

## **In Deed and Thought: Elements of the § 523(a)(1)(C) Exception to Discharge**

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Extern to Judge Harlin DeWayne Hale

United States Bankruptcy Judge

A recent opinion from Bankruptcy Judge Barbara Houser, *In re Mixon*,<sup>1</sup> illustrates the kind and degree of debtor behavior which falls under the exception to the presumption of discharge for tax obligations. The decision effectively provides a roadmap of action not to take while negotiating with the IRS. In her opinion, Judge Houser determined that the Debtor's tax liabilities were excepted from discharge under 11 U.S.C. § 523(a)(1)(C) and found that their conduct distinguished them from the "honest but unfortunate debtor"<sup>2</sup> for whom the discharge is intended.

### Facts

In September 2005, Kevin and Jamie Mixon ("the Mixons") voluntarily filed their "no asset" bankruptcy petition under Chapter 7. After the Court entered an order discharging the debtors, the IRS filed an adversary complaint in September 2007. The IRS contended that the Mixons owed \$656,376.21 in non-dischargeable debt including accrued statutory interest. During the years in question, Kevin Mixon owned and operated Color Quest, Inc., and was required to make estimated tax payments. The Mixons reported their adjusted gross income ("AGI") to the IRS to be nearly \$1.6 million for the years 1998-2001. For each of the years in question, the Mixons never paid either withholding or estimated taxes. Further, the Mixons sought at least one (and sometimes two) filing extensions for each year in question. While the Mixons eventually paid their 1998 taxes, they did not make payments towards the penalties or

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<sup>1</sup> *U. S. v. Mixon (In re Mixon)*, 2008 WL 2065895 (Bankr. N.D. Tex., May 13, 2008).

<sup>2</sup> *In re Kevin Scott Mixon and Jamie J. Mixon*, 28 (Bankr. N.D. Tex. May 13, 2008).

interest owed as a result of their failure to make estimated tax payments and their failure to pay the taxes when due. From 1999-2001, the Mixons totally avoided paying their taxes, penalties and interest resulting in a federal income tax debt that then totaled in excess of \$500,000.

Although not all of the years from 1998-2008 were at issue, the facts importantly show that the Mixons made only two voluntary income tax payments during that period. Additionally, the Mixons late-filed their returns for the years 2002-2008. Since the Mixons were at all relevant times aware of their duty to file tax returns and the deadlines for doing so, inadvertence or unawareness were not viable defenses.

After the IRS filed three different liens against the Mixons for their unpaid taxes during the 1998-2001 period, the Mixons gave the IRS an offer in compromise (“OIC”) to settle the debt.<sup>3</sup> On the basis of “Doubt as to Collectability,”<sup>4</sup> the Mixons stated that they had insufficient assets to pay the full \$500,000 debt owed and therefore offered to pay \$165,000.<sup>5</sup> In support of the OIC, the Mixons gave the IRS an IRS 433-A Collection Information Statement for Wage Earners and Self-Employed Individuals (“Form 433-A”). Signed under penalty of perjury, the Form 433-A contained information about the Mixons’ income, assets, and liabilities. However, just a month after filing the OIC and Form 433-A, Kevin Mixon provided materially different information regarding his income, assets, and liabilities on a personal financial statement to Pavillion Bank for the purpose of buying a car. The statements differed materially as to cash, ownership of vehicles, and total net worth. Judge Houser found that the Mixons were clearly “lying to either the IRS or Pavillion Bank and have continually painted differing pictures of their financial condition to the IRS, Pavillion Bank and the Court.”<sup>6</sup> The Mixons also purchased an

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<sup>3</sup> *Id.* at \*4.

<sup>4</sup> “I have insufficient assets and income to pay the full amount.” *Id.* quoting Gov’t Ex. 11.

<sup>5</sup> The Mixons offered to pay \$75,000 within 90 days followed by \$1,100 payments per month for 84 months.

<sup>6</sup> *Id.*

acre of land one month after filing their OIC. While they did not make a cash down payment, they did obligate themselves to pay \$279.00 per month for the land. Lastly, the Mixons undervalued the land by \$33,000 and failed to disclose it on any other Form 433-A submitted to the IRS. The IRS accordingly rejected the OIC since the Mixons had sufficient assets to pay their debt in full.

Further, Kevin Mixon used a credit card and a corporate checking account in the name of his father's company (David Mixon & Associates) for expenses that were not disclosed to the IRS on the OIC. David Mixon permitted his son, Kevin, to use the card as long as Kevin paid his "share" of the American Express bill directly to American Express. This arrangement permitted Kevin to hide income from the IRS. For instance, in 2001 Kevin Mixon incurred and paid over \$140,000 on the American Express card. In 2002 when the Mixons submitted their OIC claiming that their expenditures were greater than their \$10,000 monthly income, the record showed that Kevin incurred and paid \$87,000 on the card. Further, Kevin Mixon was incurring and paying charges during the months preceding filing the case despite that fact that he testified at his 341 meeting that he had no income. The court held "the compelling and inescapable inference from this evidence is that Kevin Mixon was incurring charges" in order to hide income from the IRS.<sup>7</sup>

The Mixons also used their Color Quest corporate account to pay their personal expenses. On the date that the OIC was signed, Color Quest had over \$247,000 in its corporate checking account which was being used in part to pay the Mixons' personal living expenses. For instance, in 2002 expenses for 24 Hour Fitness, dry cleaning, and a vacation were all incurred and paid the month that the Mixons swore under penalty of perjury that their monthly income was \$10,000 per month and they were unable to pay more than \$1,100 towards their tax liability. While

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<sup>7</sup> *Id.* at \*8.

Kevin Mixon testified that he would quit using business accounts for personal expenses, the court found this testimony to be false and that Kevin lacked credibility because he used his new corporation, Lone Star Graphics, to fund personal expenses in 2006. The court held that the Mixons willfully attempted to evade or defeat their taxes by using their corporate checking accounts to “prevent the IRS from levying on the accounts and collecting their income tax debt.”<sup>8</sup>

Since both the conduct and mental state elements of the § 523(a)(1)(C) test were met,<sup>9</sup> Judge Houser ruled in the IRS’ favor. The preponderance of the evidence showed that the Debtors willfully “attempted to evade or defeat their 1998-2001”<sup>10</sup> tax liabilities thereby excepting those liabilities from discharge. In looking at the totality of circumstances to determine if the exception to discharge applies, the conduct element can be satisfied by acts of commission or culpable acts of omission.<sup>11</sup> Non-payment of tax liabilities, chronic late-filing of returns, maintaining a lavish lifestyle while concurrently failing to pay taxes, and placing assets in the names of others are all factors that have established the conduct element.<sup>12</sup> Judge Houser found that four instances of the Mixons’ behavior established the element in this case: 1) complete failure to pay any tax liabilities for 1999-2001 despite their high AGI; 2) ownership of at least 7 vehicles, an RV, a trailer, and a boat with combined monthly payments of \$9,000 per month while offering to pay the IRS only \$1,100 per month in the OIC; 3) use of an American Express card in the name of his father’s company allowing Kevin to hide income from the IRS;

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<sup>8</sup> *Id.* at \*10.

<sup>9</sup> *In re Toti*, 24 F.3d 806, 809 (6<sup>th</sup> Cir. 1994).

<sup>10</sup> *Id.* at 28.

<sup>11</sup> *In re Jacobs*, 490 F.3d 913, 925-27 (11<sup>th</sup> Cir. 2007).

<sup>12</sup> See *U.S. v. Swenson (In re Swenson)*, 381 B.R. 272 (Bankr. E.D. Cal. 2008); *In re Gardner*, 360 F.3d 551, 557 (6<sup>th</sup> Cir. 2004); *Volpe v. IRS (In re Volpe)*, 377 B.R. 579 (Bankr. N.D. Ohio 2007).

4) use of a corporate account to pay their personal expenses allowing them to hide assets from the IRS.

Like the conduct element, the mental state element is determined in light of the totality of the circumstances where all inferences to be drawn about the debtor's state of mind come from his conduct. The mental element is satisfied where a debtor (1) has a duty under the law to pay the debt; (2) knew of the duty; and (3) voluntarily and intentionally violated that duty.<sup>13</sup> Notably, fraudulent intent is not a requirement to prove the mental state element.<sup>14</sup> While nonpayment of taxes alone is insufficient to prove the element, "failure to pay a known tax is relevant evidence for the court to consider."<sup>15</sup> Additionally, a debtor may not use the presence of an OIC to negate the mental element.<sup>16</sup> Judge Houser found that the Mixons were aware of their duty to pay their tax liability and that much of the same evidence used to prove the conduct element evidenced willful evasion of the taxes owed. In addition, the court held that the following behavior of the Mixons proved the mental element: 1) acquisition and enjoyment of expensive assets while not facing their tax liability; 2) offering far less money on the OIC than they were able to pay; 3) expenditure of money they could have used to pay their tax liability; 4) enjoyment of assets held in the name of family members and friends to reduce collection sources for the IRS.<sup>17</sup>

### Conclusion

This case illustrates that where a debtor's deeds and thoughts evidence a willful attempt to evade or defeat his tax liability, the discharge exception under 11 U.S.C. § 523(a)(1)(C)

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<sup>13</sup> *In re Bruner*, 55 F.3d 195 (5<sup>th</sup> Cir. 1995).

<sup>14</sup> *In re Fegeley*, 118 F.3d 979, 984 (3d Cir. 1997).

<sup>15</sup> *Id.*; quoting *In re Birkenstock*, 87 F.3d 947, 951 (7<sup>th</sup> Cir. 1996).

<sup>16</sup> The Ninth Circuit upheld the exception from discharge where it found that the debtor's cooperation with the IRS was "belated acceptance of responsibility" and not an honest attempt to comply with the law. *In re Hatton*, 220 F.3d 1057, 1061 (9<sup>th</sup> Cir. 2000).

<sup>17</sup> *In re Mixon* at \*14.

applies. Further, the decision provides guidance to debtors on how they should behave shortly before a bankruptcy case is filed. Perhaps debtors' counsel use Judge Houser's opinion to show his or her clients the consequences of dishonest conduct. As in most bankruptcy matters, honesty, consistency, and transparency underlie obtaining and maintaining a discharge.