

DISCHARGE AND DISCHARGEABILITY
AN OVERVIEW OF SECTIONS 523 AND 727

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The Bankruptcy Code has a goal of providing an honest with a fresh start through discharge of his or her debts. However, as a matter of public policy, certain debts cannot be discharged in bankruptcy despite debtor's honesty and good faith (i.e., child support, many taxes, most student loans) and other debts may be excepted from discharge due to bad conduct on the part of the debtor

Section 523 – Exceptions to Discharge

A creditor may bring an action under Section 523 when its intent is to deny debtor a discharge of the its debt while allowing the debtor to discharge his or her other debts. Actions brought under Section 523 generally allege misconduct on the part of the debtor directed toward the specific creditor bringing the action. Debts are discharged under subsections (2), (4) and (6) unless an adversary proceeding is brought and the court determines such debt to be excepted from discharge. Debts under all other subsections are deemed to be excepted from discharge without the necessity of filing an adversary proceeding.

Section 523(a)(1). Section (a)(1) excepts from discharge a debt for certain taxes or customs duties. Specifically excepted from discharge are taxes

- (A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed.
- (B) with respect to which a return, or equivalent report or notice, if required –
 - (i) was not filed or given; or
 - (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or
- (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

Section 523 (a)(2). Section 523(a)(2) excepts from discharge the following debts “for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by” --

- (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
 - consumer debts owed to a single creditor and aggregating more than \$675 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable, but the presumption is rebuttable.
 - the term luxury goods and services does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor.
 - cash advances aggregating more than \$950 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable.
 - Absent exceptional circumstances, when a creditor requests a determination of dischargeability of a consumer debt under this subsection and the court rules in favor of the debtor and finds that such debt is discharged, the court shall award costs and a reasonable attorney's fee to

the debtor, if the court finds that the position of the creditor was not substantially justified.

- (B) use of a statement in writing
 - (i) that is materially false;
 - (ii) respecting the debtor's or an insider's financial condition;
 - (iii) on which the creditor to whom the debtor is liable for such money, property, services or credit reasonably relied; and
 - (iv) that the debtor caused to be made or published with intent to deceive.

Section 523(a)(2)(B) requires a statement in writing, Section 523(a)(2)(A) does not. Section 523(a)(2)(B) requires a statement respecting the debtor's or insider's financial condition. Section 523(a)(2)(A) requires a statement other than one respecting the debtor's or insider's financial condition. Section 523(a)(2)(B) commonly involves false financial statement allegations, often involving claims of overestimating the value of assets, including assets not owned by the debtor and/or failure to disclose liabilities.

In In re Mercer, 246 F3d 391 (5th Cir. 2001), the Court held that every time a debtor uses a credit card, he or she make two representations – (1) that debtor has the intention to repay the debt and (2) that debtor has the ability to repay the debt. The Court also found that each time a creditor allows the use of the credit card, the creditor is relying on the aforementioned representations.

Section 523(a)(3). Section 523(a)(3) excepts from discharge debts not listed or scheduled in the debtor's schedules in time to permit

- (A) if the debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or
- (B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.

Section 523(a)(4). Section 523(a)(4) excepts from discharge debts for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

Defalcation requires a lower showing of misconduct – i.e., a willful neglect of duty rather than intentional fraudulent conduct. In re Schwager, 121 F3d 177, 184 (Bankr. E.D. Tex., 2008). For a finding of fiduciary duty, an express trust (one imposed by contract or statute) is generally required – a customary course of dealing or friendship is generally insufficient. The Fifth Circuit has held that a fiduciary duty is one of special trust or confidence arising prior to and apart from the transaction in question. In re Monnig's Dept. Store, 929 F2d 197 (5th Cir. 1991). But see In re Antone's Records, Inc., 445 BR 758 (Bankr. W.D. Tex. 2011), where the Court found that an informal fiduciary relationship sufficient for a Section 523(a)(4) action may be created where a "special confidence" is placed in one person who is "bound to act in good faith and with due regard to the interest of the one reposing confidence." But see In re Atkins, 458 BR 858 (Bankr. W.D. Tex. 2011), where the court found that whether there is an informal fiduciary relationship is a question of fact based on the circumstances surrounding a "moral, social, domestic or purely personal relationship", citing Thigpen v. Locke, 363 SW2d 247,253 (Tex 1962).

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