UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

JAMES LEE MOOREHEAD, **Case No. 98-24424-K**

Debtor. **Chapter 13**

JAMES LEE MOOREHEAD,

Plaintiff,

v. Adv. Proc. No. 98-0626

UNITED STATES OF AMERICA
(INTERNAL REVENUE SERVICE),

Defendant.

MEMORANDUM AND ORDER RE "PLAINTIFF'S COMPLAINT TO COMPEL TURNOVER OF CERTAIN PROPERTY FROM DEFENDANT" COMBINED WITH NOTICE OF THE ENTRY THEREOF

Introduction

This adversary proceeding arises out of a complaint filed by the plaintiff, James Lee Moorehead, the above-named debtor ("Debtor"), under 11 U.S.C. § 542(a) and FED. R. BANKR. P. 7001(1) seeking a turnover of a 1997 tax refund in the amount of $1,940.00 that was offset postpetition by the defendant, United States of America (Internal Revenue Service) ("IRS") against a prepetition tax debt owed for the 1993 tax year.

By virtue of 28 U.S.C. §157 (b)(2)(E), (A), and (O), this is a core proceeding. The court has jurisdiction of this action under 28 U.S.C. § § 1334 (a)-(b) and 157(a) and Miscellaneous District Court Order No. 84-30 entered on July 11, 1984. The parties have submitted briefs in lieu of a trial agreeing that there are no contested issues of fact. Moreover, the parties have

requested a judgment on the pleadings without the necessity of a trial on the merits. FED. R. BANKR. P. 7012(c). Based upon the pleadings and the case record as a whole, the court renders the following findings of fact and conclusions of law in accordance with FED. R. BANKR. R. 7052.

BACKGROUND FACTS

The relevant background facts have been stipulated by the parties and may be briefly summarized as follows:

1. Debtor filed this chapter 13 case on March 30, 1998, owing the IRS for a 1993 tax debt. (It is noted that the debtor's Schedule B 17 reflects that a 1997 income tax refund of $1,600.00 was owed to him by the IRS and further that Schedule E reflects that the debtor owes the IRS a total of $5,614.80.)
2. On April 15, 1998 (i.e., after bankruptcy) the debtor filed his 1997 income tax return with the IRS.
3. On May 25, 1998, the IRS gave notice to the debtor that it had offset the income tax refund in the amount of $1, 940.00 arising from the debtor's 1997 income tax return and applied it to reduce the debtor's prepetition 1993 tax debt owed to the IRS (in accordance with a local Standing Order, infra).
4. Debtor asserts that he needs the income tax refund.

The parties have submitted two issues for ultimate judicial determination. First, the court

will address the validity of its local "Standing Order"[1] which under very limited circumstances terminates the automatic stay without a specific motion being filed in chapter 7 and 13 cases, allowing the IRS to effectuate a postpetition setoff in appropriate situations and in accordance with 26 U.S.C. § 6402. This Standing Order arises out of an earlier standing motion filed in this Judicial District by the IRS seeking relief from the automatic stay in such tax refund matters. Second, whether the debtor's federal income tax refund for $1,940.00 is a prepetition obligation of the IRS to the debtor and subject to setoff by the IRS under section 553(a) of the Bankruptcy Code against the debtor's 1993 unpaid tax obligation, where the federal income tax return requesting the refund is filed by the debtor after the commencement of the bankruptcy case.

ISSUES AND CONCLUSIONS OF LAW

A. Whether this court's local *Standing Order Granting Relief from Automatic Stay in Chapter 7 and Chapter 13 Proceedings* entered on March 5, 1990 ("Standing Order") granting the IRS' prior standing motion seeking relief from the automatic stay under limited circumstances is valid or whether it impermissibly violates the statutory provisions of 11 U.S.C. § 362(d), the procedural provisions of FED. R. BANKR. P. 4001(a), and due process?

[1]See the *Standing Order Granting Relief from Automatic Stay in Chapter 7 and Chapter 13 Proceedings* filed on March 5, 1990.

The Standing Order provides, in relevant part, as follows:

> The automatic stay provided by 11 U.S.C. § 362 shall be terminated in Chapter 7 and Chapter 13 proceedings as to the matters set forth below 45 days after the filing of the debtor's original petition, if neither the debtor nor any other party in interest files an objection and requests a hearing within said 45 day period:
>
> 1. IRS assessment of amount due,
> 2. IRS issuance of notices and demands under Title 26 of the United States Code, and
> 3. IRS offset or credit of any amounts due in accordance with 26 U.S.C. 6402.

Debtor argues that the Standing Order violates the protections afforded by 11 U.S.C. § 362 (a)(7)[2] because the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure do not expressly grant the IRS authorization to setoff tax refunds within 45 days of the filing date of a bankruptcy case. More specifically, the debtor maintains that the Standing Order violates section 362(d) which specifies procedures to be followed in all requests for relief from the automatic stay and additionally violates due process. Debtor asserts that the Standing Order granting the IRS relief from the automatic stay under certain circumstances in all applicable chapter 7 and 13 cases in this District does not comport with the most basic requirements of due process by allowing relief from stay to occur automatically, without a specific motion being filed by the IRS on a case-by-case basis. Debtor relies on *In re IRS Liabilities and Refunds in Chapter 13 Proceedings*, 30 B.R. 811, 813 (M.D. Tenn. 1983), which is contrasted hereinafter. Compare 11 U.S.C. § 102(1)(A)-(B)[3] and the Standing Order itself, which actually gives debtors

[2]Section 362(a)(7), applicable to all entities, operates as a stay to the setoff of any debt owing to the debtor that arose before the commencement of the case under title 11 against any claim against the debtor.

[3]Section 102(1)(A)-(B) provides as follows:

(1) “after notice and a hearing”, or a similar phrase --

(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but

(B) authorizes an act without an actual hearing if such notice is given properly and if --

(i) such a hearing is not requested timely by a party in interest; or

(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.

in this District 45 days after bankruptcy to oppose in a particular case the IRS' standing motion in such matters. It is noted that the Western District of Tennessee is a high volume chapter 13 district. There are over 39,000 pending and active bankruptcy cases in this District. Repeat filings, although generally permissible under 11 U.S.C. § 109(d) and the rationale of *In re Barrett*, 964 F.2d 588 (6th Cir. 1992), present challenging chapter 13 case management problems. So far, this Standing Order has been a very valuable case management tool while providing, at the least, minimal due process to debtors. See 11 U.S.C. § 101(1)(A)-(B) and the Standing Order itself.

The court does not disagree with the debtor's naked assessment that the Standing Order is somewhat unfavorable to him because, absent a timely and affirmative objection and request for a hearing, setoff of such tax refunds is self executing. The Standing Order in *In re IRS Liabilities and Refunds in Chapter 13 Proceedings*, however, is different from the Standing Order at issue in this District and the instant proceeding.[4] The provisions of *In re IRS Liabilities and Refunds in Chapter 13 Proceedings* authorized the termination of the automatic stay imposed under 11 U.S.C. § 362 in all pending and future chapter 13 cases so as to permit the IRS to (1) assess amounts due from any chapter 13 debtor and issue any required notices and demands in accordance with the provisions of the Internal Revenue Code and (2) offset or credit any amounts due to the IRS from any chapter 13 debtor "with any amounts due to the debtor in accordance with the law". *Id.* at 812.

[4]The Standing Order in *In re IRS Liabilities and Refunds in Chapter 13 Proceedings* was entered into between the chapter 13 trustee and the IRS and subsequently approved by the court on February 28, 1983. 30 B.R. at 811 (M.D. Tenn. 1983).

As explained by Bankruptcy Judge G. Harvey Boswell of this District in *In re Hunter*[5] (a copy of which is annexed as "Attachment A")*:*

> 11 U.S.C. § 105(a) authorizes a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Pursuant to this section, this Court issued a Standing Order on March 5, 1990 granting relief to the IRS from the automatic stay in Chapter 7 and Chapter 13 cases under limited circumstances.
>
> The effect of the Standing Order is to terminate the automatic stay 45 days after a debtor files an original Chapter 7 or Chapter 13 bankruptcy petition. *During this period, a debtor has ample opportunity to file an objection and request a hearing on the termination of the automatic stay.* The relevant purpose of the Standing Order is to allow the IRS to offset or credit amounts owed by debtors in accordance with 26 U.S.C. § 6402. Otherwise, a debtor wishing to circumvent IRS setoffs could simply implicate the automatic stay. 11 U.S.C. § 362 *(emphasis added).*

In re Hunter, 1997 WL 460062 at *2 (Bankr. Ct. W.D. Tenn.).

Concurring with the reasoning of Judge Boswell in the *Hunter* case, this court concludes, pursuant to the court's powers under section 105(a) and the notice and opportunity for hearing provisions contained in section 102(1), that the Standing Order in question provides sufficient due process to debtors and also serves, inter alia, to prevent potential abuse of the bankruptcy

[5]*In re Hunter*, 1997 WL 460062 (Bankr. Ct. W.D. Tenn)(Injunctive relief denied because debtor did not comply with the terms of the Standing Order -- that is, the debtor did not file an objection or request a hearing within the 45 day period allowed under the Standing Order utilized in this District.)

system by generally denying a debtor the opportunity to circumvent the IRS' right of setoff by manipulating the filing date. As noted earlier, the Standing Order additionally is a tremendous case management tool in this high volume chapter 13 court.

Accordingly, this court finds that the local Standing Order does not deny protections of 11 U.S.C. § 362 and due process. As Judge Boswell correctly noted, the Standing Order provides debtors in this District with ample opportunity to file an objection and request a hearing on the termination of the automatic stay (or seek an enlargement of such time before the time has expired). Had the debtor in this case filed a timely objection to the standing motion of the IRS and requested a formal hearing, or if the IRS had filed a specific motion in this case for authorization to setoff the tax refund, the court nonetheless would have terminated the automatic stay to allow the IRS to setoff (discussed more fully, infra.).

B. Whether the debtor's 1997 income tax refund debt arose postpetition or prepetition for purposes of offset considerations under 11 U.S.C. § 553(a).

Under section 553(a) of the Bankruptcy Code and subject to the provisions of the automatic stay under section 362(d)(1), a creditor may setoff a debt owed to the debtor against a debt the debtor owes the creditor if (1) the creditor has a valid right of setoff under applicable nonbankruptcy law, (2) the parties' debts are mutual, and (3) the mutual debts arose prior to the commencement of the bankruptcy case. See *In re Baggott*, Case No. 95-21694, Adv. Proc. No. 95-1243(Oct. 23, 1996)(W.D. Tenn) at *3 (unreported opinion, a copy of which is annexed and marked "Attachment B"). The determinative second ultimate issue in this adversary proceeding

is whether the debtor's 1997 tax refund debt is prepetition or postpetition for purposes of sections 553(a) and 362(a)[6].

The IRS contends, *inter alia*, that the filing of the tax return is merely a procedural step necessary to the obligation of the IRS regarding the refund. *In re Conti*, 50 B.R. 142, 148 (Bankr. E.D. Va. 1985). To determine whether a refund is postpetition or prepetition, the IRS asserts that the determination is to be made when the tax obligation arises. See, for example, *In re Dixon*, 209 B.R. 535, 538 (Bankr. W.D. Okla. 1997), *aff'd*, 218 B.R. 150 (Bankr. 10 Cir. 1998). The IRS proffers that the end of the taxable year is when the obligation arises, whether it is a refund due to the taxpayer or money owed to the IRS by the taxpayer. See *Matter of Johnson*, 136 B.R. 307, 309 (Bankr. M.D. Ga. 1991).

Debtor heavily relies on *In re Glenn*, 198 B.R. 106 (Bankr. E.D. Pa. 1996)("*Glenn I*") to support his contention that the 1997 tax refund is a postpetition debt. In *Glenn I*, the bankruptcy

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[6]It is interesting to note that the debtor has not, as an alternative theory, formally sought to use "cash collateral" under section 363(c)(2)(B). Assuming arguendo that the IRS has recognized setoff rights under section 553(a) regarding the tax refund, section 506(a) in essence treats the IRS as if it were a secured creditor. The tax refund, as a "cash equivalent," is "cash collateral" under section 363(a). A debtor cannot use cash collateral under section 363(c)(2)(B) unless sufficient adequate protection exists. By virtue of section 363(o), the debtor has the burden of proof on the issue of adequate protection. See also sections 1323 and 1303. Not surprisingly, the concept of adequate protection for purposes of use of cash collateral is related to the concept of adequate protection for purposes of relief from the automatic stay under section 362(d)(1). Lack of adequate protection constitutes "cause" to deny a debtor's request to use cash collateral and also constitutes cause to grant a creditor's request for relief from the stay. By virtue of section 362(g)(2), the debtor has the burden of proof on the adequate protection issue in automatic stay litigation as well.

court, relying upon section 6407 of the Internal Revenue Code, held that the debtors tax refund was a postpetition claim because the debtors had no right to receive their refund until the U.S. Secretary of the Treasury authorized their refund or until a refund claimed by the taxpayers in their subsequent tax return. *Id.* at 108. On appeal, as the IRS has emphasized, *Glenn I* was overturned.

In re Glenn, 207 B.R. 418 (E.D. Penn. 1997) ("*Glenn II*") established a bright-line test for determining when a tax obligation actually arises. *Glenn II* expressly rejects the reasoning that the IRS's indebtedness in connection with a tax refund arises when the IRS authorized the assessments representing the refund. *207 B.R.* at 420-22. The *Glenn II* court held that for the purposes of section 553(a) setoff, a tax refund arises at the end of the taxable year to which it relates, and not when the right of refund is claimed by the debtor/taxpayer. *In re Rozel*, 120 B.R. at 951. This rule prevents a debtor from changing his/her right to a tax refund into a postpetition claim merely by filing his federal income tax return after the filing of the bankruptcy case. *Glenn II* at 108.

In *In re Baggott*, supra, Bankruptcy Judge William H. Brown of this District held that an individual taxpayer becomes entitled to an income tax refund immediately after the last day of the tax year, citing *In re Thorvund-Statland*, 158 B.R. 837,839 (Bankr. D. Idaho 1993; *In re Conti*, 50 B.R. 142, 148 (Bankr. E.D. Va. 1985)(holding that the obligation of the IRS to the debtor arose as of December 31).

In *Segal v. Rochelle*, 382 U.S. 375 (1966), the Supreme Court effectively held that a tax refund based on prepetition overpayments was a prepetition debt of the IRS to the taxpayer, even though a refund claim was not filed until after the commencement of the bankruptcy case. Although *Segal v. Rochelle* was decided under the former Bankruptcy Act of 1898, the result

was intended to apply under the current Bankruptcy Code as well. S. Rep. No. 989, 95th Cong., 2d Sess. 82 (1978); H.R.Rep. No. 595, 95th Cong., 1st Sess. 367 (1977); U. S. Code Cong. & Admin. News 1978, p. 5787; both reprinted *Collier on Bankruptcy*, App. 2 & 3 (15th ed. 1984).

If the debtor's theory is correct, a taxpayer contemplating bankruptcy could avoid setoff of a prepetition tax debt under section 553(a) of the Bankruptcy Code and avoid cash collateral considerations under sections 506(a), 363(a), and 363(c)(2)(B) simply by not filing a tax return (or a claim for refund) until after the debtor filed a bankruptcy petition. It has been said that, as a general rule, this would not make sense. See *United States v. Norton*, 717 F.2d 767 (3rd Cir. 1983); *Rochelle v. United States*, 371 F.Supp. 224 (N.D. Tex. 1973) aff'd 521 F.2d 844 (5th Cir. 1975); mod. & rem. 526 F.2d 405 (5th Cir. 1976), cert. den. 426 U.S. 948 (1976); *In re Morristown Lincoln-Mercury, Inc.*, 42 B.R. 413 (Bankr. Ct. E.D. Tenn. 1984). A creditor may not setoff its prepetition debt against a debt owed to the debtor which came into legal existence after the filing of a bankruptcy petition. See, for example and among others, *Cooper-Jarrett, Inc. v. Central Transport, Inc.*, 726 F.2d 93 (4th Cir. 1984); *In re Sluss*, 107 B.R. 599 (Bankr. Ct. E.D. Tenn. 1989).

In light of the sound precedent cited above, this court rejects the debtor's contentions that the tax refund here is a postpetition debt, and accordingly, finds instead that the debtor's tax refund essentially arises out of a prepetition debt subject to setoff by the IRS under section 553(a) (and in accordance with the Standing Order). See also 11 U.S.C. § 542(b).[7]

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[7] 11 U.S.C. § 542(b) provides as follows:

> (b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, <u>except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor</u>. (emphasis added.)

Considering a totality of the particular facts and circumstances of this case and applicable law, the court concludes that the IRS is entitled to setoff the debtor's prepetition tax debt against the debtor's prepetition tax refund, notwithstanding the fact that the tax return itself was not filed until after the commencement of this chapter 13 case.

The court is not apathetic to the debtor's need for the 1997 tax refund. Yet, the analysis employed by the debtor is simply not persuasive. Need, standing alone, cannot, ipso facto, override or trump the concept of adequate protection as contemplated in, for example, 11 U.S.C. §§ 361, 362(d)(1), 363(c)(2)(B), and 363(o)(2). This court is mindful that the bankruptcy process may be subject to abuse and manipulation, notwithstanding the good intentions of the vast majority of the debtors. A debtor's chapter 13 plan, if confirmed, binds the IRS and other creditors under section 1327; however, as a precondition of confirmation, the IRS is entitled to adequate protection, if, for example, the debtor seeks to use the tax refund. See 11 U.S.C. §§ 553(a), 506(a), 363(a), 363(c)(2)(B), 361, 1325(a)(5), and 363(o)(2); see also *U.S. v. Whiting Pools, Inc.*, infra.

Under the particular facts and circumstances of the instant case and applicable law, the IRS would most certainly have been successful in obtaining relief under section 362(d)(1) from the section 362(a)(7) automatic stay to allow it to setoff, if a specific motion for relief had been filed by the IRS. Debtor has offered the IRS no adequate protection whatsoever for his hoped for use of the tax refund. Debtor failed to timely object under the Standing Order to the IRS' setoff and request a hearing. Debtor still has not offered any adequate protection to allow him to eventually use "cash collateral" (i.e., the tax refund). 11 U.S.C. § 362(d)(1) and 363(o). Compare *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198 (1983). The automatic stay does not destroy substantive rights; it merely delays the enforcement of such rights. In this District, the Standing

Order ordinarily delays the IRS from exercising its setoff rights for a period of 45 days. This gives debtors ample time to object to the setoff and request a hearing (or seek relief under FED. R. BANKR. P. 9023 or 9024).

Based on the foregoing findings of fact and conclusions of law, the court denies the plaintiff-debtor's complaint seeking a turnover of the 1997 income tax refund.

ORDER DENYING PLAINTIFF-DEBTOR'S "COMPLAINT TO COMPEL TURNOVER OF CERTAIN PROPERTY FROM DEFENDANT" AND NOTICE OF THE ENTRY THEREOF

After careful consideration of the record underlying the plaintiff-debtor's complaint seeking a turnover of a 1997 income tax refund from the defendant, United States of America (IRS), and the matter having been submitted to the court at the request of the parties for a judgment on the pleadings,

IT IS ORDERED AND NOTICE IS HEREBY GIVEN THAT:

1. The section 542(a) complaint of the plaintiff-debtor, James Lee Moorehead, is hereby denied.

2. The Bankruptcy Court Clerk shall promptly send copies of this Memorandum and Order to the entities reflected below:

BY THE COURT

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DAVID S. KENNEDY
CHIEF U.S. BANKRUPTCY JUDGE

DATE: February 11, 1999

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