

September 1982

Employers' Workmen's Compensation Obligations and the Bankruptcy Tax Priority

James B. Haines

West Virginia University College of Law

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>



Part of the [Bankruptcy Law Commons](#), and the [Workers' Compensation Law Commons](#)

Recommended Citation

James B. Haines, *Employers' Workmen's Compensation Obligations and the Bankruptcy Tax Priority*, 85 W. Va. L. Rev. (1982).

Available at: <https://researchrepository.wvu.edu/wvlr/vol85/iss1/8>

This Article is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact ian.harmon@mail.wvu.edu.

EMPLOYERS' WORKMEN'S COMPENSATION OBLIGATIONS AND THE BANKRUPTCY TAX PRIORITY

JAMES B. HAINES, JR.*

I. INTRODUCTION

With business failures occurring at the highest levels since the Great Depression, the prospect of bankruptcy looms large for many enterprises.¹ Relief available under the Bankruptcy Reform Act² includes a stay of the collection activities of pressing creditors³ and, for individual debtors, a discharge of pre-bankruptcy indebtedness.⁴

The discharge available in bankruptcy is not without exception, however, and those counseling financially embarrassed clients must analyze both the amount and kind of their clients' indebtedness in order to appraise the utility of bankruptcy.⁵ Moreover, under the Reform Act, as under previous bankruptcy legislation, the order in which creditors are paid and the amount they can expect ultimately to receive from both liquidating⁶ and reorganizing⁷ debt-

* Assistant Professor, West Virginia University College of Law. B.A., Washington State University, 1970; J.D., Willamette University, 1977.

¹ See Wall Street Journal, February 22, 1982 at 1.

² 11 U.S.C. §§ 101-366 (Supp. IV 1980). Hereafter the Bankruptcy Reform Act will be referred to as either "the Reform Act" or "the Code." All references to the Code are to its 1980 version, reflecting amendments through the 96th Congress, 2d Sess. (1980), unless otherwise noted.

³ 11 U.S.C. §§ 103, 362, 1301 (Supp. IV 1980).

⁴ 11 U.S.C. §§ 727 (Supp. IV 1980) (discharge for individual debtor in straight bankruptcy), 1328 (discharge for individual debtor upon completion of Chapter 13 plan), 1141 (discharge for individual or corporate debtor upon confirmation of Chapter 11 reorganization plan). See also 11 U.S.C. § 524 (Supp. IV 1980) (effect of discharge).

⁵ Exceptions to discharge in straight bankruptcy include, generally, obligations to pay certain taxes and custom's duties (see *infra* note 145); debts arising from credit extended in reliance upon the debtor's fraudulent representations; debts incurred due to the debtor's fraudulent conduct while acting as a fiduciary; debts for alimony and child support; debts to compensate for willful and malicious injuries inflicted by the debtor; certain fines and penalties imposed by governmental units; certain student loan obligations; undischarged debts predating earlier bankruptcies; and, in some circumstances, debts not disclosed by the debtor in the course of bankruptcy proceedings. See 11 U.S.C. § 523(a) (Supp. IV 1980).

In addition to the possibility that certain debts will not be affected by a bankruptcy discharge, the court may in some circumstances, usually relating to fraudulent conduct by the debtor, refuse to grant any discharge whatsoever. See 11 U.S.C. § 727(a) (Supp. IV 1980).

Obviously, if substantial indebtedness will survive bankruptcy, a debtor should be counseled to consider alternative strategies to deal with his creditors.

⁶ "Straight" bankruptcy is the vehicle by which the debtor's nonexempt assets are liquidated and the proceeds distributed to creditors. Exempt property is defined by 11 U.S.C. § 522 (Supp. IV 1980) and the state law of the state in which the debtor resides. See W. VA. CODE § 38-10-4 (bankruptcy exemptions). See generally Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C. L. REV. 769 (1980). The mechanics of such straight bankruptcies are detailed in Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701-66 (Supp. IV 1980). Any person or entity other than railroads, domestic insurance companies, banks, savings banks, cooperative banks, savings and loan associations, building and loan associations, homestead association, and credit unions

ors is dependent upon their status as secured or unsecured creditors as well as their place in the order of priorities for payment established by the bankruptcy statute.⁸ Those who advise creditors as to the wisdom of initiating involuntary bankruptcy proceedings against debtors must first ascertain their clients' status and place in the bankruptcy distribution hierarchy.

This article will address the treatment of employer obligations to the West Virginia Workmen's Compensation Fund⁹ in bankruptcy. The discussion is intended not merely to address the narrow issue, however, but to serve as a vehicle for explanation and exploration of the bankruptcy priority system¹⁰ and its impact upon creditors and debtors.

II. BACKGROUND

In recent months increasing numbers of local and national businesses have sought relief under the Reform Act¹¹ or have been involuntarily forced into bankruptcy by their creditors.¹² Many such businesses consist of employers required by statute to participate in and contribute to the West Virginia Workmen's Compensation Fund.¹³

may be a debtor in Chapter 7, 11 U.S.C. § 109 (Supp. IV 1980).

⁷ Debtors, as an alternative to straight bankruptcy, may reorganize under Chapter 11 of the Code. Such proceedings are in the nature of court-supervised compositions in which a plan of rehabilitation is presented, agreed to by creditors (or in some circumstances imposed upon them), and confirmed by the court. The debtor retains sufficient assets under the plan to continue operation of all or part of its business and creditors are paid all or part of their claims overtime. See 11 U.S.C. §§ 1101-74 (Supp. IV 1980). See generally Coogan, *A Debtor's Choice of Chapters Under the Bankruptcy Act*, 1 VT. L. REV. 117 (1976); Klein, *The Bankruptcy Reform Act of 1978*, 53 AM. BANKR. L.J. 1, 7-17 (1979).

In addition, individuals with regular income and limited indebtedness may elect a more simplified rehabilitation mechanism, the Chapter 13 proceeding, in lieu of straight bankruptcy liquidation or Chapter 11 reorganization. See 11 U.S.C. §§ 109(e), 1301-30 (Supp. IV 1980). See generally Epstein, *Chapter 13, Its Operations, Its Statutory Requirements as to Payment and Classification of Unsecured Claims, and Its Advantages*, 20 WASHBURN L.J. 1 (1980).

⁸ See 11 U.S.C. §§ 506 (Supp. IV 1980) (determination of secured status), 507 (priorities), 726 (distribution of property of the estate); 1129(a)(9) (requirements for treatment of priority claims in Chapter 11 plan), 1322(a) (treatment of priority claims in Chapter 13 plan). The prior law, the Bankruptcy Act of 1898 (hereafter "the Act"), included analogous provisions regarding priority. See, e.g., 11 U.S.C. § 104(a) (1976) (repealed Pub.L. 95-598, title IV, §§ 401(a), 402(a), 92 Stat. 2682, eff. October 1, 1979).

⁹ W. VA. CODE § 23-3-1 (1981) (establishing fund).

¹⁰ 11 U.S.C. § 507(a), 726 (Supp. IV 1980). Hereafter all references to Chapter 23 of the West Virginia Code, unless otherwise noted, are to the 1981 version, as supplemented in 1982.

¹¹ A debtor may commence a voluntary case in bankruptcy by filing a petition. 11 U.S.C. § 301 (Supp. IV 1980). In voluntary cases, the commencement of the case constitutes an "order for relief." *Id.* A debtor may voluntarily liquidate and distribute his nonexempt assets under Chapter 7 or may voluntarily reorganize his affairs and rehabilitate himself and his, or its, business affairs under Chapter 11 or Chapter 13. See *supra* notes 6 and 7.

¹² Creditors may by filing a petition commence Chapter 7 or 11 proceedings against a debtor. 11 U.S.C. § 303(a), (b) (Supp. IV 1980). The order for relief will be granted in such cases only after notice and hearing and a finding that the debtor is generally not paying his debts as they become due or has been subject of a receivership within 120 days. 11 U.S.C. § 303(d), (e), (h) (Supp. IV 1980).

¹³ See W. VA. CODE §§ 23-1-1 to -6-1 and *infra* notes 87-92 and accompanying text.

The business entities that find themselves the subjects of bankruptcy proceedings are generally insolvent or are on the brink of insolvency.¹⁴ A large proportion of bankrupt business debtors owe substantial amounts to the state under the Workmen's Compensation scheme at the time the bankruptcy proceedings are initiated.¹⁵ Amounts owed generally include past due premiums,¹⁶ interest,¹⁷ and repayment obligations for compensation awarded to the employers' workers when the employers' premium payment obligations were in default.¹⁸

Whether the workmen's compensation-related debts of employers in bankruptcy are entitled to priority in distribution of the assets of the debtor's estate¹⁹ and whether such indebtedness is dischargeable²⁰ are questions of current concern among both creditors and debtors.²¹ This article will discuss the issues of priority and dischargeability of employer obligations arising under the

¹⁴ It is assumed throughout this discussion that the subjects of bankruptcies hold insufficient nonexempt assets to fully satisfy all of their debts. Cf. 11 U.S.C. § 101(26) (Supp. IV 1980). The distribution priority that is the focal point of this paper becomes important when such is the case.

"Insolvency" in the equitable sense is one of two alternative grounds for entry of the order for relief in an involuntary case. See 11 U.S.C. § 303(h) and *supra* note 2.

¹⁵ The significance of employer bankruptcies to the Workmen's Compensation Fund is reflected by the fact that the State Compensation Commissioner requested, and recently received, an opinion from the Office of the Attorney General of West Virginia as to the tax or non-tax status of state claims for obligations owed to the Workmen's Compensation Fund. See *infra* note 111.

¹⁶ W. VA. CODE §§ 23-2-5 to 5a (1981). Employers subject to the mandatory coverage requirements of the Workmen's Compensation Act must pay quarterly premiums based upon percentages of their payroll for the preceding quarter to the state compensation fund. The percentage applied to determine the amount of premium owed is variable from class to class of business operation, with higher percentages, and thus higher premiums, applicable to operations entailing more hazardous work. Workmen's Compensation Commissioner's 1982-83 rate schedule.

¹⁷ W. VA. CODE § 23-2-13 (1982 Supp.) (past due employer obligations bear interest at the rate of two percent per month).

¹⁸ W. VA. CODE § 23-2-5 (1981) ("Provided, that any employer required by this chapter to subscribe and pay premiums to the workmen's compensation fund as herein provided and who fails to do so shall be liable to the . . . fund for all payments paid from the fund to his employees, as well as for all premiums otherwise due and owing. . . .").

¹⁹ Designated categories of unsecured creditors, by reason of their status vis a vis the debtor or the timing of the creation of their claims in relation to the bankruptcy proceedings, are entitled to distribution of assets of the estate ahead of other, non-priority, unsecured claimants. 11 U.S.C. § 507 (Supp. IV 1980).

²⁰ In a Chapter 7 liquidation proceeding an individual debtor, in return for surrender of his non-exempt assets, is discharged from further obligation to satisfy pre-bankruptcy indebtedness. 11 U.S.C. § 524, 727 (Supp. IV 1980). Debtors who are not "individuals" (i.e. natural persons) are not entitled to a discharge. 11 U.S.C. § 727(a)(1) (Supp. IV 1980). Nevertheless, a corporate debtor may utilize Chapter 7 to effect liquidation and distribution of its assets, leaving only an empty corporate shell. In such cases, where no assets remain available for creditors, the unavailability of a formal discharge becomes irrelevant. In Chapter 11 reorganization proceedings, the issue regarding tax claims is whether the debtor's reorganization plan must provide for full payment of the claim over time. See *infra* text accompanying note 146. In Chapter 13 debtor rehabilitation proceedings, the issue also is one of whether or not the debtor's plan must provide for full payment. See *infra* text accompanying note 147.

²¹ The matter of priority is of importance not only to the state claimant, but also to competing creditors for whom the amount of available assets will be depleted if sizable workmen's compensation, or other "tax," obligations are given priority, and to debtors as to whom such priority indebtedness is not dischargeable. See, e.g., *In re Adams*, 17 Bankr. 742 (Bankr. E.D. Pa. 1982).

West Virginia Workmen's Compensation scheme and will, in its course, treat related issues, most notably relating to the enforcement of liens securing the state's claim against the employer.²³

III. DISCUSSION

This article will first explain the historical nature of and reasons for a tax priority in bankruptcy. The evolution of the definition of "tax" and factors pertinent to application of the definition will be treated next. The following section will demonstrate that the claims for amounts owed by employers under state fund workers' compensation programs, such as the West Virginia Workmen's Compensation Act, are tax claims within the meaning historically applied in bankruptcy. The article next will explore the specific provisions of the Bankruptcy Reform Act of 1978 relating to tax priorities and their application to employers' workmen's compensation indebtedness. Finally, the ramifications of priority treatment for workmen's compensation-related claims will be discussed.

A. Why Is There a Tax Priority in Bankruptcy?

1. The Priority System of Distribution

The current Bankruptcy Code,²³ like its predecessors,²⁴ contains provisions that require certain categories of unsecured indebtedness to be paid in full prior to payment of other unsecured claims.²⁵ The priority scheme for distribution of assets is a product of legislative concern for equitable treatment of certain creditors²⁶ coupled with legislative recognition that pragmatism and necessity require priority treatment of certain other claims.²⁷

Pre-bankruptcy liens that are valid under state law and not avoidable under the Bankruptcy Code are first satisfied, to the extent possible, out of the property to which they attach.²⁸ Unsecured claims against the debtor, includ-

²³ The state's claim for amounts owed to it by employers under the Workmen's Compensation Act becomes a lien against "all property of the employer." W. VA. CODE § 23-2-5a (1981). As to treatment of such liens in bankruptcy, see *infra* notes 148-56 and accompanying text.

²⁴ 11 U.S.C. §§ 101-151326 (Supp. IV 1980).

²⁵ The 1978 Code was the first major revision of federal bankruptcy laws since the Chandler Act of 1938. The first comprehensive scheme of distribution priorities was enacted in the 1867 bankruptcy act, although the concept of priorities in distribution for certain creditors, notably for creditors whose claims related to administration of the bankruptcy estate and for the federal government, was incorporated in the bankruptcy legislation of 1800 and 1841. See 3 COLLIER ON BANKRUPTCY ¶ 507.01 (15th ed. 1982).

²⁶ 11 U.S.C. § 507(a) (Supp. IV 1980).

²⁷ *E.g.*, 11 U.S.C. § 507(a)(3) (Supp. IV 1980) (priority for claims of individuals for wages, salaries or commissions); (a)(4)(priority for claims for contributions to employee benefit plans); (a)(5) (priority for claims for repayment of consumer deposits).

²⁸ *E.g.*, 11 U.S.C. § 507(a)(1) (Supp. IV 1980) (priority for claims for administrative expenses); (a)(6)(priority for designated governmental tax claims).

²⁹ See 11 U.S.C. §§ 506(a), 725. *Cf.* 11 U.S.C. § 524 (Supp. IV 1980). See generally 4 COLLIER ON BANKRUPTCY § 725.01 (15th ed. 1982). Under certain circumstances the trustee may divest the lien creditor of his lien, thus making the property available for distribution to unsecured creditors.

ing the amounts by which a claim exceeds the value of liens securing it, are next in line,²⁹ but subject to the priority system of payment.³⁰

Section 726 of the Code requires that, as to unsecured claims, assets of the estate be distributed first in payment of claims designated as "priority claims,"³¹ then to timely or excusably late non-priority claims,³² then to tardily filed claims,³³ next to claims for penalties and punitive damages,³⁴ then to claims for post-petition interest,³⁵ and, finally, any surplus is distributed to the debtor.³⁶ Each level of claims is to be paid in full before distributions are made to the next class of claimants, and, if there are insufficient assets to satisfy any such level, the claimants within each level will share pro rata.³⁷

E.g., 11 U.S.C. § 544 (Supp. IV 1980) ("strongarm" power); 547 (preference avoidance power). See generally Teofan and Creel, *The Trustee's Avoiding Powers Under The Bankruptcy Act and the New Code*, 11 ST. MARY'S L. REV. 311 (1979). In certain circumstances the debtor, too, may divest a creditor of his lien, but only insofar as it impairs the debtor's right to claim the encumbered property as exempt. *E.g.*, 11 U.S.C. § 522(f), (g), (h) (Supp. IV 1980). See generally Vukowich, *Debtor's Exemption Rights Under The Bankruptcy Reform Act*, 58 N.C.L. REV. 769 (1980). Certain liens securing governmental units tax claims can be postponed to facilitate payment of priority unsecured creditors. See 11 U.S.C. § 724 (Supp. IV 1980) and *infra* text accompanying 155.

²⁹ 11 U.S.C. § 726(a)(2) (Supp. IV 1980).

³⁰ 11 U.S.C. §§ 726(a)(1), 507(a) (Supp. IV 1980).

³¹ 11 U.S.C. § 726 (Supp. IV 1980) provides:

(a) Except as provided in section 510 of this title, property of the estate shall be distributed—

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title;

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is—

(A) timely filed under section 501(a) of this title;

(B) timely filed under section 501(b) of this title; or

(C) tardily filed under section 501(a) of this title, if—

(i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim;

(3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph (2)(C) of this subsection;

(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and

(6) sixth, to the debtor.

³² 11 U.S.C. § 726(a)(2) *supra* note 31.

³³ 11 U.S.C. § 726(a)(3) *supra* note 31.

³⁴ 11 U.S.C. § 726(a)(4) *supra* note 31.

³⁵ 11 U.S.C. § 726(a)(5) *supra* note 31.

³⁶ 11 U.S.C. § 726(a)(6) *supra* note 31.

³⁷ 11 U.S.C. § 726(b) (Supp. IV 1980) provides: "Payment on claims of a kind specified in paragraph (1), (2), (3), (4), (5), or (6) of section 507(a) of this title, or in paragraph (2), (3), (4), or (5) of subsection (a) of this section shall be made pro rata among claims of the kind specified in a

The first class of unsecured claims to receive distributions are priority claims: "the kind specified in . . . section 507. . . ."³⁸ Such section 507 claims represent the statutory "bankruptcy priority" creditors. They include, in descending order of entitlement to distribution:³⁹

particular paragraph. . . ." See *supra* notes 25-27, 31.

³⁸ 11 U.S.C. § 726(a)(1) *supra* note 31.

³⁹ 11 U.S.C. § 507(a) (Supp. IV 1980) provides:

- (a) The following expenses and claims have priority in the following order:
- (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.
 - (2) Second, unsecured claims allowed under section 502(f) of this title.
 - (3) Third, allowed unsecured claims for wages, salaries, or commissions, including vacation, severance and sick leave pay—
 - (A) earned by an individual within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only
 - (B) to the extent of \$2,000 for each such individual.
 - (4) Fourth, allowed unsecured claims for contributions to employee benefit plans—
 - (A) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only
 - (B) for each such plan, to the extent of—
 - (i) the number of employees covered by such plan multiplied by \$2,000; less
 - (ii) the aggregate amount paid to such employees under paragraph (3) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.
 - (5) Fifth, allowed unsecured claims of individuals, to the extent of \$900 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.
 - (6) Sixth, allowed unsecured claims of governmental units, to the extent that such claims are for—
 - (A) a tax on or measured by income or gross receipts—
 - (i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
 - (ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or
 - (iii) other than a tax of a kind specified in section 523 (a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;
 - (B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;
 - (C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;
 - (D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;
 - (E) an excise tax on—

- (a) administrative expenses;⁴⁰
- (b) claims of creditors who extended credit between the filing of an involuntary petition against the debtor and the entry of an order for relief;⁴¹
- (c) claims of employees or agents for "wages, salaries or commissions. . .";⁴²
- (d) claims for contributions owed to employee benefit plans;⁴³
- (e) claims by consumers for certain deposits;⁴⁴ and
- (f) governmental units' claims for certain taxes.⁴⁵

Each level of section 507 priority claims is to be paid in full in the designated order of priority, with assets to be shared pro rata within any priority level as to which there are insufficient assets to provide payment in full.⁴⁶

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

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

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisal or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

(c) For the purpose of subsection (a) of this section, a claim of a governmental unit arising from an erroneous refund or credit of a tax shall be treated the same as a claim for the tax to which such refund or credit relates.

(d) An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(3), (a)(4), (a)(5), or (a)(6) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

⁴⁰ 11 U.S.C. § 507(a)(1), *supra* note 39.

⁴¹ 11 U.S.C. § 507(a)(2), *supra* note 39.

⁴² 11 U.S.C. § 507(a)(3), *supra* note 39.

⁴³ 11 U.S.C. § 507(a)(4), *supra* note 39.

⁴⁴ 11 U.S.C. § 507(a)(5), *supra* note 39.

⁴⁵ 11 U.S.C. § 507(a)(6), *supra* note 39.

⁴⁶ See 11 U.S.C. § 726(b); 3 COLLIER ON BANKRUPTCY ¶ 507.02 (15th ed. 1982).

2. The Tax Priority

As can readily be seen, distributions from the estate must first be made to each level of "priority" claimants before assets go to general, non-priority creditors. The establishment of such priorities springs from legislative concern that bankruptcy should operate less harshly on certain categories of creditors than on others.⁴⁷ Among the classes of creditors who have consistently been recognized under modern bankruptcy statutes as deserving of the protection of a payment priority are federal, state, and local governments seeking payment certain of pre-petition taxes.⁴⁸ An understanding as to *why* such claims receive priority treatment will assist in understanding why state claims for amounts owed by employers to state worker's compensation funds such as West Virginia's, will be accorded treatment as tax priority claims.

The notion that governmental claims for pre-petition taxes should be paid ahead of non-priority claims rests on two basic legislative insights. First, and most importantly, recognition that taxes are levied and tax revenues are utilized to fund projects and programs that promote the public good led to the conclusion that payment of tax indebtedness had greater social utility than, and was therefore entitled to priority as opposed to, payment of the claims of garden-variety unsecured creditors. The United States Court of Appeals for the Third Circuit has observed:

The principle underlying tax priority is ancient and well-established. It is one of the many illustrations of the maxim "salus populi suprema lex est". Mr. Justice Story gave it expression and effect over 100 years ago.

"The right of priority of payment of debts due to the government, is a prerogative of the crown well known to the common law. It is founded not so much on any personal advantage to the sovereign, as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens and discharge the public debts. . . . The same policy which governed in the case of the royal prerogative, may be clearly traced in these statutes; and as that policy has mainly a reference to the public good, there is no reason for giving them a strict and narrow interpretation."⁴⁹

The second basis for the tax priority is more pragmatic. The mechanisms by which tax liabilities are reported or otherwise ascertained, assessed, and collected or enforced are often cumbersome, time consuming, and dependent on taxpayer cooperation.⁵⁰ As a result, the public tax creditor, unlike the private creditor, may often discover its debtor to be in default long after-the-fact. However, it is not always desirable that the taxing authority pursue immedi-

⁴⁷ 3 COLLIER ON BANKRUPTCY ¶ 507.02 (15th ed. 1982).

⁴⁸ 3 COLLIER ON BANKRUPTCY ¶ 507.04[6] & n.22 (15th ed. 1982).

⁴⁹ *In re Wm. Akers, Jr., Co.*, 121 F.2d 846, 848 (3d. Cir. 1941) (quoting *United States v. Bank of North Carolina*, 31 U.S. 29, 35 (1832)).

⁵⁰ *E.g.*, W. VA. CODE § 23-2-5 (1981) (providing for employer payment of workmen's compensation premiums based on preceding quarter's payroll). The cumbersome aspects of tax collection activities was a concern of Congress in retaining the tax priority in the 1978 Bankruptcy Code. H.R. REP. NO. 90-595, 95th Cong., 2d Sess. 190, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6150.

ately and with a vengeance all available avenues of enforcement and collection⁵¹ since the value of forbearance is often recognized when it might enable the defaulting taxpayer to weather temporary financial embarrassment and retain economic vitality.⁵² As a result, the taxing government might, for socially desirable reasons, be less adamant a creditor than one to whom private debts are owed. As a consequence, some creditors have benefited in the pre-bankruptcy period from the circumstances attending creation, ascertainment, and collection of the tax. Such circumstances led to the legislative conclusion that a distribution priority for the tax claim is appropriate.⁵³

B. What Is a "Tax" For Purposes of the Bankruptcy Distribution Priority?

The issue of what is a "tax" for purposes of bankruptcy priority has been influenced strongly by the "public benefit" factor that led to the initial adoption and later retention of the tax priority.⁵⁴ Although the 1978 Bankruptcy Code has defined more specifically than past bankruptcy statutes the types of taxes to be given priority,⁵⁵ the threshold determination to be made remains, "Is the debtor's obligation to the government unit a 'tax'?"⁵⁶

The legislative history of the Bankruptcy Code discloses no congressional intention to alter the test for determining the tax-nature of an obligation owed the government by a debtor, so pre-Code cases explaining the nature of a "tax" for priority purposes remain instructive.⁵⁷ Early in the century the Supreme

⁵¹ *E.g.*, The West Virginia Workmen's Compensation Commissioner, in addition to possessing the power to institute a civil collection action against the employer and to perfect a lien against the employer's property, may bring an action to enjoin an employer who has defaulted on its premium payment obligations for two quarters from continuing to carry on its business. W. VA. CODE § 23-2-5a (1981).

⁵² For example, if the Workmen's Compensation Commissioner were to proceed to shut down a large employer immediately after two quarters delinquency in premium payments, the adverse economic consequences would likely outweigh the benefits of quick payment. At minimum, such action would punish the very workers that the Workmen's Compensation Act was intended to benefit.

⁵³ Of course, forbearance of tax collectors in collecting taxes results in the financially embarrassed taxpayer having more resources immediately available to keep commercial creditors satisfied in the prebankruptcy period. Congress took note of this fact in enacting the tax priority section of the Bankruptcy Code:

In business cases. . . it is a frequent occurrence that the business will stop paying its taxes before it stops paying its other creditors, because the officers of the business know that the detection of nonpayment is more difficult for the taxing authority than it is for a supplier or lender, and that an unpaid supplier quickly stops shipping goods, though an unpaid taxing authority is usually unable to take collection action for months.

H.R. REP. NO. 95-595, 95th Cong., 2d Sess. 193, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6151-52.

⁵⁴ See *supra* note 49 and accompanying text.

⁵⁵ Compare 11 U.S.C. § 507(a) (1979), *supra* note 39 with former 11 U.S.C.A. § 64a(4), *infra* at note 119. See, *e.g.*, *In re Adams*, 17 Bankr. 742 (Bankr. E.D. Pa. 1982).

⁵⁶ 11 U.S.C. § 507(a)(6) (Supp. IV 1980) specifically describes the taxes eligible for priority, but each description, except that relating to customs duties, utilizes the term "tax." The term "tax" is not expressly defined in the Bankruptcy Code.

⁵⁷ See *U.S. v. King* (*In re King*), 19 Bankr. 936, 938-39 (Bankr. E.D. Tenn. 1982). The tax

Court, in *New Jersey v. Anderson*,⁵⁸ distinguished a tax obligation from other indebtedness. The Court held that New Jersey's claim for an annual corporate franchise tax owed by a domestic corporation (with no assets or business activities within New Jersey) was entitled to tax priority:

Taxes are not debts. . . . Debts are obligations for the payment of money founded upon contract, express or implied. Taxes are imposts levied for the support of Government, or for some special purpose authorized by it. The consent of the taxpayer is not necessary to their enforcement. They operate *in invitum*.⁵⁹

Several early cases denying tax priority to governmental claims held that a debtor's obligation was not a tax if it was based on part of a program not intended to create revenues of benefit to all taxpayers.⁶⁰ An "assessment against a class for the benefit of a class"⁶¹ could not be a tax under such a view. However, later cases, including several decided by the United States Supreme Court,⁶² rejected the notion that an impost levied against a distinct group to fund a program or provide a benefit⁶³ directed toward those who were members of or related in some manner to the taxed group could not be considered a "tax."⁶⁴ Such class-oriented taxes are, like other taxes, based upon a larger "public benefit" perceived by the enacting legislature.⁶⁵

priority provision of the Code was much discussed, but the congressional debate centered on how the tax priority would operate in relation to other priorities, treatment of tax penalties, and at what point governmental tax claim priority would cease to attach due to the staleness of the claim. See H.R. REP. No. 95-595, 95th Cong., 2d Sess. 191-92, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5857-59. Cases decided under the Code continue to apply the same tests as pre-Code decisions for determining whether a given governmental claim constitutes a "tax." *E.g.*, *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157 (D. Or. 1980).

⁵⁸ 203 U.S. 483 (1906).

⁵⁹ *Id.* at 492. See also *In re Berkshire Hardware Co.*, 39 F. Supp. 663, 666 (D. Mass. 1941).

⁶⁰ See, e.g., *Matter of Farrell*, 211 F. 212 (W.D. Wash. 1914). The *Farrell* decision held that employer obligations under the Washington workers' compensation statutes were not "taxes" for purposes of bankruptcy priority. Its rationale has been discredited. See cases and authorities *infra* at notes 62 and 63 and accompanying text.

⁶¹ *Matter of Farrell*, 211 F. 212, 213 (W.D. Wash. 1914).

⁶² See, e.g., *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495 (1937) and cases cited therein. See also *In re Pan American Paper Mills, Inc.*, 618 F.2d 159, 162 n. 3 (1st Cir. 1980).

⁶³ *In re Pan American Paper Mills, Inc.*, 618 F.2d 159, 162 n. 4 (1st Cir. 1980). See *State Industrial Accident Comm'n v. Aebi*, 177 Or. 361, 369-72, 162 P.2d 513, 517 (1945) (holding employer's premium obligations to a state workmen's compensation fund to be "taxes" not discharged by bankruptcy). NADLER, *THE LAW OF BANKRUPTCY* § 194 at 159 (2d ed. Supp. 1972) (for purposes of the tax priority it "makes no difference whether the tax is for a special purpose, or whether the funds are segregated or commingled with general funds.").

⁶⁴ See *In re International Automated Machines, Inc.*, 9 Bankr. 575, 577 (Bankr. N.D. Ohio 1981) (holding premium obligations due to State of Ohio under its workers' compensation statutes to be a tax for priority purposes under the Bankruptcy Act of 1898):

There has been some divergence in cases considering whether statutory charges levied for special purposes outside general revenue expenditures are taxes, "but such exceptions (to finding such charges to be taxes for purposes of Section 64(a)(4)) are few and the majority opinion is that this consideration is not controlling." 3A *Collier on Bankruptcy* 64.404 (14th ed. 1975) p. 2168, n. 5.

⁶⁵ *In re Wm. Akers, Jr., Co.*, 121 F.2d 846, 850 (3rd Cir. 1941). As to the public benefit of a workmen's compensation scheme, see *State Industrial Accident Comm'n v. Aebi*, 177 Or. 361, 369-

The objection that a class-oriented levy could not qualify as a tax was rejected by federal as well as state courts within the bankruptcy context:

A tax is an enforced contribution for the payment of public expenses. It is laid by some rule of apportionment according to which the persons or property taxed share the public burden, and whether taxation operates upon all within the state or upon those of a given class or locality its essential nature is the same.⁶⁶

For purposes of treatment in bankruptcy proceedings, taxes came to be defined generally as all pecuniary burdens put upon individuals or their property, regardless of consent, for the purpose of defraying the expenses of government.⁶⁷

Under the bankruptcy statutes, including the current Code, the word "tax" was not intended to be construed in a limited sense.⁶⁸ It includes "all types of involuntary exactions . . . levied by the Federal and State governments for governmental or public purposes."⁶⁹ In determining whether a governmental claim is for a tax, it is irrelevant whether the legislature established the impost pursuant to its police or taxing powers.⁷⁰ A tax can be levied on persons or property or upon the exercise of a personal privilege, including exercise of the right "to employ or be employed. . . ."⁷¹ Courts have consistently held that state claims against insolvent employers for contributions owed to unemployment compensation funds were tax-based and thus entitled to priority.⁷²

The question whether a governmental exaction is a tax for bankruptcy

72, 162 P.2d 513 (1945); *Mains v. J.E. Harris Co.*, 119 W. Va. 730, 732-33, 197 S.E. 10, 11 (1938). See generally 1 A. LARSON, WORKMEN'S COMPENSATION LAW § 2.20 (1978).

⁶⁶ *State Industrial Accident Com'n v. Aebi*, 177 Or. 361, 369-72, 162 P.2d 513, 517 (1945) (emphasis deleted) (addressing tax nature of obligation in regard to bankruptcy discharge issues) (quoting *Houck v. Little River Drainage District*, 239 U.S. 254 (1915) (a non-bankruptcy decision)).

⁶⁷ NADLER, THE LAW OF BANKRUPTCY § 194 at 158 (2d ed. Supp. 1972). See *United States v. New York*, 315 U.S. 510 (1942); *New Jersey v. Anderson*, 203 U.S. 483 (1906).

⁶⁸ *In re Mid America Co.*, 31 F. Supp. 601, 604 (S.D. Ill. 1939); *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157, 159 (D. Or. 1980).

⁶⁹ *In re Mid American Co.*, 31 F. Supp. 601, 604 (S.D. Ill. 1939). See *New Jersey v. Anderson*, 203 U.S. 483 (1906); *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157 (D. Or. 1980).

⁷⁰ *E.g.*, *In re Mid American Co.*, 31 F. Supp. 601, 604 (S.D. Ill. 1939); *In re Otto F. Lange Co.*, 159 F. 586, 588 (N.D. Iowa 1908).

⁷¹ *In re Wm. Akers, Jr., Co.*, 121 F.2d 846, 851 (3d Cir. 1941):

Taxes, which are but the means of distributing the burden of the cost of government, are commonly levied on property or its use, but they may likewise be laid on the exercise of personal rights and privileges. . . . [L]evies, including taxes on the exercise of the right to employ or to be employed, were known in England and the Colonies before the adoption of the Constitution, and must be taken to be embraced within the wide range of choice of subjects of taxation, which was an attribute of the sovereign power of the states at the time of the adoption of the Constitution, and which was reserved to them by that instrument.

(citations deleted) (quoting *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 508-09 (1937)).

⁷² *New York v. United States*, 118 F.2d 537 (2d Cir. 1941), *aff'd*, 315 U.S. 510 (1942); *In re Wm. Akers, Jr., Co.*, 121 F.2d 846, 851 (3d Cir. 1941); *In re Berkshire Hardware Co.*, 39 F. Supp. 663, 667 (D. Mass. 1941); *In re Mid America Co.*, 31 F. Supp. 601, 604 (S.D. Ill. 1939); *In re Oshkosh Foundry Co.*, 28 F. Supp. 412, 414 (E.D. Wis. 1939).

purposes is, of course, a federal question.⁷³ The label given the imposition of a pecuniary burden by the state is not determinative,⁷⁴ although it is unlikely that a court would force a state to take a priority if the state officials were, for one reason or another, not inclined to seek it. In determining whether a state claim constitutes a tax a federal court will consider as one factor how the purported tax scheme has been treated within the state.⁷⁵ A state court's construction of the statute will receive "great consideration," but not complete deference.⁷⁶

In addition to the views expressed by state courts, executive bodies, and legislatures, other important factors in establishing the tax character of the claims include the *in invitum* nature of the state's scheme, its statutory basis, and the ability of the state to collect or enforce its claim regardless of the taxpayer's wishes.⁷⁷ The form of collection, whether by summary proceeding, distraint of property, retention of lien or mere ability to institute an action for debt is of less importance.⁷⁸

C. Workers' Compensation and the Tax Priority.

State workers' compensation schemes generally require that employers secure compensation liability "insurance" in one of three ways.⁷⁹ The most common form of statutory workers' compensation programs rely upon private insurance carriers to provide coverage commensurate with mandatory statutory coverage requirements.⁸⁰ States, such as West Virginia, that require employers

⁷³ *City of New York v. Feiring*, 313 U.S. 283, 285 (1941); *New Jersey v. Anderson*, 203 U.S. 483, 491 (1906).

⁷⁴ 203 U.S. at 490-91. See *In re Otto F. Lange Co.*, 159 F. 586, 588 (N.D. Iowa 1908): Many taxes are imposed under the name of license fees, franchise taxes, or taxes for special purposes under some other name, and are therefore special taxes; but they are nevertheless taxes imposed for a public purpose, no matter what the name under which they are levied or imposed, and are clearly within the meaning of the term "tax" as used in the bankruptcy act.

⁷⁵ *Accord New Jersey v. Anderson*, 203 U.S. 483, 490-92 (1906); *In re Berkshire Hardware*, 39 F. Supp. 663, 666-67 (D. Mass. 1941). See also *In re Adams*, 17 Bankr. 742 (Bankr. E.D. Pa. 1982).

⁷⁶ *New Jersey v. Anderson*, 203 U.S. 483, 491 (1906).

⁷⁷ *Id.* at 492.

⁷⁸ *Id.* Statements that manner of enforcement or collection are not determinative of the issue of tax/non-tax character are typically made in refuting arguments to the effect that the existence of an action for debt as the taxing authority's exclusive remedy demonstrates that the obligation is not a tax. *E.g., Id.* at 492-93. The existence of criminal sanctions or civil penalties for nonpayment would seem to support the characterization of a given charge as a tax because the existence of such sanctions is indicative of the important public purpose for and character of the obligation. The availability of a lien to secure a governmental unit's claim has been considered a factor strongly indicating that the claim is for a tax. See *In re Adams*, 17 Bankr. 742 (Bankr. E.D. Pa. 1982) (city's claim for water and sewer rents held to be a tax).

⁷⁹ Forty-nine of the fifty states require employer participation in some form of workmen's compensation program; the exception is Louisiana. 4 A. LARSON, WORKMEN'S COMPENSATION LAW § 92.10 at 17-1 (1982).

⁸⁰ Such private insurance programs are found in forty-four of the fifty states, either as the sole avenue of securing compensation coverage or in competition with state fund programs. 4 LARSON, WORKMEN'S COMPENSATION LAW § 92.10 at 17-2 (1982).

to pay premiums to a state compensation fund⁸¹ which serves as the sole avenue of securing coverage, aside from self-insurance,⁸² are in the distinct minority.⁸³

Because the forms of workers' compensation systems are diverse, generalizing the treatment of employers' workers' compensation obligations in bankruptcy proceedings has been difficult. Moreover, such compensation systems have insurance and tort characteristics, obscuring their essential social welfare function.⁸⁴ Certainly, an employer's premiums obligation to a private compensation insurance carrier providing such coverage in a jurisdiction adopting a private coverage system would never constitute a tax priority debt.⁸⁵ However, the jurisdictions that have established state workers' compensation funds, under which employers may or must secure coverage, have considered the matter of ensuring such compensation to be an appropriate government function. They have embraced the compensation scheme as a public concern, to be administered under government agency supervision and funded by a program of employer taxation. Such states have concluded that the purpose of a workers' compensation scheme can be best achieved as a governmental program.⁸⁶ In exclusive, mandatory state fund jurisdictions the adoption of workers' compensation as a public program is total.

The West Virginia Workmen's Compensation Act⁸⁷ establishes a mandatory program requiring all "employers"⁸⁸ to pay premiums⁸⁹ to a state

⁸¹ See W. VA. CODE § 23-2-1 (1981).

⁸² See W. VA. CODE § 23-2-9 (1981). Only three states, West Virginia, Washington and Ohio have exclusive state fund programs with a self-insurance alternative.

⁸³ Eighteen states have established state compensation funds, but in twelve of those states (Arkansas, California, Colorado, Idaho, Maryland, Michigan, Montana, New York, Oklahoma, Oregon, Pennsylvania, and Utah) employers may elect private coverage or, if qualified, self-insure. 4 A. LARSON, WORKMEN'S COMPENSATION LAW § 92.10 (1982). The exclusive state fund states are Nevada, North Dakota, Ohio, Washington, West Virginia and Wyoming. *Id.* Puerto Rico's statute also provides for an exclusive governmental compensation fund. *Id.* at app. A, table 7, p. A-7-3.

⁸⁴ 1 A. LARSON, WORKMEN'S COMPENSATION LAW § 1.20 (1978).

⁸⁵ The tax priority is available only for claims of "governmental units." 11 U.S.C. § 507(a)(6) (Supp. IV 1981). See 11 U.S.C. § 101(21) (Supp. IV 1981) (defining "governmental unit").

⁸⁶ Larson comments that while private insurers may balk at providing coverage for high-risk ventures, "[m]onopolistic state funds. . . seem to accept all applications from qualified employers as a matter of routine practice. . . ." 4 A. LARSON, WORKMEN'S COMPENSATION LAW § 92.53 at 17-29 (1982).

⁸⁷ W. VA. CODE §§ 23-1-1 to 23-6-1 (1981).

⁸⁸ Public employers required to participate in the workmen's compensation program include state and local governments, boards of education, volunteer fire departments, and emergency service organizations. W. VA. CODE § 23-2-1 (1981). All private persons and entities which regularly employ others in "any form of industry, service, or business" in the state are "employers" required to pay premiums under the Workmen's Compensation Act. *Id.*

Excepted from mandatory coverage are employers of six domestic servants, employers of five or fewer employees in agricultural service, employers whose employees are employed outside the state (other than on a temporary basis), and "casual employers" (who employ three or fewer employees on a temporary basis—not exceeding ten days per calendar quarter. *Id.* See Comment, *Workmen's Compensation—Meaning and Effect of Casual Employer Proviso*, 58 W. VA. L. REV. 314 (1956).

⁸⁹ W. VA. CODE § 23-2-5 (1981). See *supra* note 16.

fund⁹⁰ from which compensatory awards are made to workers who have "received personal injuries in the course of and resulting from their covered employment or to the dependents, if any, of such employees in case death has ensued. . . ."⁹¹ Employers who qualify may self-insure in lieu of participating in the otherwise mandatory state fund scheme.⁹²

Employers subject to the Act must make the required premium payments into the fund administered by the Workmen's Compensation Commissioner. Participation is not, generally speaking,⁹³ elective.⁹⁴ Although earlier versions of West Virginia's, as well as other states', compensation statutes created programs that were available at the employer's election,⁹⁵ such versions were drafted in order to avoid perceived constitutional infirmities in mandatory programs, a problem that no longer exists.⁹⁶ In any event, the present West Virginia Act creates a program that operates on employers *in invitum*.⁹⁷ The employer's obligation to make payments under the Act is an obligation imposed on his status as a statutory employer,⁹⁸ rather than arising from any contractual or quasi-contractual relationship among employer, employee, and the state. West Virginia's highest court has characterized the employer's obligation as follows:

[D]espite our course of decisions in this area of the law, [we] are of the opinion that the rights and duties under our workmen's compensation statute are no longer contractual but grow out of the employer-employee status to which the law attaches certain duties and responsibilities. The liability of employers arises from the law itself, rather than from any agreement of the parties.⁹⁹

⁹⁰ W. VA. CODE § 23-3-1 (1981).

⁹¹ W. VA. CODE § 23-4-1 (1981).

⁹² See W. VA. CODE § 23-2-9 (1981). See generally *Smith v. State Workmen's Compensation Comm'r*, 219 S.E.2d 361 (W. Va. 1975) (discussing self-insurer's rights and liabilities).

⁹³ See *supra* notes 83 to 85 and accompanying text; *Lester v. State Workmen's Compensation Comm'r*, 242 S.E.2d 443, 451 n. 14 (W. Va. 1978).

⁹⁴ *Jenkins v. Sal Chem. Co.*, 280 S.E.2d 243, 244 (W. Va. 1981); *Pnakovich v. State Workmen's Compensation Comm'r*, 259 S.E.2d 127, 130 (W. Va. 1979). Cf. W. VA. CODE § 23-2-9 (1981) (self-insurance; permitting voluntary participation of self-insuring employers in "surplus fund" available to pay awards stemming from catastrophes and second injuries).

⁹⁵ *Lester v. State Workmen's Compensation Comm'r*, 242 S.E.2d 443, 448 (W. Va. 1978) (discussing the history of the present statute).

⁹⁶ *Id.* 242 S.E.2d at 449-50. Early compulsory workmen's compensation statutes, of both the "private" and "state fund" variety were held unconstitutional in a number of jurisdictions. See, e.g., *Cunningham v. Northwestern Improvement Co.*, 44 Mont. 180, 119 P. 554 (1911); *Ines v. South Buffalo Ry.*, 201 N.Y. 271, 94 N.E. 431 (1911). The response to such decisions was the enactment of elective workmen's compensation statutes in some states and statutes covering only "hazardous" employments in others. See 1 A. LARSON, WORKMEN'S COMPENSATION LAW § 5.20 (1978). The United States Supreme Court issues a series of opinions in 1917 holding compulsory, elective and exclusive-state-fund compensation statutes valid under the United States Constitution. *Id.* at 39.

⁹⁷ *Jenkins v. Sal Chem. Co.*, 280 S.E.2d 243, 244 (W. Va. 1981); *Pnakovich v. State Workmen's Compensation Comm'r*, 259 S.E.2d 127, 130 (W. Va. 1979). A contract between employer and employee to waive the benefits and burdens of the Workmen's Compensation Act is void. W. VA. CODE § 23-2-7. See *Jenkins v. Sal Chem. Co.*, 280 S.E.2d 243, 244 (W. Va. 1981).

⁹⁸ W. VA. CODE § 23-2-1 (1981).

⁹⁹ *Lester v. State Workmen's Compensation Comm'r*, 242 S.E.2d 443, 450-51 (W. Va. 1978).

The West Virginia Workmen's Compensation Act's scheme for mandatory employer contributions to the state fund has the essential characteristics of obligations held to be tax programs for purposes of the historical bankruptcy distribution priority. Employers' obligations are to pay an impost levied by the state to support a governmental program.¹⁰⁰ The state establishes the obligation and its amount without the employer's consent and the employer must pay, on pain of substantial civil¹⁰¹ and even criminal,¹⁰² sanctions.

Furthermore, workers' compensation programs have been enacted for achievement of broader social purposes than merely insuring workers against on-the-job injuries.¹⁰³ West Virginia's Workmen's Compensation Act is a product of the legislature's exercise of police power¹⁰⁴ to "provide a system by which injuries due to industry may be liquidated and compensation provided"¹⁰⁵ with the costs allocated, ultimately, to all consumers of the products of industry.¹⁰⁶ The West Virginia Supreme Court of Appeals has expressly stated that issues arising under the Workmen's Compensation Act are affected by the public interest.¹⁰⁷

Claims arising under the state's workmen's compensation system carry all the hallmarks of a tax obligation of the nature traditionally accorded priority in bankruptcy distributions. The system is mandatory, established to exact payments to a state fund that enables execution of a governmental program furthering the general welfare and the legislation's public purpose.¹⁰⁸ The pro-

¹⁰⁰ See *supra* note 67 and accompanying text.

¹⁰¹ W. VA. CODE §§ 23-2-5 to 5a (1981). In addition to penalties collectible by the state, an employer's default triggers loss of statutory immunity from actions by employees at common law for work-related injuries and loss of the common law defenses of fellow-servant, assumption of risk and contributory (now likely comparative) negligence. W. VA. CODE § 23-2-8 (1981); *Jenkins v. Sal Chem. Co.*, 280 S.E.2d 243 (W. Va. 1981).

¹⁰² Employers subject to the mandatory coverage of the Workmen's Compensation Act and who knowingly fail to subscribe to the fund, or who knowingly fail to make reports or perform required duties are guilty of a misdemeanor. Those who knowingly submit false sworn statements to the Workmen's Compensation Commissioner are guilty of perjury. W. VA. CODE § 23-1-16 (1981).

¹⁰³ See *Lester v. State Workmen's Compensation Comm'r*, 242 S.E.2d 443, 449 (W. Va. 1978) (public has direct interest in workmen's compensation as it affects the common welfare); *Mains v. J.E. Harris Co.*, 119 W. Va. 730, 732-33, 197 S.E. 10, 11 (1938).

Larson has commented:

The ultimate social philosophy behind compensation liability is belief in the wisdom of providing, in the most efficient, most dignified, and the most certain form, financial and medical benefits of the victims of work-connected injuries which an enlightened community would feel obliged to provide in any case in some less satisfactory form, and of allocating the burden of these payments to the most appropriate source of payment, the consumer of the product.

1 A. LARSON, WORKMEN'S COMPENSATION LAW § 2.20 (1978).

¹⁰⁴ *Rogers v. State Compensation Comm'r*, 140 W. Va. 376, 380-81, 84 S.E.2d 218, 221 (1954); *Blevins v. State Compensation Comm'r*, 127 W. Va. 481, 496-98, 33 S.E.2d 408, 415 (1945).

¹⁰⁵ *Rogers v. State Compensation Comm'r*, 140 W. Va. 376, 380, 84 S.E.2d 218, 221 (1954).

¹⁰⁶ *Mains v. J. E. Harris Co.*, 119 W. Va. 730, 732-33, 197 S.E. 10, 11 (1938). See generally 1 A. LARSON, WORKMEN'S COMPENSATION LAW § 1.20 (1978).

¹⁰⁷ *Mains v. J.E. Harris*, 119 W. Va. 730, 732-33, 197 S.E. 10, 11 (1938).

¹⁰⁸ The defaulting employer's obligation to pay not only current premiums but to pay all past

gram's successful execution has been considered to depend upon all employers paying the required premiums.¹⁰⁹ Application of the bankruptcy priority (and accompanying nondischargeability under the Code)¹¹⁰ is consistent with the purpose of the bankruptcy tax priority—to elevate the claims of public creditors for tax revenues essential to funding of government programs above those of garden-variety unsecured creditors.¹¹¹

Most courts that have considered the matter have concluded that employers' mandatory premium obligation¹¹² and obligations to repay to state funds compensation awards made to their workers during periods in which they were in default of premiums¹¹³ are entitled to tax priority in bankruptcy.¹¹⁴ Such decisions have recognized the public purpose of workers' compensation statutes,¹¹⁵ and that employers' mandatory obligations to provide revenue to de-

due premiums is another characteristic typical of a taxation scheme. See W. VA. CODE § 23-2-5 (1981). In considering a similar obligation imposed by a Puerto Rico statute, the United States Court of Appeals for the First Circuit commented, "The cumulative obligations underline the point that the employer's so-called premium obligation is not the conventional premium familiar with ordinary cases of insurance, (see 5 G. J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 30:1 (2d ed. 1960), but is indeed a tax which is payable even if it is not advantageous to the employer." *In re Pan American Paper Mills, Inc.*, 618 F.2d 159, 163 (1st Cir. 1980).

¹⁰⁹ *West Virginia Coal & Coke Corp. v. State Compensation Comm'r*, 116 W. Va. 701, 705, 182 S.E. 826, 828 (1935).

¹¹⁰ 11 U.S.C. § 523(a) (Supp. IV 1980).

¹¹¹ See *supra* notes 35-41 and accompanying text. In a recent opinion the West Virginia Attorney General has concluded that employers' obligations to the state under the Workmen's Compensation Act constitute "taxes" for purposes of the bankruptcy priority. See Op. Att'y Gen., Sept. 7, 1982. Such a conclusion is one factor pertinent to the federal issue of priority. See *supra* text accompanying note 75.

¹¹² *E.g.*, W. VA. CODE § 23-2-5 (1981).

¹¹³ *Id.*

¹¹⁴ See *In re Pan American Paper Mills, Inc.*, 618 F.2d 159 (1st Cir. 1980) (unpaid premiums, exclusive state fund statute—Puerto Rico); *In re Int'l Automated Machines, Inc.*, 9 Bankr. 575 (Bankr. N.D. Ohio 1981) (unpaid premiums, exclusive state fund statute); *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157 (Bankr. D. Or. 1980) (compensation repayment obligation, competitive state fund statute); *Cf. State Industrial Accident Comm'n v. Aebi*, 177 Or. 361, 162 P.2d 513 (1945) (addressing dischargeability of claims arising under a competitive state fund statute). See generally NADLER, THE LAW OF BANKRUPTCY § 194 (2d ed. Supp. 1972).

Several very old decisions do exist which deny tax treatment under the bankruptcy laws to amounts owed by employers under workmen's compensation acts. *In re Farrel*, 211 F. 212 (W.D. Wash. 1914), discussed *supra* note 60, rested on the unsound proposition that a levy against a class for the benefit of a class could not be a tax. See *supra* notes 61-65 and accompanying text. *Farrel* also rested on an inaccurate reading of Washington case law. See Annot., 161 A.L.R. 217, 218-19 (1946). Another early case, *Mississippi Valley Trust Co. v. Oregon-Washington Timber Co.*, 213 F. 988 (W.D. Wash. 1914), held that Washington's workmen's compensation statutes did not impose a "tax" on employers. *Mississippi Valley* addressed the issue not in the bankruptcy context but in determining the relative priority of liens of the state and a foreclosing private creditor; the *Mississippi Valley* court merely followed *Farrell* without further analysis.

One other case denying tax priority to a state claim in bankruptcy for workmen's compensation premiums exists, *In re Eureka Paper Co.*, 44 Am. Bankr. Rep. (F.) 179 (N.D.N.Y. 1919). That opinion was founded on the proposition that the state's claim would not be accorded priority in bankruptcy if it did not have priority under state insolvency laws. *Id.* at 180. The current Code contains no provisions relating the question of tax priority to state insolvency laws and such a test for tax nature has not been utilized in any other cases.

¹¹⁵ *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 159 (Bankr. D. Or. 1980); *Accident Comm'r*

fray the costs of workmen's compensation programs are obligations to contribute to pay "expenses of government or undertakings authorized by it".¹¹⁶

In addition, employer obligations to contribute to state unemployment compensation funds, which have been long-recognized as bankruptcy tax priority obligations¹¹⁷ have been considered indistinguishable, for purposes of applying the priority, from required contributions to state workers' compensation funds.¹¹⁸

D. *The Tax Priority Under the Bankruptcy Code of 1978.*

Prior to the 1978 revision of the federal bankruptcy laws, the priority accorded taxes was found in section 64a of the Bankruptcy Act of 1898, which provided, in pertinent part:

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankruptcy estates, and the order of payment, shall be . . . (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy. . . .¹¹⁹

This category of priority tax claims was further defined in section 17 of the 1898 Act as those taxes which became "legally due and owing" from the debtor to the taxing authority within three years preceding bankruptcy.¹²⁰

Under the Bankruptcy Code, the tax priority was rewritten and lowered from fourth to sixth in the hierarchy of priority creditors.¹²¹ The scope of the tax priority was refined as well, as can be seen in the statutory language that follows:

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

* * *

(6) Sixth, allowed unsecured claims of governmental units, to the extent that such claims are for—

- (A) a tax on or measured by income or gross receipts—
- i. for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
 - ii. assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or
 - iii. other than a tax of a kind specified in section 523(a)(1)(B) or

v. Aebi, 177 Or. 361, 162 P.2d 513 (1945).

¹¹⁶ New Jersey v. Anderson, 203 U.S. 483, 491 (1906). See also *In re Pan American Paper Mills*, 618 F.2d 159, 162 (2d Cir. 1980).

¹¹⁷ See, e.g., cases cited *supra* note 72.

¹¹⁸ *In re Pan American Paper Mills, Inc.*, 618 F.2d 159 (1st Cir. 1980); *State Industrial Accident Comm'r v. Aebi*, 177 Or. 361, 162 P.2d 513 (1945).

¹¹⁹ 11 U.S.C. § 104a (1976) (*repealed* Pub. L. No. 95-598, 92 Stat. 2682, *eff.* October 1, 1978).

¹²⁰ 11 U.S.C. § 35 (1976) (*repealed* Pub. L. No. 95-598, 92 Stat. 2682, *eff.* October 1, 1978).

¹²¹ 11 U.S.C. § 507(a)(6) (Supp. IV 1980), *supra* note 39.

523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

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

(D) *an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;*

(E) *an excise tax on—*

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

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

(F) a customs duty arising out of the importation of merchandise—

i. *entered for consumption within one year before the date of the filing of the petition;*

ii. *covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or*

iii. *entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisal or classification of such merchandise was not available to the appropriate customs officer before such date; or*

(G) *a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss. (Emphasis added).¹²²*

Rather than retaining a general priority for any taxes that become legally due and owing from the debtor to the taxing authority within three years of bankruptcy, the Bankruptcy Code extends the tax priority only to taxes specifically described in the statute. Among the taxes so described are "employment taxes" on wages, a description fitting precisely the mandatory premium obligations owed by employers to the Workmen's Compensation Fund.¹²³

¹²² *Id.*

¹²³ See W. VA. CODE § 23-2-5 (1981), which provides *inter alia*: "each employer. . . shall pay the premiums of liabilities based upon and being such a percentage of the payroll of such employer. . . ." The mandatory obligation to pay such premiums, arising as it does by law by reason of the taxpayers status as a covered "employer," *Lester v. State Workmen's Compensation Commissioner*, 242 S.E.2d 443, 450-51 (W. Va. 1978), constitutes a tax on exercise of the privilege of employing others. *In re Wm. Akers, Jr., Co.*, 121 F.2d 846, 851 (3d Cir. 1941). See *supra* note 71.

The legislative history of the Bankruptcy Code indicates that priority tax claims were specifically enumerated and described in the Code in order to make application of the priority more apparent in "complex situations in which tax collection issues arise" and to clear up "uncertainties and ambiguities in the tax rules of . . . bankruptcy law as well as certain loopholes under which some debtors have been able to exploit the administrative processes of a governmental unit so as to escape taxes unfairly."¹²⁴ The House Committee on the Judiciary noted that although the bill before it specifically described the taxes entitled to priority, the taxes specified "closely follow the categories granted priority under the Bankruptcy Act. . ."¹²⁵ with the exception of eliminating the priority of tax penalties not representing repayment to the taxing authority of "pecuniary loss."¹²⁶ The legislative history indicates that the drafters of the Code intended to cast the net carefully to capture priority distributions for taxes and to mend the holes through which some debtors escaped tax liability in bankruptcy unfairly.¹²⁷ If anything, one must conclude that changes in the tax priority under the Code were intended to retain a comprehensive, inclusive tax priority and to eliminate the priority only for obligations which did not actually fund the tax-supported program.¹²⁸

As discussed above, the West Virginia employer's obligation to pay premiums based on his reported payroll fits precisely the category of "employment tax," particularly in light of legislative history indicating that the Code's prior-

¹²⁴ S. REP. NO. 989, 95TH CONG., 2D SESS. 14, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5800. A primary concern in Congress's estimation was the impact that ready discharge of tax obligations in bankruptcy would have upon tax systems dependent on taxpayer cooperation for efficient operation. The Senate Judiciary Committee expressed concern that if all tax debts were discharged and if bankruptcy proceedings held little hope of payment (as would be the case absent priority treatment), other taxpayers would react to a perceived unfairness by failing to cooperate with taxing authorities:

Since tax authorities are creditors of practically every taxpayer, another important element is that tax collection rules for bankruptcy cases have a direct impact on the integrity of the Federal, State and local tax systems. These tax systems, generally based on voluntary assessment, work to the extent that the majority of taxpayers think they are fair. This presumption of fairness is an asset which should be protected and not jeopardized by permitting taxpayers to use bankruptcy as a means of improperly avoiding their tax debts. To the extent that debtors in a bankruptcy are freed from paying their tax liabilities, the burden of making up the revenues thus lost must be shifted to other taxpayers.

Id.

To the extent that West Virginia employers' debts to the Workmen's Compensation Fund go unpaid in bankruptcy, other employers may expect higher premium tax rates. According such indebtedness priority as a tax will reduce bankruptcies' impact on the Fund, as will nondischargeability of the tax debt. This is precisely the intended function of the Code's interrelated tax priority and nondischargeability provisions. Of course, in the case of corporate debtors in straight bankruptcies, nondischargeability is of reduced significance, *see supra* note 20, and the priority provision is therefore of increased importance.

¹²⁵ H.R. REP. NO. 595, 95th Cong., 2d Sess. 190, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6151.

¹²⁶ *See* 11 U.S.C. §§ 507(a)(6)(G) & 726(a)(4)(1979).

¹²⁷ S. REP. NO. 989, 95th Cong., 2d Sess. 13-14, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5799-5800.

¹²⁸ *Id.* *See also* 11 U.S.C. §§ 507(a)(6)(G) & 726(a)(4) (Supp. IV 1980).

ity was intended to remain much the same as that provided by the Act.¹²⁹ The committee report on the Senate version of the bill indicates that the employer's obligations for social security, railroad retirement and unemployment compensation taxes were considered to be priority "employment taxes."¹³⁰ The examples proffered by the Senate Committee cannot, however, be taken as exclusive, particularly in light of the indistinguishability of state-fund workmen's compensation programs from state unemployment compensation programs under the court-enunciated principles governing proper application of the distribution priority.¹³¹

The conclusion that the employer's premium obligation under West Virginia law constitutes an employment tax permits the State to obtain priority payment of its claims for premiums owed by the employer-debtor for which returns were due within three years of the filing of the petition.¹³² Premiums owed for periods for which returns were due more than three years prior to the petition in bankruptcy will be treated as general, unsecured, nonpriority claims.¹³³ Interest accrued on the employer's obligation in the pre-petition period will be a part of the priority claim.¹³⁴ Post-petition interest on such obligations at the legal rate will be paid only in the event *all* unsecured creditors and all claims for (noncompensatory) penalties are fully paid.¹³⁵

The employer's obligation to repay the Workmen's Compensation Fund for all benefits paid from the fund to his employees while he is in default of his premium payment obligation should also qualify for tax priority in distribution.¹³⁶ Such an obligation to the fund represents an involuntary impost that is

¹²⁹ See *supra* note 125.

¹³⁰ S. REP. No. 989, 95th Cong. 2d Sess. 70, reprinted in § 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5856.

¹³¹ See *In re Pan American Paper Mills, Inc.*, 618 F.2d 159 (1st Cir. 1980). In considering an employer's obligations under Puerto Rico's "state" fund compensation program and after noting that the term "taxes" for bankruptcy priority purposes is to be construed broadly, the court stated:

That broad approach led lower courts to hold that where, pursuant to an unemployment compensation law, a state exacts . . .so-called "contributions" a state's claim for such contributions is entitled to priority under Bankruptcy Act § 64(a)(4). . . .

We see no reason not to apply the same approach to situations where pursuant to workmen's compensation law a state . . .exactes from an employer so-called "premiums." *State Industrial Insurance Commission v. Aebi*, 177 Or. 361, 162 P.2d 513 (1945). The reason that such premiums should be treated as taxes within § 64(a)(4) of the Bankruptcy Act is that they are pecuniary obligations imposed by the government for the purpose of defraying the expenses of an undertaking which it authorized.

618 F.2d 159, 162 (footnote deleted). See also *In re International Automated Machines, Inc.*, 9 Bankr. 575 (Bankr. N.D. Ohio, W.D. 1981).

¹³² 11 U.S.C. § 507(a)(6)(D) (Supp. IV 1980).

¹³³ *Id.*

¹³⁴ Cf. 11 U.S.C. § 502(b)(2) (Supp. IV 1980).

¹³⁵ Claims for post petition interest will virtually never be paid as such claims are senior in the distribution order only to the debtor's right to undistributed surplus assets of the estate. See 11 U.S.C. § 726(a)(5).

¹³⁶ 11 U.S.C. § 507(a)(6)(E) (Supp. IV 1980). See *In Re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157 (Bankr. D. Or. 1980).

part and parcel of the overall program and employment tax scheme.¹³⁷ Moreover, the obligation represents a penalty "related to" the employment tax and intended to compensate the state for "actual pecuniary loss."¹³⁸ Finally, and most persuasively, the repayment obligation is accurately characterized as an excise tax entitled to priority.¹³⁹ A similar obligation under the Oregon's workers' compensation statute was recently held to be an excise tax on a pre-bankruptcy transaction, separately and specifically entitled to sixth distribution priority.¹⁴⁰ The reasoning employed by the Oregon bankruptcy court in so holding has been extended in a recent case arising in the Bankruptcy Court for the Eastern District of Tennessee which held that fees assessed against coal miners under the Surface Mining Control and Reclamation Act¹⁴¹ constituted priority, nondischargeable excise taxes.¹⁴²

E. Dischargeability and Related Issues

In Chapter 7 liquidation proceedings under the Bankruptcy Code, only "individual" debtors may receive a discharge of pre-petition indebtedness.¹⁴³

¹³⁷ See 11 U.S.C. § 507(a)(6)(D) (Supp. IV 1980).

¹³⁸ See 11 U.S.C. § 507(a)(6)(G) (Supp. IV 1980). The argument proceeds on the premise that compensation paid to employees of employers in default represents out-of-pocket expenditures by the fund and such expenditures are required by statute to be made, notwithstanding the employers' default. W. VA. CODE § 23-2-5 (1981). Because the Fund is entitled to recover the benefits paid, until repayment is received the amount represents "pecuniary loss." The argument is somewhat circular, but absent the statutory mandate that employees of defaulting employers not be denied benefits (a mandate that indicates the program is a social welfare program rather than merely a system of insurance) the Fund would not be expected to make awards to employees of defaulting employers.

¹³⁹ See U.S.C. § 507(a)(6)(E) (Supp. IV 1980).

¹⁴⁰ The Bankruptcy Court for the District of Oregon held that an employer's benefit repayment obligation to the state fund under Oregon's worker's compensation statute, similar to the mandatory state fund program of West Virginia, constitutes a priority "excise" tax. The court held that an employer's obligation to repay the state for benefits paid to its workers was an excise tax under 11 U.S.C. § 507(a)(6)(E) and, therefore, not discharged by the employer's bankruptcy. According to the court, the "excise tax" for priority and nondischargeability purposes was intended to be construed flexibly and was designed to encompass "all indirect taxes not otherwise included in § 507(a)(6)." *In re Beaman*, 4 COLLIER BANKR. CAS. 2d (MB) 157, 160 (D. Or. 1980).

The court found the employer's obligation clearly to be a "tax" before going on to characterize it as an "excise tax":

The requirement that noncomplying employers reimburse the state for benefits paid to their injured workers promotes a governmental interest which would otherwise be funded by the State Administrative Fund and by all employers who contribute indirectly or directly to the fund. The debt is a tax on noncomplying or outlaw employers. Neither compliance with the law nor payment of the tax imposed is elective once benefits are paid to an injured worker.

Id. at 159. Under the Code, the questions of priority and non-dischargeability hinge on the same issues. See *infra* note 145.

¹⁴¹ 30 U.S.C. §§ 1201, 1232a (Supp. IV 1980).

¹⁴² *U.S. v. King (In re King)*, 19 Bankr. 936 (Bankr. E.D. Tenn. 1982). The court first held the reclamation fees to be "taxes," see 19 Bankr. 937-38 and discussion *supra* at notes 67 to 72. It then went on to explain that an "excise tax," for bankruptcy and other purposes is a very broad concept encompassing virtually all indirect taxes, such as employer obligations under state fund workers' compensation programs. *Id.*, 19 Bankr. at 939.

¹⁴³ See *supra* note 20.

Corporate debtors are not discharged of their obligations.¹⁴⁴ To the extent a claim against an individual debtor for amounts owed under a state fund compensation program such as West Virginia's qualifies for the bankruptcy tax distribution priority, it will not be discharged in bankruptcy.¹⁴⁵

As for debtors reorganizing under Chapter 11, the Code requires that the plan of reorganization provide for payment of the tax claim either fully in cash on confirmation, or by deferred cash payments of a value equal to the allowed amount of the claim on the date of confirmation, within six years of the date the tax obligation was assessed.¹⁴⁶ Individual debtors undergoing rehabilitation under Chapter 13 of the Code must provide for full payment of all priority claims, including a tax claim, within their rehabilitation plans.¹⁴⁷

In the event that the State has filed a lien securing the employer's obligation¹⁴⁸ that lien will not be avoidable by the trustee unless it is unperfected¹⁴⁹ or unenforceable on the date the petition is filed.¹⁵⁰ Distribution of proceeds of the sale of property encumbered by such a lien, however, is subject to special subordination rules governing tax liens.¹⁵¹ Generally speaking, the provisions

¹⁴⁴ 11 U.S.C. § 727(a)(1) (Supp. IV 1980); *see supra* note 20.

¹⁴⁵ 11 U.S.C. § 523(a)(1)(A) (Supp. IV 1980). The debt may remain undischarged even if more than three years old if the employer failed to file a return, filed a late return within 2 years of bankruptcy, or fraudulently evaded the tax. 11 U.S.C. § 523(a)(1)(B) & (C) (Supp. IV 1980).

¹⁴⁶ 11 U.S.C. § 1129(a)(9)(C) (Supp. IV 1980). This requirement is subject to waiver by the claimant in the event he and the trustee agree to different terms. *Id.*

¹⁴⁷ 11 U.S.C. § 1322(a)(2) (Supp. IV 1980). As under Chapter 11, the claimant may agree to different treatment. *Id.*

¹⁴⁸ W. VA. CODE § 23-2-5a (1981).

¹⁴⁹ 11 U.S.C. § 545(2) (Supp. IV 1980). Because the lien does not become effective upon the filing of bankruptcy or the occurrence of other insolvency-related events, it is not avoidable under § 545(1). Generally speaking, "perfection" will take place at the time that the lien is docketed because docketing is the act which renders the lien enforceable against a bona fide purchaser. W. VA. CODE § 23-2-5a (1981). *See generally* 4 COLLIER ON BANKRUPTCY § 545.04[2] (15th ed. 1982).

¹⁵⁰ *See supra* note 149.

¹⁵¹ The lien for taxes will be junior to liens of other creditors who are senior lienors under state law. In addition, priority unsecured creditors under 11 U.S.C. § 507(a)(1), (a)(2), (a)(3), (a)(4) and (a)(5) (Supp. IV 1980), *see supra* text accompanying notes 28-32, are entitled to distributions from the encumbered property before the property or proceeds from its sale are distributed to the tax lienor:

§ 724. Treatment of certain liens

(a) The trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title.

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for taxes, or proceeds of such property, shall be distributed—

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;

(2) second, to claims specified in sections 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), and 507(a)(5) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

(3) third, to the holder of such tax lien, to any extent that such holder's allowed claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;

(4) fourth, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is junior to such tax

relating to distributions of property subject to nonavoidable tax liens provide that the lienor will be subordinated to the claims of creditors with priority under section 507.¹⁵² Thus, tax liens that are not avoided by the trustee¹⁵³ are not treated in the same manner as other nonavoidable liens.¹⁵⁴

The tax lien will be accorded its appropriate rank as against junior and senior liens on the same property.¹⁵⁵ However, the property or its proceeds, to the extent subject to the lien, will be distributed first to the unsecured priority claimants designated in section 507.¹⁵⁶ Thus, the tax lienor will be subordinated to claims for administrative expenses, creditors whose claims arose between the filing of an involuntary proceeding and entry of an order for relief or appointment of a trustee, wage claims, claims for contributions to employee benefit plans, and consumer deposit refund claims.¹⁵⁷ After distributions to the unsecured priority claimants have been made, the tax lienor will receive any undistributed property or proceeds encumbered by its tax lien.¹⁵⁸ Thereafter, junior lienors will be paid and, if value in the encumbered property remains, the tax claimant will receive the balance of its entire allowed claim originally secured by the lien before the property or its proceeds go to the estate.¹⁵⁹ The tax lien will be avoided to the extent it secures a "penalty, fine or forfeiture" not imposed to compensate the taxing authority for pecuniary loss.¹⁶⁰

The state's claim for a "tax" entitled to priority is not limited to tax obligations which "arose" prior to filing the petition. In other words, if the obligation to make payment of premiums on pre-petition wages did not mature until

lien;

(5) fifth, to the holder of such tax lien, to the extent that such holder's allowed claim secured by such tax lien is not paid under paragraph (3) of this subsection; and

(6) sixth, to the estate.

(c) If more than one creditor is entitled to distribution under a particular paragraph of subsection (b) of this section, distribution to such creditors under such paragraph shall be in the same order as distribution to such creditors would have been other than under this section.

(d) A statutory lien whose priority is determined in the same manner as the priority of a tax lien under section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. 6323) shall be treated under subsection (b) of this section the same as a tax lien.

11 U.S.C. § 724 (Supp. IV 1980).

¹⁵² *Id.* See *supra* notes 38-46 and accompanying text. The special treatment of creditors with claims entitled to priority under section 507 represents a legislative judgment that the claims of secured creditors who are governmental taxing authorities should be postponed *vis a vis* the creditors whom, by reason of status or administrative necessity, must be paid before virtually all others (except secured claims of private creditors).

¹⁵³ See *supra* note 149.

¹⁵⁴ See *supra* note 28 and accompanying text.

¹⁵⁵ 11 U.S.C. §724(b)(1), (3) (Supp. IV 1980).

¹⁵⁶ 11 U.S.C. §724(b)(2) (Supp. IV 1980).

¹⁵⁷ 11 U.S.C. §724(b)(2), (3) (Supp. IV 1980).

¹⁵⁸ 11 U.S.C. §724(b)(3) (Supp. IV 1980).

¹⁵⁹ 11 U.S.C. §724(b)(5) (Supp. IV 1980).

¹⁶⁰ See 11 U.S.C. § 724(a), *supra* note 151; § 726(a)(4) (Supp. IV 1980), *supra* note 31. Cf. 11 U.S.C. § 507(a)(6)(G) (Supp. IV 1980), *supra* note 39.

after the petition was filed, the state's claim for those premiums may be assessed after the petition is filed, notwithstanding the automatic stay, and the claim will be treated as arising before bankruptcy.¹⁶¹

CONCLUSION

Among the unsecured debts that are by their nature entitled to priority in distribution of the assets of a debtor's estate in bankruptcy are designated "taxes" owed to governmental entities. As an impost involuntarily levied against employers to fund a program established by government to fulfill a public welfare purpose, "premium" obligations of employer's under state fund workers' compensation programs are "employment taxes" entitled to sixth priority in bankruptcy distributions. Interest accruing before the filing of the petition on such unpaid obligations receives the same priority. Employers' obligations to repay the state fund for awards made to employees for injuries sustained during periods of employer delinquency are entitled to the same priority as an "excise tax," as a part of the overall "employment tax" scheme, or as a tax-related penalty that compensates the state for pecuniary loss.

To the extent the claim qualifies as a priority tax claim, it is not dischargeable in a Chapter 7 liquidation. In the business reorganization context of Chapter 11 and the individual debtor rehabilitation context of Chapter 13, such claims, to the extent they qualify for priority, must be paid in full over time.

The obligations of employers to state workers' compensation funds are but one example of "tax" debts for bankruptcy purposes that may appear at first blush to be programs without generally appreciated tax characteristics. The tax character of obligations such as those owed under state fund workers' compensation schemes has substantial impact upon the amount of assets available to general unsecured creditors as well as upon the extent of discharge available in bankruptcy. Before bankruptcy is initiated, a thorough analysis of the amount and character of all of the debtor's indebtedness is a necessary and prudent first step.

¹⁶¹ 11 U.S.C. § 502 (i) (Supp. IV 1980).