



# 11 USC 523 Exceptions to Discharge

BY KIRK BRENNAN, ESQ.

One of the major policy objectives of the Bankruptcy Code is to provide the “honest but unfortunate” debtor with a fresh start. This is achieved by granting a discharge of certain debts. The discharge received by a debtor in bankruptcy is determined by the chapter of the bankruptcy code under which the debtor files: Bankruptcy Code Section 727 for a Chapter 7 case, Section 1141 for a Chapter 11 case, Section 1228 for a Chapter 12 case and Section 1328 for a Chapter 13 case.

Congress has determined that creditors’ interests in recovering full payment of certain debts outweighs debtors’ interests in making a complete fresh start. Section 523 of Title 11, entitled “Exceptions to Discharge,” enumerates 21 categories of debt that are not discharged in certain cases. This article provides a brief overview of some of the more salient provisions of 11 USC 523.

The exceptions to discharge in 523(a) apply to individual (as opposed to, for example, corporate) debtors. Discharges under Chapters 7, 11 and 12, and hardship discharges under Chapter



13, will not discharge an individual debtor from debts listed in Section 523(a), except that debts listed under 523(a)(2), (a)(4) and (a)(6) require action by the creditor to avoid their discharge.

The standard Chapter 13 discharge provides broader relief for individual debtors than discharges under Chapters 7, 11 and 12, and the Chapter 13 hardship discharge under Section 1328(b), because it allows for the discharge of some of the types of debt listed in Section 523(a). Although subsections (1)(B), (1)(C), (2), (3), (4), (5), (8) and (9) of Section 523(a) are excepted from the standard Chapter 13 discharge under Section 1328, the remaining subsections of 523(a) are not, and they will be discharged.

Exceptions to discharge are confined to those plainly expressed in the statutes and are generally construed in favor of the debtor.<sup>1</sup> A creditor seeking to except a debt from the debtor's discharge generally bears the burden of proof to establish the statutory exception upon which the creditor relies, except where courts have found exceptions, such as

in the case of student loan debt under 523(a)(8).<sup>2</sup> The standard of proof for the dischargeability exceptions in 11 USC 523(a) is preponderance of the evidence.<sup>3</sup>

Collateral estoppel principles apply in discharge proceedings under 11 USC 523(a).<sup>4</sup> The record in the prior proceeding, and whether the court entered findings of fact, determines a court's collateral estoppel analysis. Bankruptcy courts are less likely to apply collateral estoppel where a default judgment was entered or where the debtor did not fully participate in the prior litigation.

### 11 USC 523(a)

11 USC 523(a) provides that a discharge under Section 727, 1141, 1228(a), 1228(b) or 1328(b)<sup>5</sup> of Title 11 does not discharge an individual debtor from the following debts:<sup>6</sup>

1. Most tax debts (the details are somewhat technical and complicated, and tolling applies in certain situations).
2. Debt for money, property, services, or an extension, renewal or refinancing of credit, to the extent obtained by:
  - a. false pretenses, a false presentation or actual fraud; or
  - b. use of a statement in writing that is materially false, regarding the debtor's or an insider's financial condition, on which the creditor to whom the debtor is liable reasonably relied, and that the debtor caused to be made or published with intent to deceive.

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The Supreme Court construed the terms in 523(a)(2)(A) “to incorporate the general common law of torts, the dominant consensus of common-law jurisdictions, rather than the law of any particular State.”<sup>7</sup> The Supreme Court held that 523(a)(2)(A) requires justifiable, but not reasonable, reliance. In a later case the Supreme Court held that “[t]he term actual fraud in 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.”<sup>8</sup> Fraud claims reduced to a settlement, or to a stipulation, and consent judgments, may be found nondischargeable in bankruptcy court.<sup>9</sup> A denial of discharge under Section 523(a)(2)(A) bars the discharge of all liability arising from the fraud, “including damages, attorney’s fees and other relief that may exceed the value obtained by the debtor.”<sup>10</sup>

3. Debt not listed or scheduled by the debtor in time to permit the creditor to timely take action to protect certain rights, unless the creditor had notice or actual knowledge of the case.

This subsection is intended to protect creditors’ rights to receive a distribution through the filing of a proof of claim, and to file a dischargeability complaint under 523(a)(2), (a)(4) and (a)(6). Many courts have held that where these rights are not affected because there

are no assets to distribute (a no-asset case), with no deadline to file a proof of claim, and where the debt does not fall under 523(a)(2), (a)(4) or (a)(6), the debt is discharged, even if not listed or scheduled by the debtor.<sup>11</sup> Some courts have even held that a debtor’s failure to list or schedule a debt covered by 523(a)(2), (a)(4) or (a)(6) does not result in automatic exception from discharge, but merely results in the loss of the 60-day limitations period under Federal Rule of Bankruptcy Procedure 4007(c) to file a 523(c) dischargeability complaint.<sup>12</sup>

## Most student loan debt is presumptively nondischargeable unless a determination of undue hardship is made.

4. Debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny.

The Supreme Court has clarified that “defalcation” under 523(a)(4) requires a state of mind involving “knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior.”<sup>13</sup>

5. Debt “for a domestic support obligation.”  
A domestic support obligation is a debt in the nature of “alimony, maintenance, or support.”<sup>14</sup>  
The determination of whether an obligation is in the nature of alimony, maintenance or support

is a factual determination made by application of federal, rather than state, law.<sup>15</sup> Although labels used by state courts are not binding, a relevant factor for the court to consider in making the determination is how state law characterizes the debt. The Ninth Circuit has held that experts’ and attorneys’ fees incurred in connection with a marital dissolution, or in connection with custody, visitation or child support issues are generally non-dischargeable debts under 11 USC 523(a)(5).<sup>16</sup>

6. Debts for willful and malicious injury by the debtor to another entity or the property of another entity.

The Supreme Court held that medical malpractice judgments attributable to negligent or reckless conduct do not qualify as willful or malicious injuries under 11 USC 523(a)(6).<sup>17</sup>

7. Debts for fines, penalties and forfeitures owed to the government, that are not compensation for actual pecuniary loss, with certain exceptions.

Courts have held that criminal restitution payments are nondischargeable under this subsection.<sup>18</sup>

8. Most student loan debt is presumptively nondischargeable unless a determination of undue hardship is made.

To obtain such a determination, the debtor files a complaint against the lender in bankruptcy court.

9. Debts for death or personal injury caused by a debtor’s operation of a vehicle, vessel or aircraft, if such operation was unlawful due to the debtor’s intoxication.
10. Debts that were listed, or could have been listed, in a prior bankruptcy case in which the debtor waived discharge, or was denied discharge under certain bankruptcy code sections.
11. Debts related to fraud or defalcation while acting in a fiduciary capacity, committed with respect to a federal depository institution or insured credit union.

12. Debts for malicious or reckless failure to fulfill a commitment by the debtor to a federal depository institution's regulatory agency to maintain the capital of an insured depository institution, with some exceptions.
13. Debts for any payment of an order of restitution under title 18 of the U.S. Code (federal crimes).
14. Debts incurred to pay a tax to the United States that would be nondischargeable pursuant to 523(a)(1).
  - 14A. Debts incurred to pay a tax to a governmental unit, other than the U.S., that would be nondischargeable under 523(a)(1).
  - 14B. Debts incurred to pay fines or penalties imposed under federal election law.
15. Debts to a spouse, former spouse or child of the debtor not described in 523(a)(5) in the course of a divorce or separation.
 

This is commonly interpreted to mean property settlement payments intended to effect the equitable division of community property.
16. Debts owed to homeowner's associations that come due after the filing of the bankruptcy petition.
17. Debts imposed on a prisoner by a court for the filing of a case, motion, complaint or appeal, or for other costs and expenses assessed with respect to such filing.
18. Debts owed for loans under certain pension, profit-sharing, stock bonus or other retirement plans.
19. Debts for violations of certain securities laws and for fraud, deceit or manipulation in connection with security purchases or sales, under certain circumstances.

## 11 US 523(c)

11 USC 523(c) provides that debts listed in (a)(2), (a)(4) or (a)(6) shall be discharged, unless on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge. Therefore, 11 USC 523(c) requires creditors to take affirmative steps to obtain a denial of discharge of debts listed in 523(a)(2), (a)(4) and (a)(6). The procedure for doing so is the filing of a complaint in the bankruptcy court. Federal Rule of Bankruptcy Procedure 4007 sets a 60-day deadline for filing a 523(c) complaint, beginning on the date of the

first meeting of creditors.<sup>19</sup> Bankruptcy courts have exclusive jurisdiction to determine dischargeability of debts listed in 523(a)(2), (a)(4) and (a)(6).

**11 USC 523(c) provides that debts listed in (a)(2), (a)(4) or (a)(6) shall be discharged, unless on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge.**

By contrast, bankruptcy courts and other courts may exercise jurisdiction over dischargeability determinations under the other 523(a) discharge exceptions.<sup>20</sup> Moreover, under Rule 4007, a complaint to determine the dischargeability of a debt other than under 523(c) may be filed at any time.

**NL**

1. *Snoke v. Riso (In re Riso)*, 978 F.2d 1151, 1154 (9th Cir. 1992).
2. *Grogan v. Garner*, 498 U.S. 279, 287; see, e.g., *Pennsylvania Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298, 301 (3d Cir. 1995)(debtor has burden of proving undue hardship under 523(a)(8)); *Otto v. Niles (In re*

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- Niles*, 106 F.3d 1456 (9th Cir. 1997) (shifting the burden of proof in a 523(a) (4) case from the creditor to the debtor once the creditor showed a fiduciary relationship).
3. *Grogan v. Garner*, 498 U.S. at 291.
  4. *Id.* at 284, n. 11.
  5. Chapter 13 hardship discharge, as opposed to standard discharge.
  6. Many of the subsections are summarized or simplified. Refer to the statute itself for details.
  7. *Field v. Mans*, 516 U.S. 59, 70, n.9 (1995).
  8. *Husky Int'l Elecs., Inc.*, 136 S. Ct. 1581, 1586 (2016).
  9. See *Archer v. Warner*, 538 U.S. 314 (2003); *Brown v. Felsen*, 442 U.S. 127 (1979) (superseded by statute on other grounds).
  10. *Cohen v. De La Cruz*, 523 U.S. 213, 223 (1998).
  11. See, e.g., *In re Beezley*, 994 F.2d 1433 (9th Cir. 1993).
  12. See, e.g., *Fidelity Nat'l Title Ins. Co. v. Franklin (In re Franklin)*, 179 B.R. 913 (Bankr. E.D.Cal. 1995).
  13. *Bullock v. BankChampaign, N.A.*, 569 U.S. 267, 269.
  14. *Rivera v. Orange Cty. Prob. Dep't*, 832 F.3d 1103, 1106 (9th Cir. 2016).
  15. *Beaupied v. Chang (In re Chang)*, 163 F.3d 1138, 1140 (9th Cir. 1998); see also *Stout v. Prussel*, 691 F.2d 859, 861 (9th Cir. 1982).
  16. See, e.g., *In re Chang*.
  17. *Kawaauhau v. Geiger*, 523 U.S. 57 (1998).
  18. *Kelly v. Robinson*, 479 U.S. 36, 50 (1986); *In re Silverman*, 616 F.3d 1001, 1008 (9th Cir. 2010).
  19. *Bustos v. Molasky (In re Molasky)*, 843 F.3d 1179, 1184 (9th Cir. 2016). In chapter 13 cases, the time for filing a complaint under 523(a)(6) is different. See FRBP 4007(d).
  20. 4 Collier on Bankruptcy, ¶523.03, p.523-17 (A. Resnick & H. Sommer, eds., 16th ed. 2017).



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