

STATE OF ALABAMA,
DEPARTMENT OF REVENUE,

vs.

GUNVANT H. PATEL
d/b/a Montgomery Inn
1015 West South Boulevard
Montgomery, AL 36105
Taxpayer.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 91-110

OPINION AND PRELIMINARY ORDER

The Revenue Department entered two assessments for lodgings tax against Guntant H. Patel, d/b/a the Montgomery Inn (Taxpayer).

One assessment involves the months of July and August, 1984, May, 1985, and March, April, May, June, August and October, 1987. The second assessment is for the months of May, June, August and October, 1989. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on October 14, 1993. Richard A. Lawrence appeared for the Taxpayer. Assistant counsel Gwen Garner represented the Department.

The issue in this case is whether the Alabama lodgings tax levied at Code of Ala. 1975, §40-26-1, et seq. can be discharged in a federal bankruptcy proceeding. That issue turns on whether the lodgings tax is a non-dischargeable tax as described in 11 U.S.C. §507(a)(7)(C). If the tax is non-dischargeable, a second issue is whether a penalty assessed with the tax can be discharged.

The Taxpayer operated the Montgomery Inn during the months in issue but failed to pay the State lodgings tax for those months.

The Taxpayer filed a petition for relief under Chapter 7 of Title 11 of the U.S. Code on November 3, 1989. The Department as a creditor was notified of the bankruptcy action but was directed not to file a claim because no assets existed from which to receive a dividend. The Taxpayer was discharged from bankruptcy on October 16, 1990. The Department subsequently entered the two assessments in issue on December 12, 1990.

The Taxpayer claims that the lodging taxes were discharged in the bankruptcy proceeding. The Department counters that the taxes are non-dischargeable under §507(a)(7)(C). That section provides that a tax cannot be discharged if it is "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity."

The Taxpayer argues that a tax is non-dischargeable under §507(a)(7)(C) only if it is a trust fund tax levied on someone other than the debtor and the debtor is required to collect or withhold the tax and hold it in trust for the government. Typical trust fund taxes are income taxes withheld by an employer from an employee's wages, an employee's share of federal social security taxes, and state and local sales and use taxes. See generally, Rosenow v. State of Ill., Department of Revenue, 715 F.2d 277. The Taxpayer argues that the Alabama lodgings tax is not a trust fund tax and thus is dischargeable because it is levied directly on the debtor, the Taxpayer in this case.

I recognize that the lodgings tax is not a classic trust fund tax like the sales or withholding tax. However, that is not determinative of whether the lodgings tax is non-dischargeable under §507(a)(7)(C). As stated in Rosenow, supra, at page 279, "the plain language of Section C (11 U.S.C. 507(a)(7)(C)) is not confined to 'trust fund taxes'". Rather, a tax is non-dischargeable if (1) it is required to be collected or withheld, and (2) the debtor is liable for it in whatever capacity.

Section 40-26-16 requires that the lodgings tax must be charged to and collected from the customer and cannot be absorbed by the person responsible for paying over the tax to the Department. Section 40-26-16 reads in pertinent part as follows: It shall be unlawful for any person, firm or corporation engaged in or continuing within this state in any business for which a license or privilege tax is required by this chapter to fail or refuse to add to the price of the service rendered the amount due by the taxpayer on account of the tax levied by this chapter. Nor shall any person refund or offer to refund all or any part of the amount collected as tax under this chapter or to absorb such tax or to advertise directly or indirectly the absorption or refund of such tax or any portion of the same.

The above clearly provides that the Alabama lodgings tax is "required to be collected" from the customer. It is unlawful not to collect the tax from the customer. The person collecting the tax, the Taxpayer/debtor in this case, is also clearly liable to pay over the tax to the Department. Consequently, the Alabama lodgings tax is non-dischargeable pursuant to the plain wording of §507(a)(7)(C). The lodgings taxes in issue thus were not discharged in the Taxpayer's bankruptcy proceeding.

If the taxes are not dischargeable, the next issue is whether the penalties also assessed by the Department can be discharged.

The Taxpayer argues that even if a tax is non-dischargeable, a penalty relating to the tax can be discharged if the event giving rise to the penalty (non-payment and/or non-filing of return in this case) occurred more than three years prior to the filing of the bankruptcy petition, citing In re Burns, 887 F.2d 1541. I agree.

11 U.S.C. §523(a)(7) provides that a penalty is dischargeable if (1) the underlying tax to which it relates is dischargeable, or (2) the event giving rise to the penalty occurred more than three years prior to the filing of the bankruptcy petition. The penalty is dischargeable if either of the above applies. See, In re Burns, supra, at page 1544.

The bankruptcy petition in this case was filed on November 3, 1989. Thus, any penalty relating to a period more than three years prior to that date, or before November 3, 1986, should be discharged.

The Department is directed to delete the penalties assessed for the months of July and August, 1984 and May, 1985, and thereafter notify the Administrative Law Division of the adjusted amounts due. A Final Order will then be entered. The Final Order when entered may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on November 24, 1993.

BILL THOMPSON
Chief Administrative Law Judge