priority to penalty debts may exist, Congress has chosen to give priority to excise taxes without distinguishing among them based upon a court's view of their purpose or nature. This Congress clearly may do.⁸⁴

The Revenue Code and the Bankruptcy Code are creatures of the legislature. Congress, in deciding whether to tax certain activity, is restricted only by the Constitution.⁸⁵ Similarly, whether Congress provides a vehicle by which debtors in bankruptcy can be relieved of certain debt is entirely up to them.⁸⁶ Having created that vehicle, Congress may choose to prioritize claims as it sees fit, even if innocent creditors are injured.

Further, the facility with which the courts continued to rely on *Kline* after the 1978 overhaul of the bankruptcy scheme is troubling. *Kline* addressed a statute which contained a more obvious contradiction: taxes to governmental entities were entitled to priority, but debts to governmental entities representing penalties were expressly subordinated to the extent of pecuniary loss and disallowed otherwise.⁸⁷ The Bankruptcy Code does not expressly subordinate or disallow penalties under chapter 11. Chapter 11 does, however, contain a clear priority for certain taxes and penalties.⁸⁸ Therefore, the Bankruptcy Code does not contain a contradiction as manifest as under the older bankruptcy laws. Thus, courts' continued reliance on *Kline* to support their inquiry regarding a statute's true nature is inappropriate absent a conscious and well-reasoned decision that pre-1978 law continues to apply.

The decision of the Sixth Circuit rests on solid ground. However, assuming the decision is wrong, any harm caused by the decision is not irrevocable. The decision is based on statutory

84. *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F. 2d 1055, 1059 (6th Cir. 1991).

85. U.S. CONST. art. I, § 8, cl. 1; *see also Helvering v. Gerhardt*, 304 U.S. 405 (1938).

86. *Id.* cl. 4 (authorizing Congress power to establish uniform laws regarding bankruptcy).

87. *See supra* note 15.

88. *See* 11 U.S.C. § 507.

interpretation. If Congress in fact meant for the courts to continue to distinguish between taxes by their nature and not their title, Congress can amend the Bankruptcy Code to express more accurately their intention. Should Congress so act, the courts will be justified in applying again *Kline* and its progeny. Until then, the clearest import of section 507 is that claims for excise taxes, regardless of whether they resemble more closely taxes or penalties, are entitled to priority.

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