

United States District Court
Northern District of California

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

CHRISTOPHER COTE,
Appellant,
v.
EMPLOYMENT DEVELOPMENT
DEPARTMENT,
Appellee.

Case No. 17-CV-01991-LHK
**ORDER REVERSING BANKRUPTCY
COURT**

Appellant Christopher Michael Cote (“Appellant”) appeals the Bankruptcy Court’s finding that Appellant’s liability for uncollected disability insurance withholdings and personal income tax withholdings is nondischargeable. Having considered the parties’ submissions, the relevant law, and the record in this case, the Court REVERSES the Bankruptcy Court’s decision and REMANDS with instruction to enter judgment for Appellant.

I. BACKGROUND

A. Factual Background

Appellant was the president, secretary, director, and sole shareholder of Cote Distribution Systems, Inc. (“CDS”). ECF No. 16-1, Appellee’s App. (“APA”) at 29. CDS did not file required tax returns from the second quarter of 1982 through the second quarter of 1987. ECF No. 14-1,

1 Appellant’s Appendix (“AA”) at 7.

2 In 1988, California’s Employment Development Department (“Appellee”) issued a tax
 3 assessment for delinquent employment-related taxes against CDS. On December 12, 1988,
 4 Appellee and CDS entered into a stipulation under which CDS accepted liability for (1) employer
 5 training tax, (2) unemployment insurance tax, (3) disability insurance withholdings, and (4)
 6 personal income tax withholdings, plus penalties and interest. ECF No. 14-1, Appellant’s
 7 Appendix (“AA”) at 147.

8 On October 31, 1991, Appellee issued a tax assessment against Appellant as an individual
 9 for the taxes set forth in the CDS stipulation on the grounds that Appellant was responsible for
 10 CDS’s nonpayment under California Unemployment Insurance Code § 1735, which holds officers
 11 and major stockholders responsible for the nonpayment of entities that they control. *Id.*
 12 Subsequently, Appellant was twice discharged from Chapter 7 bankruptcy on January 29, 1993,
 13 and January 31, 2013. *Id.* at 19–21.

14 **A. Procedural History**

15 On July 3, 2013, Appellant initiated an adversary proceeding against Appellee seeking a
 16 discharge of CDS tax liability that Appellee had imposed on Appellant. *Id.* at 5–14. The United
 17 States Bankruptcy Court found that Appellant’s liability was nondischargeable. *Id.* at 63, 122.
 18 United States District Judge Ronald Whyte affirmed the Bankruptcy Court on September 29,
 19 2015. *Id.* at 140.

20 On October 14, 2015, Appellant appealed to the Ninth Circuit. *Id.* at 141–42. While the
 21 appeal was pending, Appellant uncovered a previously overlooked 1988 order from the California
 22 Unemployment Insurance Appeals Board (“CUIAB”) concerning the unemployment insurance
 23 taxes and employment taxes at issue. *Id.* at 143. Appellant brought the CUIAB decision to the
 24 Ninth Circuit’s attention. *See id.* at 143–44. On July 16, 2016, the Ninth Circuit summarily
 25 remanded the case to the Bankruptcy Court to determine what effect, if any, the CUIAB decision
 26 had on Appellant’s tax liability. *Id.* The parties had not yet filed any merits briefs. ECF No. 14 at 4
 27 (“Appellant’s Br.”).

1 On December 13, 2016, the Bankruptcy Court concluded that the CUIAB decision
 2 rendered Appellant’s unemployment insurance tax and employment tax liability dischargeable.
 3 AA at 160, 162–64. The Bankruptcy Court therefore issued an Amended Judgment which
 4 specified that Appellant’s liability for the unemployment insurance tax and employment tax was
 5 discharged. *Id.* at 162–64. However, the amended judgment did not alter the previous judgment’s
 6 holding that Appellant’s liability for CDS’s unpaid disability insurance withholdings and personal
 7 income tax withholdings was nondischargeable. *Id.* at 122, 163.

8 On March 16, 2017, Appellant appealed the Bankruptcy Court’s finding that Appellant’s
 9 liability for CDS’s failure to collect disability insurance withholdings and personal income tax
 10 withholdings was nondischargeable. ECF No. 1-2 at 13.

11 On September 28, 2017, Appellant filed his opening brief. Appellant’s Br. On October 27,
 12 2017, Appellee filed its brief in response. ECF No. 16 (“Appellee’s Br.”). On November 27, 2017,
 13 Appellant filed his reply brief. ECF No. 17. (“Appellant’s Reply Br.”).

14 **II. LEGAL STANDARD**

15 A federal district court has jurisdiction to entertain an appeal from the Bankruptcy Court
 16 under 28 U.S.C. § 158(a), which provides: “The district courts of the United States shall have
 17 jurisdiction to hear appeals ... from final judgments, orders, and decrees[] of bankruptcy
 18 judges[.]” On appeal, a district court reviews a bankruptcy court's conclusions of law de novo, and
 19 the bankruptcy court's factual findings for clear error. *In re Greene*, 583 F.3d 614, 618 (9th Cir.
 20 2009) (citing *In re Raintree Healthcare Corp.*, 431 F.3d 685, 687 (9th Cir. 2005)); *In re Salazar*,
 21 430 F.3d 992, 994 (9th Cir. 2005). Because the only question before the Court is a legal one, the
 22 Court’s review is de novo.

23 **III. DISCUSSION**

24 The lone question in this appeal is whether the state disability insurance withholdings and
 25 personal income tax withholdings (collectively, “withholdings”) that CDS did not collect and for
 26 which Appellant has held liable are exempt from discharge in bankruptcy because they are “a tax
 27 required to be collected or withheld and for which the debtor is liable in whatever capacity.” 11

1 U.S.C. § 507(a)(8)(C).

2 Appellant advances two arguments as to why the withholdings are not subject to §
3 507(a)(8)(C). First, Appellant argues § 507(a)(8)(C) only applies to taxes that the debtor was
4 charged with collecting and points out that CDS, not Appellant, was charged with collecting the
5 withholdings. Second, Appellant argues § 507(a)(8)(C) only applies to taxes that were actually
6 withheld or collected, and notes that CDS never withheld or collected any taxes. The Court agrees
7 with Appellant's first argument, and so does not reach the second.¹

8 **A. Section 507(a)(8)(C) Does Not Apply to Taxes that the Debtor Was Not**
9 **Charged With Collecting**

10 The Court's evaluation of Appellant's argument that § 507(a)(8)(C) only applies to taxes
11 the debtor was charged with collecting or withholding consists of three steps. First, the Court
12 considers and rejects Appellee's claim that Appellant has waived this argument. Second, the Court
13 looks to the text of § 507(a)(8)(C) and concludes that the statute is ambiguous. Third, the Court
14 examines § 507(a)(8)(C)'s legislative history and determines that the statute only applies to taxes
15 that the debtor was charged with collecting or withholding.

16 Some background is necessary. The Bankruptcy Code contains a number of exceptions to
17 the general rule that an individual's debts are discharged in bankruptcy. *See* 11 U.S.C. § 523
18 (listing exceptions). Section 523(a)(1)(A) is the exception at issue here:

19 (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title
20 does not discharge an individual debtor from any debt—

21 (1) for a tax or a customs duty—

22 (A) of the kind and for the periods specified in section 507(a)(3) or
23 507(a)(8) of this title, whether or not a claim for such tax was filed
24 or allowed;

25 *Id.* § 523(a)(1)(A). Section 523(a)(1)(A) thus exempts from discharge a tax or customs duty that is
26 listed in § 507(a)(8). Although § 507(a)(8) lists a number of taxes this case centers on §
27 507(a)(8)(C):

28 ¹ Judge Whyte previously found that § 507(a)(8)(C) unambiguously applied to taxes that were not
collected. AA at 138. The Court does not evaluate this holding because Appellant prevails on an
alternative ground.

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(a) ...

...
(8) ... [A]llowed unsecured claims of governmental units, only to the extent that such claims are for—

...
(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

Id. § 507(a)(8)(C). In sum, the question here is whether the withholdings are nondischargeable because they are “a tax required to be collected or withheld and for which the debtor is liable in whatever capacity.” *Id.* The Court now turns to the substance of the parties’ dispute.

Appellee contends that Appellant has waived the argument that § 507(a)(8)(C) only applies to taxes a debtor was supposed to collect or withhold because Appellant has not raised that theory previously. Appellee’s argument is unpersuasive. Appellant argued that the withholdings do not fall under § 507(a)(8)(C) during the initial proceedings before the Bankruptcy Court, during the appeal before Judge Whyte, before the Bankruptcy Court following remand from the Ninth Circuit, and continues to press the point before this Court.² Granted, this is the first time that Appellant has argued the withholdings are not subject to § 507(a)(8)(C) because it only applies to taxes for which the debtor was responsible. Yet parties waive issues, not arguments: “Once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below.” *Harris Trust and Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 245 (2000) (quoting *Yee v. City of Escondido*, 503 U.S. 519, 534–35 (1992)). Here, Appellant has properly presented the claim that § 507(a)(8)(C) does not apply to the withholdings by arguing that claim at every phase of these proceedings. Appellant is therefore entitled, even at this late stage, to advance a new argument in support of his claim.

The next question is whether § 507(a)(8)(C)’s language is ambiguous. If a “statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.” *Sebelius v. Cloer*, 569 U.S. 369, 381

² The Ninth Circuit remanded the case before either party had submitted briefs, so Appellant could not have raised the argument before the Ninth Circuit. Appellant’s Br. at 4.

1 (2013) (internal quotations and citation omitted). Only “[i]f the statutory language is ambiguous,
 2 ... [do courts] consult legislative history. *Hawkins v. Franchise Tax Bd. of California*, 769 F.3d
 3 662, 666 (9th Cir. 2014).

4 Appellee contends that § 507(a)(8)(C)’s language is plain and that it encompasses “a tax
 5 required to be collected or withheld” by anyone for which the “debtor is liable in whatever
 6 capacity.” In turn, Appellant is liable under § 507(a)(8)(C) because CDS was required to collect
 7 the withholdings and Appellant has been found liable for CDS’s failure to do so under California
 8 Unemployment Insurance Code § 1735.³ For his part, Appellant argues that § 507(a)(8)(C) is
 9 ambiguous, pointing to its language, structure, and past decisions examining its application.

10 The Court finds Appellant’s argument more persuasive. Section 507(a)(8)(C) nowhere
 11 states *who* is “required to collect[] or with[o]ld” a tax, leaving the statute ambiguous on the key
 12 question of whether a debtor must be the person responsible for collecting or withholding a tax, or
 13 whether the debtor can be held liable based on a third party’s failure to collect or withhold a tax.
 14 Section 507(a)(8)(C)’s ambiguity is further underscored by the statute’s failure to specify from
 15 whom the tax must be collected or withheld. The bottom line is that § 507(a)(8)(C) does not say
 16 who is supposed to collect or withhold the tax, or from whom the tax should be collected or
 17 withheld. The absence of specificity on these important points suggests the statute is ambiguous.
 18 *Cf. United States v. Wilson*, 503 U.S. 329, 334–35 (1992) (“When Congress writes a statute in the
 19 passive voice, it often fails to indicate who must take a required action. This silence can make the
 20 meaning of a statute somewhat difficult to ascertain.”).

21 In determining whether a statute’s meaning is plain, courts also consider the “structure of
 22 the statute as a whole, including its object and policy.” *Hawkins*, 769 F.3d at 666. Section 507(a)’s
 23 structure further supports the conclusion that § 507(a)(8) is ambiguous. Many of the taxes
 24 enumerated in § 507(a) have explicit time limits beyond which liability for unpaid taxes is
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 27 ³ California Unemployment Insurance Code § 1735 holds an officer or major stockholder who
 28 controls a corporate entity personally liable for unpaid contributions or withholdings if they
 willfully fail to pay the contributions or withholdings. Cal. Unemp. Ins. Code § 1735.

1 dischargeable. *See, e.g.*, 11 U.S.C. § 507(a)(8)(A)(i) (limiting income tax liability to three years);
 2 *id.* § 507(a)(8)(B) (limiting property tax liability to one year); *id.* § 507(a)(8)(E) (limiting excise
 3 tax liability to three years). Section 507(a)(8)(C) has no such time limit. Appellee’s broad reading
 4 of § 507(a)(8)(C) therefore risks overriding the time limits specified elsewhere in § 507(a). For
 5 instance, although § 507(a)(8)(A)(i) limits income tax liability to three years before the date of the
 6 filing of the bankruptcy petition, that time limit would be nullified if a debtor was also liable under
 7 § 507(a)(8)(C) because § 507(a)(8)(C) lacks a time limit. *See Hernandez v. Williams, Zinman &*
 8 *Parham PC*, 829 F.3d 1068, 1073 (9th Cir. 2016) (noting that determinations of plainness or
 9 ambiguity pursue consistency among a statute’s different provisions).

10 Precedent also supports Appellant. The Bankruptcy Appellate Panel (“BAP”) has found
 11 that § 507(a)(8)(C) is ambiguous as to who is supposed to collect or withhold the tax. *In re*
 12 *Hansen*, 470 B.R. 535, 543 (B.A.P. 9th Cir. 2012). In *Hansen*, the EDD argued that under §
 13 507(a)(8)(C)’s plain meaning an unemployment insurance tax constituted “a tax required to be
 14 collected or withheld” even though it was the EDD, not the debtor, who was charged with
 15 collecting it. *Id.* at 542. The BAP disagreed, and concluded that § 507(a)(8)(C) was ambiguous
 16 because “it is not clear whether the language anticipates that the collector of the tax must be the
 17 taxing agency (as the EDD contends) or the taxpayer (as argued by Hansen).” *Id.* at 543. In light
 18 of this ambiguity, the BAP “turn[ed] to the legislative history to ascertain which of the two
 19 meanings urged upon us is most consistent with congressional intent.” *Id.* So too here. As in
 20 *Hansen*, the Court finds that § 507(a)(8)(C) is ambiguous as to who the collector or withholder of
 21 the tax must be and, more specifically, is ambiguous as to whether the collector or withholder
 22 must be the debtor or can also be a third party. Thus, as in *Hansen*, the Court turns to §
 23 507(a)(8)(C)’s legislative history for guidance.

24 The legislative history suggests that Congress meant for § 507(a)(8)(C) to only apply to
 25 taxes that the debtor was charged with collecting or withholding. Section 507 is the result of the
 26 Bankruptcy Reform Act of 1978, 95 Pub. L. No. 95–598, 92 Stat. 2549. Subsection (C), in
 27 particular, “is the result of a compromise which reconciled the differences between the House and
 28

1 Senate drafts of the provision.” *Id.* at 544 (citing Kenneth N. Klee, *Legislative History of the New*
 2 *Bankruptcy Law*, 28 DEPAUL L. REV. 941, 953–57 (1979)). The Joint Statement of Representative
 3 Edwards and Senator DeConcini,⁴ which accompanied the negotiated provision, stated that
 4 subsection (C) would establish priority for claims stemming from:

5 Taxes which *the debtor was required by law to withhold or collect* from others and
 6 for which he is liable in any capacity, regardless of the age of the tax claims. This
 7 category covers the so-called “trust fund” taxes, that is, income taxes which an
 8 employer is required to withhold from the pay of his employees, and the
 9 employees’ share of social security taxes.

10 *Id.* (quoting 124 Cong. Rec. 32,415 (1978)) (emphasis added). The statement that taxes subject to
 11 § 507(a)(8)(C) are those the “the debtor” was required to withhold or collect indicates that
 12 Congress did not intend for § 507(a)(8)(C) to apply to taxes that others, be it the EDD or CDS,
 13 were charged with collecting. That conclusion is reinforced by previous iterations of the
 14 Bankruptcy Act. Section 17(a)(1)(e) of the former Bankruptcy Act, the predecessor to §
 15 507(a)(8)(C), deemed nondischargeable “taxes . . . which *the bankrupt* has collected or withheld
 16 from others . . . but has not paid over.” 11 U.S.C. § 35(a)(1)(e) (1976 ed.) (emphasis added); Act
 17 of July 5, 1966, Pub. L. No. 89–496, 80 Stat. 270.

18 The prevailing approach to the construction of the Bankruptcy Code further supports this
 19 reading of § 507(a)(8)(C). As the Ninth Circuit notes, “[t]he Bankruptcy Code is designed to
 20 provide a ‘fresh start’ to the discharged debtor.” *Hawkins*, 769 F.3d at 666. Consequently, “the
 21 Supreme Court has interpreted exceptions to the broad presumption of discharge narrowly.” *Id.*
 22 (citing *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998)). Appellee’s broad reading of § 507(a)(8)(C)
 23 is therefore at odds with the United States Supreme Court’s traditionally narrow construction of

24 ⁴ There was no formal conference to resolve the differences between the House and Senate
 25 versions of the Bankruptcy Reform Act of 1978. *Begier v. I.R.S.*, 496 U.S. 53, 64 n.5 (1990).
 26 Consequently, “[b]ecause of the absence of a conference and the key roles played by
 27 Representative Edwards and his counterpart floor manager Senator DeConcini, [the United States
 28 Supreme Court] ha[s] treated their floor statements on the Bankruptcy Reform Act of 1978 as
 persuasive evidence of congressional intent.” *Id.* In line with *Begier*, this Court will treat the
 statements of Representative Edwards and Senator DeConcini as persuasive evidence. *See also*
Hansen, 470 B.R. at 544 n. 13 (doing same).

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1 the exceptions to the rule that bankruptcy discharges one’s debts. Moreover, a broad reading of a
2 limitation on discharge is at odds with a statute designed to provide debtors with a fresh start.
3 *United States v. Neal*, 776 F.3d 645, 652 (9th Cir. 2015) (noting particular phrases must be
4 construed in light of the statute’s purpose).

5 Appellee responds that limiting § 507(a)(8)(C) to debtors’ own failure to collect or
6 withhold taxes creates an incentive for debtors to avoid ensuring that entities for which they are
7 responsible, like CDS in this case, actually collect or withhold taxes. However, this argument
8 ignores the fact that the Bankruptcy Code has separate provisions for dealing with deliberate tax
9 avoidance. Section 523(a)(1) itself makes that quite clear, as it not only exempts from discharge
10 not only the taxes listed in § 507(a)(8), but also any tax “with respect to which the debtor made a
11 fraudulent return or willfully attempted in any manner to evade or defeat such tax.” 11 U.S.C. §
12 523(a)(1)(C). Simply put, Appellee’s argument fails because the Bankruptcy Code has opted to
13 address such concerns through § 523(a)(1)(C) instead of § 523(a)(1)(A).

14 In sum, the Court finds that § 507(a)(8)(C) only applies to taxes that the debtor was
15 charged with collecting or withholding. Because CDS, not Appellant, was charged with collecting
16 the withholdings at issue in this case, Appellant’s imputed liability for those withholdings does not
17 fall under § 507(a)(8)(C) and is therefore dischargeable.

18 **IV. CONCLUSION**

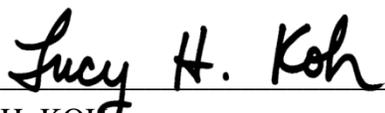
19 For the foregoing reasons, the decision of the Bankruptcy Court is REVERSED. The Court
20 REMANDS the action to the Bankruptcy Court with instruction to enter judgment for Appellant.

21 **IT IS SO ORDERED.**

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23 Dated: February 27, 2018

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LUCY H. KOH
United States District Judge

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