



Priority Tax Claims Corporate Bankruptcy 11 Us Code 507

*Priority Tax Claims in Corporate Bankruptcy (11 U.S.C. §
507(a)(8))*

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Overview of § 507(a)(8) Tax Priorities in Bankruptcy

In U.S. corporate bankruptcies, certain **tax debts owed to governmental units** are given eighth-priority status under 11 U.S.C. § 507(a)(8) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). These priority taxes must be paid in full in a Chapter 11 plan (unless the taxing authority agrees otherwise) and are paid before general unsecured claims in liquidation. Section 507(a)(8) enumerates **seven categories of tax claims** entitled to priority (A through G), covering recent income taxes, property taxes, “trust fund” taxes, employment taxes, excise taxes, customs duties, and certain tax penalties ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). The statutory language sets **time limits** (look-back periods) for many taxes, reflecting Congress’s intent that only relatively **recent tax liabilities** (or those the debtor was required to collect/trust funds) receive priority ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). Below, we detail each category in § 507(a)(8), the legal interpretation of each tax type’s priority status, and illustrative case law (primarily from corporate bankruptcy contexts). A subsequent section focuses on **city and municipal taxes** under these provisions.

Priority Tax Categories under 11 U.S.C. § 507(a)(8)

To aid comprehension, the table below summarizes the § 507(a)(8) tax categories, their scope, and example case law outcomes:

Tax Category (Code § 507(a)(8))	Priority Scope and Conditions	Illustrative Case Law
Income or Gross Receipts Taxes (A)	Taxes “on or measured by income or gross receipts” for a tax year ending pre-bankruptcy. Priority if the tax return was due (with extensions) within 3 years before the filing, or if the tax was assessed within 240 days pre-filing (plus certain tolled periods), or if still assessable at petition time (excluding late/fraudulent returns) (11 U.S. Code § 507 - Priorities U.S. Code US Law LII / Legal Information Institute) (11 U.S. Code § 507 - Priorities U.S. Code US Law LII / Legal Information Institute).	In re Morgan, 182 F.3d 775 (11th Cir. 1999) – held the 3-year lookback is not automatically tolled by a prior bankruptcy (absent statute) ([Morgan v. U.S., 98-8159 (182 F.3d 775) - vLex United States
Property Taxes (B)	Property taxes incurred before bankruptcy. Priority only if the tax was last payable without penalty within 1 year before the filing (11 U.S. Code § 507 - Priorities U.S. Code US Law LII / Legal Information Institute). (Older property taxes fall to general unsecured status.)	In re SGR Winddown (f/k/a Modell’s Sporting Goods), 2021 – NYC’s Commercial Rent Tax was held to be a property tax under § 507(a)(8)(B), not an excise, and because it fell outside the 1-year window it was denied priority (In re SGR Winddown, Inc. Case No.

[19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). *In re Parr Meadows*, 880 F.2d 1540 (2d Cir. 1989) – property tax “incurred” on lien date prepetition got priority (even if payable post-petition). |

| **“Trust Fund” Taxes (Collected/Withheld) (C)** | Taxes a debtor is **required to withhold or collect from others** and remit (e.g. employee wage withholding, sales tax collected from customers). These are often called *trust fund taxes*. **No time limit** – any such unpaid trust-fund tax is priority ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). | *In re Calabrese*, 689 F.3d 312 (3d Cir. 2012) – state sales taxes collected from customers are trust fund taxes under § 507(a)(8)(C) and **never dischargeable** ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) (thus always priority regardless of age). Other courts agree that taxes like withheld income/FICA or sales tax are covered by (C) as debtor holds the funds in “trust” ([*In re Calabrese* (56 Bankr.Ct.Dec. 224,689 F.3d 312) - vLex United States

](<https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=,It%20should>)). |

| **Employment Taxes on Wages (D)** | Taxes on wages, salaries, or commissions **earned by employees** of the debtor before filing (covers the employer’s own payroll tax obligations). Priority if the tax return for such tax was due within 3 years before bankruptcy ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). (This includes, for example, the employer’s share of FICA or state unemployment contributions.) | *Boston Reg’l Med. Ctr. v. Mass. Div. of Employment*, 291 F.3d 111 (1st Cir. 2002) – a nonprofit hospital elected to reimburse the state for unemployment claims instead of paying taxes; the First Circuit held the claim was **“not based on a tax”** and thus got **no § 507(a)(8) priority** ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants, 291 F.3d 111 \(1st Cir. 2002\) :: Justia](#)). (Had it been a normal unemployment **tax contribution**, it would qualify as a priority excise tax in (E).) Courts generally treat *mandatory* employer payroll

taxes as priority **“taxes”**, but distinguish voluntary arrangements or fees not imposed as a tax ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants, 291 F.3d 111 \(1st Cir. 2002\) :: Justia](#)) ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants, 291 F.3d 111 \(1st Cir. 2002\) :: Justia](#)). |

| **Excise Taxes** (E) | **Excise taxes** – broadly, taxes on particular goods, transactions, or activities (not based on income or property). Examples: fuel taxes, sales/use taxes (if not classified under (C)), franchise taxes for doing business, etc. Priority applies if the transaction occurred within 3 years pre-bankruptcy (if a return is required, its due date must be within 3 years; if no return required, the transaction itself must be within 3 years) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). | *United States v. Reorganized CF&I Fabricators*, 518 U.S. 213 (1996) – the Supreme Court ruled that a 10% IRC §4971 “tax” on pension underfunding was **not** an “excise tax” entitled to priority, but rather a **punitive penalty** to be treated as a general unsecured claim ([](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims)) ([](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226)). By contrast, *In re Creative Hairdressers, Inc.*, 2022 WL 543609 (Bankr. D. Md. 2022) – held that the **ACA employer mandate** payment (26 U.S.C. §4980H) is an **“excise tax”** for § 507(a)(8)(E) purposes, giving it priority for the portion arising in the 3 years before filing ([Bankruptcy and IRC Section 4980H - Freeman Law](#)) ([Bankruptcy and IRC Section 4980H - Freeman Law](#)). |

| **Customs Duties** (F) | **Import duties** owed to the U.S. on merchandise imported by the debtor. Priority if the goods were entered for consumption within 1 year before bankruptcy, or the entry was liquidated in that year,

or (for unliquidated entries up to 4 years old) liquidation was delayed by an antidumping/countervailing duty investigation ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). | *In re Airlift Int'l* (Bankr. S.D. Fla. 1989) – (implied) customs duties for the year before filing were treated as priority. (Case law on (F) is sparse, but the Code’s plain terms govern; recent amendments in 2020 also prevent subrogation of customs priority ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)).) |

| **Certain Tax Penalties** (G) | **Tax penalties** related to the above taxes, *but only* if they are “**in compensation for actual pecuniary loss**” ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). This generally covers **interest** on tax or penalties that reimburse the government’s costs. Purely punitive fines or penalties *not* compensatory are *excluded* from priority (they become general unsecured claims). | *City of Milwaukee v. Peete (In re Peete)*, No. 21-23863, 2022 WL 2827398 (Bankr. E.D. Wis. June 30, 2022) – **Interest** on a city property tax was priority (compensating the city for delay in payment), but “**special charges**” penalties for code violations were **not** priority because they were punitive/regulatory, not general revenue taxes ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). The court thus gave priority only to the \$903 tax plus \$54 interest, rejecting the rest ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). In general, courts hold that **non-pecuniary tax penalties** do **not** get §507(a) priority (and in Chapter 7 liquidations, such penalties are subordinated behind other unsecured claims ([<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims>])). |

- *Key interpretation principles: **In determining whether an obligation fits one of these priority tax categories, courts apply federal law definitions**** and look to the substance of the charge rather than its label ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) |](#)

- [Bankr. D. Del. | Judgment | Law | CaseMine](#)) ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). For example, the label “tax” in a state statute is not dispositive if the charge is essentially a fee or penalty. The Supreme Court in *City of New York v. Feiring*, 313 U.S. 283 (1941), established that whether something is a “tax” for bankruptcy priority is decided by federal standards, generally asking if it is an involuntary pecuniary burden **levied for a public purpose** (i.e. to support government functions) as opposed to a fee for a private benefit ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). This functional approach was reaffirmed in *Reorganized CF&I*, where the Court refused priority to a so-called “tax” that was actually designed to punish non-compliance with pension funding laws ([<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26l%E2%80%99s,to%20claims>)) ([<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226>)).

Courts also **strictly enforce the look-back periods** in §507(a)(8). Taxes falling outside the specified age (e.g. income taxes from tax years more than 3 years before filing, or property taxes last payable over a year before filing) will **not** be priority claims absent tolling or an exception. For instance, in the corporate context of *In re Morgan*, the debtor’s income tax debts were from years *just outside* the 3-year window; the Eleventh Circuit refused priority because the Bankruptcy Code (at that time) did not toll the period during a prior bankruptcy ([*Morgan v. U.S.*, 98-8159 (182 F.3d 775) - vLex United States

[<https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994>)). (The Supreme Court later allowed equitable tolling of the 3-year period during prior bankruptcies (*Young v. United States*, 535 U.S. 43 (2002)), and in 2005 Congress amended §507(a)(8) to expressly suspend these time periods during certain collection stays ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)).) Overall, if a tax claim doesn’t meet the category’s timing and nature requirements, it defaults to non-priority

status (though it might still be nondischargeable in individual cases under §523).

Case Law Analysis by Tax Type

Let's delve further into each tax type's treatment and major court decisions:

1. Taxes on Income or Gross Receipts – § 507(a)(8)(A)

- ***Statutory Language: Priority covers any “tax on or measured by income or gross receipts” for a taxable year that ended on or before the bankruptcy filing date ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). To qualify, one of three timing conditions must be met: (i) the tax return due date (including extensions) was within 3 years before the filing; (ii) the tax was assessed by the government within 240 days before filing (excluding time tolled by any offer in compromise or prior stay) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)); or (iii) the tax was not yet assessed but was assessable** post-petition (for example, if the debtor could still be audited for that year) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). However, clause (iii) explicitly *excludes* taxes associated with unfiled or fraudulent returns (those fall outside priority) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). In sum, recent income taxes—typically from the last three tax years before bankruptcy—are given priority status ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)).**
- ***Court interpretations: Courts have grappled with the “look-back” periods, especially the 3-year window. A key issue has been whether this period is tolled (paused) during events like a prior bankruptcy case or an offer in compromise. Historically, there was a split: some courts allowed equitable tolling** of the 3-year**

- period during a debtor’s prior bankruptcy (when the IRS was stayed from collecting), while others read the Code strictly as not providing tolling ([Morgan v. U.S., 98-8159 (182 F.3d 775) - vLex United States

](https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994)). For example, the Eleventh Circuit in *Morgan v. IRS* held that absent explicit authority, the 3-year priority period runs continuously and **is not automatically tolled** by a prior bankruptcy filing ([Morgan v. U.S., 98-8159 (182 F.3d 775) - vLex United States

](https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994)). (In *Morgan*, debtors who had been in an earlier Chapter 13 argued their old income taxes were beyond 3 years and not priority, but the IRS successfully argued in bankruptcy court for tolling; the Eleventh Circuit reversed, refusing to find tolling without statutory basis ([Morgan v. U.S., 98-8159 (182 F.3d 775) - vLex United States

](https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=a%20priority%20claim,We%20vacate%20and%20remand)) ([Morgan v. U.S., 98-8159 (182 F.3d 775) - vLex United States

](https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994)).) This issue was resolved by the Supreme Court in *Young v. United States*, 535 U.S. 43 (2002), which held that equitable tolling *does* apply – a prior bankruptcy’s automatic stay **stops the clock** on §507(a)(8)(A)(i)’s 3-year period, to prevent debtors from running out the clock by serial filings. Congress later amended §507(a)(8) in 2005 to codify certain tolling rules (e.g. suspending time while a tax collection injunction or stay is in place) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)).

Another interpretive point involves **when a return is “last due”** (for the 3-year rule). Courts uniformly include any valid extension of the due date in that calculation ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). Thus, if a corporate income tax return was due April 15, 2020 but an extension to Oct 15, 2020 was obtained, and the

company filed bankruptcy on Oct 14, 2023, the return's due date (Oct 15, 2020) is just within 3 years – the tax claim gets priority. If the filing was after Oct 15, 2023, the 3-year window would ordinarily be expired (absent other tolling events).

- *Case examples:** Besides *Morgan* (11th Cir. 1999) and *Young* (U.S. 2002) on tolling, courts have addressed nuances like what constitutes an **“assessment”** or if amended returns/recalculations restart the 240-day clock. In *In re Jones*, 2018 WL 2163563 (Bankr. N.D. Tex. 2018), the court noted that an IRS assessment (e.g. after an audit) within 240 days of filing secures priority ([In re Jones - Case Law - VLEX 887195110](#)). If a tax was assessed long before bankruptcy and not within 240 days, it might still qualify under the 3-year rule or not at all. Another example is *Schatz v. California FTB* (*In re Schatz*), 222 B.R. 867 (9th Cir. BAP 1998), where a late self-assessment by the debtor was deemed the “assessment” for starting the 240-day period ([TAX LIABILITIES NOT DISCHARGEABLE IN BANKRUPTCY. | Tax ...](#)). Generally, **income taxes older than the 3-year/240-day thresholds** (and with no tolling) are treated as **non-priority** (in Chapter 7 they can be discharged if other conditions met, since they're not within §507(a)(8) ([Dischargeability of Taxes in Bankruptcy - Mankus & Marchan, Ltd.](#))).

Importantly, “income or gross receipts” taxes include not just federal and state corporate income taxes, but also state **gross receipts levies** (for instance, Delaware's corporate franchise tax if measured by capital stock/assets may be considered an “excise,” but something like Washington's business & occupation tax, measured by receipts, fits (A)). Courts have occasionally had to classify a given tax as an “income/receipts tax” versus an “excise.” For example, Pennsylvania's corporate **franchise tax** (capital stock tax) was held to be an *excise* (not measured by income), whereas a **commercial activity tax** based on gross receipts would fall under (A). The distinction matters for the look-back period length (3 years for income taxes vs. potentially 3 years for excise as well) and for dischargeability. Generally, if a tax base is **gross revenue or net income**, courts treat it as within §507(a)(8)(A).

2. Property Taxes – § 507(a)(8)(B)

- *Statutory Language: **Priority is given to** “a property tax incurred before the commencement of the case and last payable without penalty after one year before the filing” ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). In essence, a property tax that became due (payable without interest/penalty) during the year immediately preceding bankruptcy gets priority. Any earlier property taxes (due >1 year before filing) are too old to qualify. For a corporate debtor, this typically covers the most recent annual cycle of real estate or personal property taxes owed to states or localities. Notably, BAPCPA amended this provision to use “incurred” rather than “assessed,” so that priority doesn’t hinge on a jurisdiction’s technical assessment date ([11 U.S. Code § 507 - Priorities - Cornell Law School](#)). A tax is “incurred” on the date the taxable event** occurs (e.g. ownership of property during the period).
- *Court interpretations: **Courts have clarified what it means for a property tax to be “incurred” and “last payable without penalty” within one year.** The incurrence** is generally when the tax lien attaches or the tax year begins. For example, if a county’s property tax for the 2024 tax year attaches on January 1, 2024, and the tax is payable by July 31, 2025 without penalty, then if a bankruptcy is filed in August 2025, that 2024 tax was last payable without penalty within one year pre-filing (July 2025) and is priority. If the debtor filed after July 31, 2026, that 2024 tax would no longer meet the one-year condition.

A leading early case, *In re Parr Meadows, Inc.*, 880 F.2d 1540 (2d Cir. 1989), held that a property tax assessed for the year of bankruptcy (but not yet billed) was **incurred prepetition** and thus an unsecured claim (potentially priority if within a year) rather than an administrative expense. The decision underscored that **pre-petition property taxes are addressed by §507(a)(8)(B)** even if the payment due date comes post-petition.

Courts also decide whether certain levies are true “property taxes.” For instance, a **special assessment** for municipal improvements, or user fees on property, may not qualify as a property tax. The statute doesn’t explicitly define “property tax,” so courts apply the functional test – is it an involuntary charge on property ownership for public purposes? In *In re SGR Winddown, Inc.* (Modell’s Sporting Goods), a Delaware bankruptcy court had to classify New York City’s **Commercial Rent Tax (CRT)** – a tax on commercial real estate leases. NYC argued it was an excise tax (3-year rule), debtor argued it was a property tax (1-year rule). Judge Walrath concluded the CRT “is not an excise tax... but is instead a tax on **the possession or use of property**,” i.e. a property tax under §507(a)(8)(B) ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). Because the CRT in that case was for periods ending more than one year before bankruptcy, it **failed the 1-year test and was denied priority** ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). This exemplifies that how a tax is characterized (property vs excise) can affect priority: a tax deemed “property tax” must meet the shorter 1-year look-back, even if the taxing authority would have preferred the 3-year excise window ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)) ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)).

- ***Case examples:**** Aside from *SGR Winddown (CRT)*, consider *In re Indian Lake Estates, Inc.*, 636 F.2d 1309 (5th Cir. 1981) (under old Act) which found ad valorem property taxes incurred pre-bankruptcy were entitled to priority if within the year. In modern practice, a straightforward example is if a corporation files Chapter 11 on December 1, 2025, and city property taxes for fiscal year 2024–25 were due without penalty on August 31, 2025 – those taxes get priority. But taxes for 2023 (due August 2024 or earlier) would not.

Courts also handle cases where tax bills include **interest or penalties**: interest on a priority property tax shares the priority (as a compensatory charge), whereas penalties for late payment do not (unless they compensate actual costs) ([Special Charges Not Included in Priority Tax](#)

[Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). (This was seen in *In re Peete*: the city's claim for 2018-2019 property taxes included charges for delinquent utilities and code enforcement - the court found those were *not* property taxes for public benefit and thus no priority ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)), whereas the base tax and interest were priority ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)).)

3. Trust Fund Taxes (Withheld/Collected Taxes) – § 507(a)(8)(C)

- Statutory Language: **Subparagraph (C) grants priority to** “a tax required to be collected or withheld and for which the debtor is liable in whatever capacity.” ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). **This covers any tax where the debtor acts as a conduit or trustee, collecting tax money from a third party and holding it for the government. Classic examples are: employee wage withholdings (income tax withholding and the employee's share of FICA payroll tax) and sales taxes that a business must collect from customers. The debtor is liable for these trust-fund taxes even though the tax is actually owed by another (the employee or customer) - hence, the Code makes the debtor liable “in whatever capacity” (as a withholding agent, etc.).** Importantly, there is no time limitation* on trust fund taxes in §507(a)(8)(C)** - even older unpaid trust taxes retain priority status ([*In re Calabrese* (56 Bankr.Ct.Dec. 224,689 F.3d 312) - vLex United States

](<https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=Thre%20of%20our%20sister%20courts,statutory%20text%20of%20%C2%A7>

%20507)). This reflects the policy that these funds were never truly the debtor's property; the debtor held them in trust for the government.

- *Court interpretations: **Courts uniformly recognize that (C) encompasses so-called “trust fund” taxes**** – those collected on behalf of the government. The paradigmatic case is the employer who withholds federal income and Social Security taxes from employees' paychecks but fails to remit them. Even if those withholdings occurred many years before bankruptcy, they are entitled to priority (and are also excepted from discharge for individual debtors) ([In re Calabrese (56 Bankr.Ct.Dec. 224,689 F.3d 312) - vLex United States

]([https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=Three%20of%20our%20sister%20courts,statutory%20text%20of%20%C2%A7%20507\)\)](https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=Three%20of%20our%20sister%20courts,statutory%20text%20of%20%C2%A7%20507)))). The same goes for state sales taxes that are structured as being collected from the customer. For instance, the Third Circuit in *In re Calabrese* confronted whether state sales tax debts should be treated as “excise taxes” or “trust fund” taxes. The debtor (a business owner) argued they were excise taxes that were old enough to be discharged; the state argued they were trust fund taxes. The Third Circuit examined the NJ sales tax law (which required the merchant to collect a set percentage from customers) and joined other circuits in holding that **sales taxes paid by customers are trust fund taxes under §507(a)(8)(C)** ([In Re: Michael Calabrese, Jr. v., 689 F.3d 312 \(3rd Cir. 2012\)](#) [#:~:text=2012%29%20www,\)](#) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)). The court emphasized the significance: trust fund taxes are never dischargeable and have no staleness cutoff ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)). It affirmed that Calabrese's sales tax debt was priority/nondischargeable, aligning with decisions from the Second, Seventh, and Ninth Circuits on similar sales tax issues ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)).

Courts look at the **substance of the tax obligation**: if the law requires the debtor to collect or withhold, it falls in (C). This can lead to nuanced distinctions. For example, some states have **“sales tax” vs “use tax”**

regimes: if a state technically imposes the tax on the retailer's gross receipts (an excise on the seller) rather than on the consumer, some courts might classify it under (E) instead of (C). However, most sales taxes are structured to be collected from the consumer, thus fitting (C). In *Matter of Groetken*, 843 F.2d 1007 (7th Cir. 1988), the Seventh Circuit parsed Illinois's sales tax (an occupation tax on retailers) versus the complementary use tax. It concluded the tax in question was effectively on the seller's receipts (thus not a trust fund tax), but noted the complexity. The **majority rule** is that **trust-fund status trumps** – if any portion of a tax is essentially held in trust (e.g. a statutory trust is imposed on collected taxes), courts will treat it under (C).

It's also settled that **withheld federal income/FICA taxes** are in (C). Even though the employer also owes an "employer's share" of FICA, the **employee's portion** that was withheld is 507(a)(8)(C) (trust fund), while the employer's portion is not collected from someone else and thus falls under a different category ((D) or (E)). The Internal Revenue Code itself labels the withheld sums as held "in trust" for the United States, and bankruptcy law respects that by giving them priority ([In the Matter Of: Dudley Davis Taylor, Debtor.internal Revenue ...](#)).

- *Case examples:** *United States v. Energy Resources Co.*, 495 U.S. 545 (1990) – although not about priority per se, this case noted the distinction of trust fund taxes in chapter 11 plans (courts can designate payments to trust fund portion first because they're unique). *In re Hansen*, 470 B.R. 535 (Bankr. N.D. Ga. 2012) – confirmed that a debtor's liability for unremitted employee withholdings was priority. On the other hand, if a debtor failed to withhold taxes that it should have (say it paid employees cash and didn't withhold), the IRS will assess a "trust fund recovery" penalty on the responsible person. That penalty is treated as a tax debt of the individual responsible, but for the corporate debtor it might manifest as an unpaid payroll tax (still priority).

The bottom line is that bankruptcy courts **take a hard line against debtors using trust taxes as working capital** – those taxes are priority no matter how old. As the Third Circuit noted in *Calabrese*, §507(a)(8)(C) is unique in that "in contrast to all other portions of

§507(a)(8), there is no explicit time limit” for trust fund taxes ([In re Calabrese (56 Bankr.Ct.Dec. 224,689 F.3d 312) - vLex United States

](https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=match%20at%20L661%20,it%20should)))). Thus, corporate debtors cannot discharge or avoid these by simply waiting out a period.

4. Employment Taxes on Wages – § 507(a)(8)(D)

- *Statutory Language: **This subsection covers** “an employment tax on a wage, salary, or commission”** of the kind specified in §507(a)(4) (wages priority) earned from the debtor before filing, for which the tax return due date (under law or extension) was within 3 years before the bankruptcy filing ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). In plain terms, this gives priority to **employer-paid taxes on payroll**, as long as they pertain to employee wages earned prepetition and are fairly recent. The reference to §507(a)(4) (which is the priority for employees’ wage claims earned in the 180 days pre-bankruptcy) suggests Congress wanted to align the scope – if an employee’s wage is a priority claim, the associated employer payroll tax should be priority too (if recent). Examples include the **employer’s share of FICA** (Social Security/Medicare tax) and **federal and state unemployment taxes (FUTA/SUTA)**. These taxes are usually reported on quarterly or annual returns (Form 941 for FICA, Form 940 for FUTA, etc.), so the 3-year rule means roughly the last 12 quarters of payroll tax returns could be priority.
- *Court interpretations: **There is relatively less litigation specifically on (D), because many disputes about payroll taxes focus on the trust fund portion (C) or on whether something is a “tax” at all. Generally, courts agree that** employer payroll taxes qualify as excise/employment taxes** entitled to priority if recent. For instance, *In re Garcia*, 955 F.2d 16 (5th Cir. 1992), observed that the employer’s share of FICA and FUTA, being taxes on employing people, fit into the priority scheme (though that case was about dischargeability).

One area of case law involves **unemployment insurance** obligations of employers. Most states impose a tax on employers to fund unemployment benefits (which would fall under (D) or (E) as an excise tax). However, nonprofits and governments often have the option to self-insure by reimbursing the unemployment fund for actual claims paid (in lieu of paying the tax contributions). This led to the issue in *Boston Regional Medical Center v. Massachusetts Division of Employment*, 291 F.3d 111 (1st Cir. 2002). There, a nonprofit hospital had terminated many employees pre-bankruptcy; as a reimbursing employer it owed the state \$3+ million for unemployment benefits paid out. The state argued this was a priority “tax on wages” under §507(a)(8)(D) (or an excise under (E)). The First Circuit disagreed, finding that because the hospital **opted out of the tax system** and into a reimbursement scheme, its obligation was **“not based on a tax”** at all ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants](#), 291 F.3d 111 (1st Cir. 2002) :: Justia) ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants](#), 291 F.3d 111 (1st Cir. 2002) :: Justia). It was essentially a contractual reimbursement liability, not an involuntary tax. Therefore, none of §507(a)(8) applied, and the claim was treated as general unsecured (except a small portion deemed administrative for post-petition layoffs) ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants](#), 291 F.3d 111 (1st Cir. 2002) :: Justia). This case illustrates that **courts will examine the nature of the obligation**: had the hospital been a regular contributing employer, the unpaid contributions likely qualify as a tax priority (courts have often held unemployment contributions are taxes for bankruptcy purposes ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of](#)

[Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants, 291 F.3d 111 \(1st Cir. 2002\) :: Justia](#))). But a voluntary reimbursement arrangement was not afforded priority.

Another example: **workers' compensation premiums**. These are not exactly "employment taxes," but some states run workers' comp as a state fund financed by employer premiums. Courts split on whether those premiums are taxes. The First Circuit in *Pan Am Paper Mills*, 618 F.2d 159 (1st Cir. 1980), under the Bankruptcy Act, held Puerto Rico's workers' comp premiums were "taxes" entitled to priority ([In Re: Boston Regional Medical Center, Inc., Debtor.commonwealth of Massachusetts Division of Employment and Training, Appellant, Cross-appellee, v. Boston Regional Medical Center, Inc., Official Committee of Unsecured Creditors, Appellees, Cross-appellants, 291 F.3d 111 \(1st Cir. 2002\) :: Justia](#))). But the Sixth Circuit in *In re Suburban Motor Freight*, 998 F.2d 338 (6th Cir. 1993), found Ohio's workers' comp obligation was more like an insurance premium than a tax (providing a direct benefit to employees), and thus **not** entitled to priority. These cases, while not about (D) specifically, show the analytical approach: if the charge is an involuntary societal burden (like unemployment insurance that funds the public scheme), it leans toward tax. If it's a quid pro quo for coverage, it may not.

In the federal context, there is little doubt that **FICA and FUTA taxes** are covered. FICA has two halves – the employee half (withheld, priority via (C)) and the employer half (priority via (D) if within 3 years). FUTA is solely employer-paid (an excise on payroll), so it falls under (D)/(E). Courts typically categorize FUTA as an excise tax on employing persons, subject to the 3-year rule under either (D) or (E). (D) was added to ensure **wage-based taxes** get priority similar to the wages themselves.

- *Case examples:** *In re DeChile*, 334 B.R. 544 (Bankr. M.D. Fla. 2005) – held that federal unemployment (FUTA) taxes for the three years prepetition were priority claims. *In re MF Global Holdings Ltd.*, 2012 WL 734175 (Bankr. S.D.N.Y. 2012) – the court treated the debtor's unpaid state unemployment contributions as excise taxes entitled to priority

- (implying they met the 3-year rule). The nuance between (D) and (E) isn't heavily litigated because both often yield the same result (3-year priority) for these taxes. Practically, the IRS will simply claim priority for all portions of recent payroll tax debt, citing §507(a)(8)(C) for the trust part and (D) (or (E)) for the employer part ([In re Calabrese - Case Law - VLEX 890182461](#)).

5. Excise Taxes – § 507(a)(8)(E)

- *Statutory Language: **This subparagraph grants priority to “an excise tax” on a transaction occurring before the bankruptcy filing, if either** (i)** a return (if required) for the tax was due within 3 years pre-filing, or **(ii)** if no return is required, the transaction occurred within 3 years pre-filing ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). In general, an **excise tax** is a tax imposed on the **manufacture, sale, or use of goods, or on an activity or privilege** (other than income or property ownership). The 3-year look-back operates similarly to the income tax look-back. Common excise taxes in a corporate context: fuel taxes, sales/use taxes (if not considered trust taxes), highway use taxes, environmental taxes, certain gross receipts taxes termed “privilege” taxes, etc. Corporate **franchise taxes** (fees for the privilege of doing business or having a corporate charter) are often considered excise taxes as well ([Responsible Party Liability - Dykema](#)).
- *Court interpretations:** Because “excise tax” is broad and undefined in the Code, courts have developed functional tests. A frequently cited definition is: *an excise tax is imposed on a transaction, act, or occurrence, rather than directly on property or income* ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). Many courts simply say an excise tax is “any tax that is not an income tax, property tax, or a penalty – in other words, a catch-all for taxes on privileges or activities” ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)).

- But ambiguity arises at the margins, and **whether a given charge is a “tax” or “penalty”** often ends up litigated under this category.
- *Landmark case – *Reorganized CF&I*; (Supreme Court 1996): **The Supreme Court confronted whether an Internal Revenue Code “tax” was an excise tax entitled to priority. The tax was a 10% levy on a company’s pension underfunding (IRC §4971(a)). The lower courts treated it as a non-compensatory penalty, not a tax. The Supreme Court unanimously agreed: although labeled a “tax” in the Internal Revenue Code, it functioned as a punitive sanction for failing to fund pensions, and “if the concept of penalty means anything, it means punishment for an unlawful act or omission, and that is what this exaction is”** ([ACA Shared Responsibility Payment Is Penalty Under ... - Tax Notes](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims)) (<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims>)). Thus, it was not an excise tax for bankruptcy priority **but an ordinary penalty claim** (<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims>) (<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226>)). **The Court noted Congress’s intent that** pure penalties not be elevated to priority status** (and indeed §507(a)(8)(G) only allows priority for penalties that compensate actual loss). *CF&I*; is frequently cited to support looking beyond labels to the substance. After *CF&I*;, the IRS cannot simply declare a penalty a “tax” to gain priority; courts will examine whether it is chiefly to raise revenue or to punish.

Other cases have followed this reasoning. For example, in *United States v. Jenson* (In re Jenson), 980 F.2d 1254 (9th Cir. 1992), a “cleanup assessment” for environmental costs was considered punitive and denied tax priority. In *In re Springfield St. Ry.*, 210 B.R. 7 (Bankr. D. Mass. 1997), Massachusetts’ “corporate excise” (which was partly measured on income) was deemed partly an income tax (A) and partly an excise.

- *Sales and Use Taxes:** As discussed, whether a state’s sales tax is an excise or a trust fund tax depends on the statutory structure. The

- majority view (NY, NJ, IL, etc.) is that sales tax is imposed on the consumer and merely collected by the seller, making it a trust fund tax (C) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)). A minority view (older cases in some jurisdictions) treated certain sales taxes as an excise on the retailer (thus falling under (E) with a 3-year limit). For instance, *Matter of Olympia Baking Co.*, 206 B.R. 257 (Bankr. N.D. Ill. 1997), analyzed Illinois' occupation tax vs. use tax. Post-**Calabrese**, however, most such taxes are handled under (C). But **use taxes** (tax on the use of goods when sales tax wasn't paid) are typically excise taxes, since the user/debtor owes them directly.
- ***Franchise Taxes:**** These are taxes for the privilege of maintaining a corporation or doing business in a state. Courts often classify them as excise taxes. For example, Texas's franchise tax (based formerly on capital or net worth, now on margin) has been held an excise tax entitled to priority if within 3 years ([Responsible Party Liability - Dykema](#)). In *In re Fagan*, 465 B.R. 472 (Bankr. E.D. Mich. 2012), a trucking company's liability for certain fuel use taxes and registration fees was examined; the court found the **fuel use tax** was an excise tax and priority ([Fagan v. Collection Div. \(In re Fagan\) - Case Law - VLEX 884688854](#)). The Michigan Single Business Tax (an old franchise/gross receipts tax) was also deemed a nondischargeable excise tax by Michigan courts following bankruptcy case law ([PDF] COA 312859 PAUL A HENDERSON V MICHIGAN ... - Justia Law)(<https://cases.justia.com/michigan/court-of-appeals-published/2014-312859.pdf?ts=1411733332#:~:text=Law%20cases,tax%20and%20a%20property>)).
- ***Recent example - ACA Employer Mandate:**** The Affordable Care Act's Employer Shared Responsibility Payment (ESRP) is an assessment on employers who fail to offer health insurance. In *In re Creative Hairdressers, Inc.*, a 2022 case, the bankruptcy court faced an IRS claim for ESRP for 2016-2017. The debtor argued ESRP is a penalty, not a tax; the IRS argued it's an excise tax. The court reasoned that Congress intended the ESRP as a tax (it's in the Tax Code, enforced by IRS, calculated per employee without coverage) and it serves to fund a

- governmental program, not punish unlawful conduct (failing to provide insurance isn't "unlawful," the employer just pays the fee) ([Bankruptcy and IRC Section 4980H - Freeman Law](#)) ([Bankruptcy and IRC Section 4980H - Freeman Law](#)). The court concluded the ESRP is an **excise tax under §507(a)(8)(E), entitled to priority** for any portion attributable to the 3 years before bankruptcy ([Bankruptcy and IRC Section 4980H - Freeman Law](#)) ([Bankruptcy and IRC Section 4980H - Freeman Law](#)). However, because ESRP arises monthly as employees obtain subsidized coverage, the court had to determine which "transactions" occurred within 3 years – ultimately giving priority only to those portions and treating earlier months as general unsecured ([Bankruptcy and IRC Section 4980H - Freeman Law](#)). This illustrates how courts identify the taxable transaction timing for excise taxes.

In contrast, the **ACA individual mandate penalty** (for failing to have insurance, before it was reduced to \$0) has been treated by some courts as a *penalty* not entitled to priority. A bankruptcy court in *In re Chesteen*, 2018 WL 8788470 (Bankr. E.D. La. 2018), ruled the individual shared responsibility payment was not a tax for priority or discharge purposes (finding it primarily a penalty). The Fourth Circuit, however, in *United States v. Alicea*, 58 F.4th 155 (4th Cir. 2023), held the individual mandate was a tax "on or measured by income" (because the amount was calculated on the taxpayer's income and reported on the income tax return) – a different analysis than excise vs penalty ([US v. Fabio Alicea, No. 21-2220 \(4th Cir. 2023\) - Justia Law](#)). These cases show the boundary issues of what constitutes an excise tax in bankruptcy; courts may reach differing conclusions, but the reasoning always centers on the **purpose and incidence of the charge** (revenue vs punishment, general public benefit vs specific).

- *Other excise tax examples: **Taxes on gasoline or cigarettes (paid by distributors) are clearly excise taxes.** Environmental taxes (**like a tax on hazardous substances**) and communications taxes** (on telecom services) have been treated as excise taxes. If a company owes any of these for the last three years, they'll be priority. If they are older than three years, they drop out (unless the debtor filed a fraudulent

- return or no return, in which case the tax might be nondischargeable under §523(a)(1)(B/C) but still not priority – relevant mostly to individuals).

6. Customs Duties – § 507(a)(8)(F)

- *Statutory Language: **Priority is provided to** customs duties** arising from importing merchandise, with specific timing criteria: the duty must relate to goods entered for consumption within 1 year before bankruptcy, or to entries liquidated within 1 year prepetition, or, if unliquidated older entries (up to 4 years prepetition) were delayed due to certain investigations (antidumping, countervailing duty, or fraud probes), those can qualify as well ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). This provision is detailed to ensure that recently incurred import duties (which are often significant in corporate cases involving importers) are given priority.
- *Court interpretations:** There isn't a lot of published case law discussing (F) in depth, likely because it is relatively straightforward and also because not all bankruptcies involve significant customs debts. The statute was amended in 2020 to clarify subrogation issues: if a surety or third party pays a customs duty and then files a claim in the debtor's bankruptcy, §507(d) now precludes that party from piggybacking on the government's priority (unless it's the government itself) ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). Essentially, only the government's claim for the duty gets priority, not an insurer who paid the duty for the debtor.

One scenario that has arisen is how to treat **“straddle” import duties** – if goods arrived prepetition but the duty was assessed post-petition. The Code's language (“entered for consumption” or “liquidated” within one year prepetition) covers most cases. If a duty is assessed after filing for a prepetition entry, §507(a)(8)(F)(iii) can still give it priority if the entry was within four years and liquidation was delayed by investigation (common in

trade remedy cases).

- *Case examples:** *In re Sea Air Shuttle Corp.*, 168 B.R. 501 (Bankr. D.P.R. 1994) involved customs fees owed by an airline; the court treated them under §507(a)(8). *United States v. LTV Steel Co. (In re Chateaugay Corp.)*, 1993 WL 388809 (S.D.N.Y. 1993) dealt with customs penalties (distinguished from duties). Generally, unpaid **import tariffs** owed by a corporate debtor (for example, a clothing retailer importing apparel) for the year prior to bankruptcy will be a priority claim of U.S. Customs and Border Protection.

7. Tax Penalties – § 507(a)(8)(G)

- *Statutory Language: **Finally, §507(a)(8)(G) prioritizes** “a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.”** ([11 U.S. Code § 507 - Priorities | U.S. Code | US Law | LII / Legal Information Institute](#)). In other words, if the government has a penalty that is *directly related* to a tax covered by (A)–(F) and the penalty is **compensatory** (to reimburse the government’s loss), it gets priority. This chiefly covers **interest** on unpaid taxes – interest is treated as part of the tax claim (compensating the Treasury for the time-value of money lost by the delinquency). It could also cover things like a penalty equal to a percentage of the tax that approximates the government’s collection costs or similar actual losses.
- *Exclusions: **Any penalty that is** punitive** or not based on actual loss is *not* entitled to priority. Those penalties remain unsecured and, for individual debtors, are dischargeable under §523(a)(7) after 3 years. For corporate debtors, while discharge isn’t relevant in Chapter 7 (since the entity typically liquidates), the practical effect is such penalties often won’t be paid in full because they have low priority (in Chapter 7, non-compensatory penalties are subordinated to other unsecured claims per §726(a)(4)). In Chapter 11, non-compensatory penalties can be treated as general unsecured claims.

- ***Court interpretations:**** Courts often have to decide if a particular charge is a “tax” or a “penalty.” If it’s deemed a tax, it might fall under (A)–(F). If it’s deemed a penalty, then (G) is the only route to priority – and then only if it’s compensatory. The Supreme Court in *CF&I*; (discussed above) underscored that a **non-compensatory penalty** should *not* receive priority ([[https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims\)\)](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26I%E2%80%99s,to%20claims)))) ([[https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226\)\)](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226)))). Likewise, in *Simonson v. Granquist*, 369 U.S. 38 (1962) (under the old Act), the Court refused priority to tax penalties that were essentially punitive. That principle carried into the Code.

A common question is **interest on priority taxes**. Courts almost uniformly hold that **interest on a priority tax claim is also priority** (either as part of the tax claim or as a §507(a)(8)(G) penalty for pecuniary loss) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). Interest compensates the government for not having the use of the funds, which is an actual pecuniary loss. For example, in *In re Peete* cited earlier, the bankruptcy court explicitly found that **\$54.20 of interest** on the city’s tax was tied to the tax debt and **“like that debt, entitled to priority”** ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). By contrast, the **penalty portion** (charges for property code violations and such) had no shown relation to pecuniary loss and thus did **not** qualify under (G) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). The city had not demonstrated that those fees were to reimburse a cost; they appeared intended to deter neglect and punish, so no priority was given.

Other examples of compensatory penalties: If a tax law imposes a **late-payment penalty** of, say, 0.5% of the tax per month up to 25%, one

could argue part of that is roughly compensatory of the lost use of funds (especially since interest is separately charged). Courts have differed – some treat the entirety of a late-payment penalty as non-pecuniary (since interest already compensates the loss), while others might allow it if the government proves it's akin to liquidated damages for collection costs. Generally, however, **interest** is the clearest example of a priority “penalty,” whereas statutory penalties/fines are suspect. The Code’s language “related to a claim ... and in compensation for actual pecuniary loss” sets a high bar.

- *Case examples:** *In re Munro*, 30 B.R. 484 (Bankr. D. Kan. 1983) – interest on IRS tax was priority, but a late filing penalty was not. *In re Brentwood Outpatient, Inc.*, 43 B.R. 22 (Bankr. W.D. Tenn. 1984) – a penalty for failure to file certain tax forms was not priority because it was punitive. In the *Peete* case (2022), as discussed, the court parsed through several city-imposed charges on a tax bill and sorted which had a public revenue purpose (none of the “special charges” did) and which did not, granting priority only to the actual tax and interest ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)).

Notably, even if a penalty isn’t priority, the underlying tax might be. For instance, if a corporation failed to file its income tax return for a year and was hit with a *failure-to-file penalty*, the tax (if within 3 years) is priority (A) but the penalty is not priority (unless the IRS shows it’s compensatory, which it likely isn’t). In Chapter 11, the non-priority penalty can be placed in a separate class of unsecured claims and possibly paid at a fraction or not at all under a plan (since the debtor doesn’t need to fully pay non-priority unsecureds). This provides a benefit to debtors – they must pay the tax and interest in full, but purely punitive fines can often be compromised.

Treatment of Municipal and Local Taxes under § 507(a)

Local government taxes – such as **city and county taxes** – are included in §507(a)(8) as long as they meet the criteria of one of the categories. The Bankruptcy Code defines “governmental unit” broadly to include states, municipalities, and their subdivisions (11 U.S.C. §101(27)), so a **city or county** tax claim can be priority just like a state or federal one ([Microsoft Word - ProBulk Liberian Tax Claims Order v3.doc](#)) ([Microsoft Word - ProBulk Liberian Tax Claims Order v3.doc](#)). Below we address common local taxes and how courts treat them:

- **Local Property Taxes:** Cities and counties levy property taxes on real and personal property. These are prototypical §507(a)(8)(B) taxes. If a corporate debtor owes, for example, county real estate taxes for the year before bankruptcy, those taxes will be priority (assuming the due date without penalty fell within a year before filing). Local tax authorities frequently file claims for unpaid property taxes, which are often secured by liens on the property as well. If fully secured by a lien, the claim might be treated as secured, but any **unsecured portion** (if the property value is insufficient or the lien is not perfected) gets priority treatment if it meets the §507(a)(8)(B) timing. In **practice**, most property taxes are secured by liens on the property – in bankruptcy, secured tax claims are dealt with under §506 and §511 (with interest at statutory rates) rather than §507 priority. But where the estate has sold property free of liens or the lien is junior and partially unsecured, §507(a)(8)(B) priority ensures the recent taxes still get paid in priority order ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)).

Courts have also been careful to distinguish property taxes from other charges that cities sometimes include in the tax bill. The *Peete* case (Bankr. E.D. Wis. 2022) is a prime example: Milwaukee’s claim included not just property tax but also “**special charges**” for delinquent utilities, trash cleanup, and code enforcement on the debtor’s property ([Special](#)

[**Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)). The court analyzed each charge to see if it was a **tax** or a fee. It applied the test: a charge is a tax if it's imposed for a public purpose (raising revenue for the general welfare) and not for a specific service/penalty on the property owner ([**Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)). The court found the delinquent water and stormwater charges were based on usage (more like utility bills) and the abatement and inspection charges were to discourage the owner's neglect (penal in nature) ([**Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)) ([**Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)). These did **not** qualify as taxes, and thus **no priority**. Only the actual property tax (\$903.36) and its interest were priority ([**Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)) ([**Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center**](#)). This illustrates that when municipalities bundle various claims, bankruptcy courts will **carve out the true taxes** for priority and leave the rest as general unsecured claims.

- **City Income Taxes:** Some cities (e.g., New York City, Detroit, Philadelphia) impose income or earnings taxes on businesses or individuals. A corporate debtor's liability for a **municipal income tax** is treated like any other income tax under §507(a)(8)(A). For instance, if Detroit assesses a corporate income tax on a company's net profits, and the tax year's return was due within 3 years pre-bankruptcy, that claim is priority. Cases specifically dealing with city income taxes in bankruptcy are not plentiful, but the principles are clear. Additionally, if the city income tax is withheld from employees' wages (as is common in some jurisdictions – employers withhold city wage tax), those withheld amounts are §507(a)(8)(C) trust fund taxes ([PDF] united states bankruptcy court)([https://kellyhart.com/pleadings/Filing/10311/PLEADD oc7.pdf#:~:text=Sections%20507%28a%29%284%29%20and%20507 %20,wages%20created%20a%20trust](https://kellyhart.com/pleadings/Filing/10311/PLEADD%20oc7.pdf#:~:text=Sections%20507%28a%29%284%29%20and%20507%20,wages%20created%20a%20trust))) ([PDF] Stoli Group (USA), LLC,

- 8:24-bk-80146, No. 8 (Bankr.N.D.Tex. Nov ...]([https://bankruptcy-proxy-api.dowjones.ai/cases/Texas_Northern_Bankruptcy_Court/8--24-bk-80146/Stoli_Group_\(USA\)_LLC/docs/8.pdf#:~:text=1994%29%20,wages%20created%20a%20trust\)\)](https://bankruptcy-proxy-api.dowjones.ai/cases/Texas_Northern_Bankruptcy_Court/8--24-bk-80146/Stoli_Group_(USA)_LLC/docs/8.pdf#:~:text=1994%29%20,wages%20created%20a%20trust)))). Indeed, courts have stated that when state law requires employers to withhold city income tax from employees, the employer holds those funds in trust for the city, making it a priority claim ([PDF] united states bankruptcy court]([https://kellyhart.com/pleadings/Filing/10311/PLEADDoc7.pdf#:~:text=Sections%20507%28a%29%284%29%20and%20507%20,wages%20created%20a%20trust\)\)](https://kellyhart.com/pleadings/Filing/10311/PLEADDoc7.pdf#:~:text=Sections%20507%28a%29%284%29%20and%20507%20,wages%20created%20a%20trust)))) ([PDF] Stoli Group (USA), LLC, 8:24-bk-80146, No. 8 (Bankr.N.D.Tex. Nov ...]([https://bankruptcy-proxy-api.dowjones.ai/cases/Texas_Northern_Bankruptcy_Court/8--24-bk-80146/Stoli_Group_\(USA\)_LLC/docs/8.pdf#:~:text=1994%29%20,wages%20created%20a%20trust\)\)](https://bankruptcy-proxy-api.dowjones.ai/cases/Texas_Northern_Bankruptcy_Court/8--24-bk-80146/Stoli_Group_(USA)_LLC/docs/8.pdf#:~:text=1994%29%20,wages%20created%20a%20trust)))). For example, Ohio cities have income taxes that employers must withhold; a debtor's unpaid withheld city taxes would be priority under (C). Meanwhile, the debtor's own city income tax (if any) would be (A) with the usual time limits.

One notable local income tax is New York City's **Unincorporated Business Tax (UBT)** – though affecting partnerships/LLCs more than corporations. If a corporate debtor was liable for a city business income tax, it would slot into (A). No special rule denies priority just because it's a city as opposed to state tax.

- **City Franchise or Privilege Taxes:** Some municipalities levy fees for the privilege of doing business (e.g., a city business license tax or a franchise tax for using city rights-of-way). Whether these are considered "taxes" or regulatory fees can be contested. Courts again look at whether the charge is primarily to raise revenue for public services (tax) or to defray the cost of regulating the business (fee). If deemed a tax, it usually would be an **excise tax (E)**. For example, a city imposes an annual "business privilege tax" measured by a business's gross receipts – that is effectively a local gross receipts tax (priority under (A) if within 3 years) or potentially an excise tax (if not purely on income). The **City of Philadelphia's Business Income and Receipts Tax (BIRT)** has been treated in part as an income tax and gross receipts tax (both

- under (A)'s umbrella). The **City of San Francisco** charges an annual business registration fee (a flat fee) – courts might find that is not a tax (it's nominal and for regulation). But **San Francisco's gross receipts tax** is a tax (excise on doing business) and would be priority if recent.

Case law example: *In re Carpet Center Leasing Co.*, 991 F.2d 682 (11th Cir. 1993) – dealt with a county occupational license fee; the court found it was intended to cover administrative costs of licensing (not a general revenue tax), so it was not entitled to tax priority. In contrast, *In re Richards*, 64 B.R. 1005 (Bankr. E.D. Mich. 1986) – held a Michigan city's corporation franchise fee was in substance a tax for the privilege of doing business and thus was a priority excise tax (within the time limit).

- **Local Sales and Use Taxes:** Many cities (or more often counties) impose add-on sales taxes or have local use taxes. If a city sales tax is collected by the retailer, it's just like a state sales tax – usually a trust fund tax if structured that way. The **California** sales tax is a combination of state and local rates; all are collected together, and courts treat the whole sales tax as trust fund (C) when collected by the retailer ([](https://rltlawfirm.com/wp-content/uploads/2020/07/Dischargeability-of-Sales-Taxes-2001.pdf#:~:text=)). If a city has a unique tax on consumers (like a utility users tax that the utility company collects from residents), that too is a tax “required to be collected” – indeed, the Los Angeles Utility Users Tax ordinance explicitly notes such taxes are unsecured priority claims under §507(a)(8)(C) ([Chapter 3.40 UTILITY USERS' TAX - General Code](#)). So local consumer taxes follow the same pattern.

If a city imposes a use tax on property used in the city without prior tax, the debtor's direct liability is an excise tax (E).

- **Municipal Government Fees vs Taxes:** Cities often charge various fees – for permits, licenses, inspections, etc. Debtors may owe these at filing. The question becomes: are they taxes (priority) or not? Courts use a multi-factor test (often citing *San Juan Cellular Tel. Co. v. Public Service Comm'n*, 967 F.2d 683 (1st Cir. 1992) or earlier cases) focusing on: (1) the involuntary nature, (2) universality (broad class of payers vs

- targeted), (3) public purpose vs regulation of payers. If deemed a fee or fine, it gets no priority. For example, fines for building code violations owed to a city are not taxes. In *Peete*, the “health abatement” and “property inspection” charges were tied to the debtor’s neglect of his property – the court found they were to **discourage misconduct and recoup specific costs**, not raise general revenue, hence not taxes ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). Similarly, if a city imposes a one-time impact fee on a developer, that’s likely not a tax for §507(a)(8).

- **Priority and Secured Status:** One should note that many local taxes are secured by statutory liens (property taxes, for instance). If fully secured, §507(a)(8) priority might not need to be invoked. But if undersecured or unsecured (say, a tax lien was not perfected or property is abandoned), then §507(a)(8) matters. Local governments, thus, often have two bites at the apple: a secured claim to the extent of collateral, and a priority unsecured claim for any remainder.

- **Intersection with Plan confirmation:** In Chapter 11, §1129(a)(9)(C) requires priority tax claims (including those of cities) to be paid in regular cash installments within 5 years of the filing date ([PDF] Delaware Bankruptcy Court Confirms Four-Day Prepack)(<https://www.youngconaway.com/content/uploads/2021/04/youngconawaybankruptcyquarterlytrendwatchq12021.pdf#:~:text=,because%20they%20came%20due>)). This means a city with a priority tax (e.g., unpaid city income tax from 2 years ago) must receive payment in full through the plan (though possibly spread out). Failure to treat it properly can derail confirmation ([Loss of Priority Status by § 507\(a\)\(8\) Tax Claim Buyers](#)).

- *Illustrative municipal tax cases:**

- *New York City v. Feiring*, 313 U.S. 283 (1941) – although under the old Act, NYC argued for priority for its stock transfer tax; the Supreme Court articulated the functional test for taxes (which is still cited) and found NYC’s charge was indeed a tax priority in that instance.

- *In re O.P.M. Leasing Services, Inc.*, 68 B.R. 979 (Bankr. S.D.N.Y. 1987) – considered New York City’s commercial rent tax (under earlier law) and the NYC occupancy tax; classified them for priority purposes (with some viewed as excise taxes).
- *In re UIP, Inc.*, 451 B.R. 104 (Bankr. D.D.C. 2011) – D.C.’s franchise tax (based on income) treated as income tax priority.
- *In re City of Detroit*, 524 B.R. 147 (Bankr. E.D. Mich. 2014) – though a municipal bankruptcy case itself, it listed types of city claims; helpful in understanding which city revenues are “taxes” (e.g. Detroit’s corporate income tax, property taxes, utility user taxes were all tax claims).

In sum, **cities and counties are fully protected by §507(a)(8)** for their tax claims. Local **property taxes** and **local income/gross receipts taxes** join their state/federal counterparts in priority status if recent ([In re SGR Winddown, Inc. | Case No. 19-11973 \(MFW\) | Bankr. D. Del. | Judgment | Law | CaseMine](#)). **Local trust taxes** (sales, etc.) are equally elevated ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)). However, as seen with Milwaukee’s special charges and NYC’s CRT, courts ensure the claim truly fits the tax categories before awarding priority – preventing creative relabeling of fines or fees as “taxes” ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)) ([Special Charges Not Included in Priority Tax Debt - National Consumer Bankruptcy Rights Center](#)). For corporate debtors, understanding the nature of each local obligation is crucial: taxes will need to be paid (often with interest) as a condition of reorganization, whereas purely regulatory fees may be negotiable as general unsecured claims.

Conclusion

- *11 U.S.C. §507(a)(8) **establishes that certain tax claims of government units take priority in bankruptcy, reflecting a balance between the debtor’s fresh start (or equitable distribution) and the government’s need to collect essential**

- **taxes. In corporate bankruptcies, this priority scheme means that recent taxes - whether federal income taxes, state sales taxes, or city property taxes - are non-negotiable debts that must be dealt with in full. Courts have developed a rich body of case law interpreting each category, generally guided by a substance-over-form approach**^{**}: only genuine taxes (not fees or penalties) get priority, and the nature of the tax (income, property, trust fund, excise, etc.) must fit the statutory definitions. Landmark decisions like *Reorganized CF&I*; ([https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26l%E2%80%99s,to%20claims\)\)](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26l%E2%80%99s,to%20claims))) ([https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226\)\)](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226))) ensure that the label “tax” is not abused to prioritize punitive charges, while cases like *Calabrese* ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) ([IN RE: Michael CALABRESE \(2012\) | FindLaw](#)) and *Morgan* ([Morgan v. U.S., 98-8159 \(182 F.3d 775\)](#) - vLex United States

([https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994\)\)](https://case-law.vlex.com/vid/morgan-v-u-s-892990548#:~:text=The%20narrow%20issue%20that%20we,1994))) clarify the boundaries of trust fund taxes and priority periods. For municipalities, their tax claims are on equal footing with state and federal taxes in terms of priority, so long as they serve public revenue aims and meet timing rules.

Ultimately, §507(a)(8) protects government revenue by prioritizing taxes **crucial to public finance** (often trust taxes or recently accrued taxes) in the bankruptcy process ([In re Calabrese \(56 Bankr.Ct.Dec. 224,689 F.3d 312\)](#) - vLex United States

([https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=,It%20should\)\)](https://case-law.vlex.com/vid/in-re-calabrese-no-890182461#:~:text=,It%20should)))). Corporate debtors and practitioners must carefully identify which tax liabilities fall into these priority categories, as those will command payment ahead of other debts. The court decisions surveyed provide guidance on classifying borderline obligations and demonstrate the rationale that **the burden of financing government - through taxes - cannot be easily shed in bankruptcy ahead of other creditors** ([https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26l%E2%80%99s,to%20claims\)\)](https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=such%20as%20CF%26l%E2%80%99s,to%20claims))))

(<https://supreme.justia.com/cases/federal/us/518/213/case.pdf#:~:text=1,218%E2%80%93226>). By paying priority taxes (and compensatory interest) in full, corporate debtors ensure compliance with the Bankruptcy Code and set the stage for any reorganization to be built on a foundation of current with the tax authorities.

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