

M e m o r a n d u m**170.0007.055**

To : Ms. Kitty Steen, Compliance Specialist
Special Procedures Section (MIC:55)

Date: December 31, 2002

From : Bruce Emard
Tax Counsel (MIC:82)

Telephone: (916) 323-2481

Subject:: **G--- T. D---**
Account No. SR -- XX-XXXXXX

This responds to your August 23, 2002 memorandum addressed to Assistant Chief Counsel Janice L. Thurston regarding the above-referenced matter. In your memorandum, you explain the background of the matter and ask questions as follows.

“Special Procedures is requesting a legal opinion on the dischargeability of a Chapter 13 Expense of Administration Claim on which we received a partial payment. The opinion will be included in a response for Margaret Shedd to our taxpayer’s correspondence directed to Governor Davis and Senator Sher. Bruce Emard has already been approached by Special Projects regarding this case and I have a similar situation previously discussed with Bruce.

“The facts of this case are as follows:

“G--- D--- and P--- D--- operated a retail store from February 18, 1995 through March 31, 1998. On February 5, 1997 they filed a Chapter 13 Bankruptcy petition. The Board did not file a pre-petition claim, as there was only \$35.32 in interest that was claimable on the account. After the petition date, Mr. D--- filed returns without payment for the periods February 6, 1997 to March 31, 1997 and April 1, 1997 to June 30, 1997. He did not file returns for the remainder of the time he operated the business. The Board issued assessments for the delinquent periods of July 1, 1997 to December 31, 1997 and January 1, 1998 to March 31, 1998.

“The account was not in legal status because we had not filed a claim, and liens were issued. Mr. D---’s attorney, K--- I---, sent the Board a letter requesting releases of the liens and advised the Board to file a Cost of Administration Claim in the D---’s Chapter 13 case. Free releases of lien were issued and an expense claim was prepared on March 15, 1999 for the amount of \$46, 166.52. On May

12, 1999 we receive (sic) a check from the Chapter 13 Trustee for \$4,616.65 on our claim, and the debtor received a discharge on September 23, 1999.

“The Board recorded liens for the post-petition periods on October 25, 2000 in --- County. This lien is now causing Mr. D--- a problem as he wishes to refinance his home. The district suggested a subordination of lien, but Mr. D--- believes the taxes were discharged and wants the lien released.

“Since our administrative tax claim was allowed, were we entitled to payment in full? If so, should we have objected to the discharge at the time? Did the discharge apply to post-petition debt? Section 1305(a)(1) states that a governmental unit may file a post-petition claim, but nothing is said regarding payment in full of the tax claim. Are we better off not filing a claim, so we may pursue the debtor when the case closes?

“Special Procedures recently filed a Chapter 13 Expense claim in a case in the Eastern District after a discussion I had with Bruce Emard with respect to filing a claim as opposed to referring the case to the Attorney General. This issue of dischargeability could impact Special Procedures filing future Chapter 13 COA claims if we are paid less than the full amount, and the balance is discharged.”

Before I address the questions you ask, I note that a copy of Mr. D---’s chapter 13 plan was not provided with your memorandum and it is not located in the file. A chapter 13 plan is an important legal pleading in a chapter 13 case and should always be reviewed to determine its impact on the Board’s claim and the Board’s rights in the chapter 13 case. Since it is not available in this particular case, I will make certain assumptions regarding the plan. If these assumptions are incorrect, then the opinion may change.

The first assumption is that Mr. D---’s chapter 13 plan provides for payment of all administrative claims. Most chapter 13 plans contain such a provision. However, it is possible to submit a plan to the court that does not contain such a provision. With this assumption, I’ll address your question whether the Board’s post-petition debt was discharged when Mr. D--- received his discharge in his chapter 13 case. Pursuant to 11 U.S.C. section 1328(a), with certain limited exceptions not applicable here, a chapter 13 discharge discharges a debtor from all debts provided for by the plan. This includes pre-petition debts and post-petition debts to the extent the plan provides for their payment. In this case, under my assumption, Mr. D---’s chapter 13 plan provided for payment of all administrative claims, including administrative tax claims. When the Board filed its Expense of Administration Claim for Taxes in Mr. D---’s chapter 13 case, the Board brought its claim within the plan provision for its payment as an administrative claim. Thus, the Board’s debt was discharged when Mr. D--- received his discharge. Not all post-petition claims are characterized as administrative claims, as discussed below.

You also ask, "Since our administrative tax claim was allowed, were we entitled to payment in full?" This question assumes that the Board's claim was allowed as an expense of administration claim. There is nothing in the file or in the documents provided to support this assumption. If the assumption is correct, then yes, the Board was entitled to payment in full. However, it is more likely that the chapter 13 trustee unilaterally decided to treat the Board's claim as a general unsecured claim. I say this because the amount of the payment to the Board was ten percent of the full amount of the claim. It is common for a chapter 13 plan to provide for payment of ten cents on the dollar to general unsecured claims. In addition, the filing of an expense of administration claim does not assure that it will be allowed as such. 11 U.S.C. section 503(b) provides for an expense of administration claim to be allowed only after notice and a hearing. Some bankruptcy courts ignore this rule; others enforce it. If the Board wishes to avoid the risk that its claim will not be allowed as an administrative expense claim, then it should refer the administrative expense claim to the Attorney General for the filing of a motion seeking allowance and payment of the claim as an expense of administration.

You ask if the Board should have objected to Mr. D---'s discharge since the Board did not receive full payment on its claim. The answer is yes. However, such an objection may present difficulties for the Board. In most courts, the clerk of the court enters the debtor's discharge soon after the chapter 13 trustee files a notice that the debtor has completed the plan. Usually, there is no notice to creditors of the clerk's intent to enter the discharge or of the trustee's notice of plan completion. Thus, the Board will not learn of the discharge until after it is entered and it is too late to object. Some courts have identified this as a problem and require the trustee and the clerk to give notice to creditors of the notice of plan completion and intent to enter discharge of the debtor. (*See In re Avery*, (Bankr. E.D. Cal. 2002) 272 B.R. 718.)

Regarding your other questions, I consider them to ask for general guidance in handling chapter 13 matters. The D--- case provides a good example of the problems that result when a chapter 13 case is not handled properly. I'll use it to illustrate the problems that can result when the steps I recommend below are not followed.

The following are the steps that should be taken when the Board receives any form of notice that a taxpayer has filed a chapter 13 bankruptcy petition.

1. The Board should verify the bankruptcy filing through the PACER system.
2. If the bankruptcy filing is verified, the Board should immediately place the taxpayer's account in legal status as a chapter 13 matter, whether or not the Board intends to file a proof of claim in the case. In the D--- case, the Board did not place the matter in legal status apparently because it did not intend to file a proof of claim. The Board took steps to collect post-petition taxes by recording liens while Mr. D--- was in his chapter 13 case. These steps violated the automatic stay. The Board was required to record

free notices of lien releases and spent unnecessary time and effort as a result of its violation of the automatic stay. The Board also ran the risk of a citation for contempt of court for violating the bankruptcy court's automatic stay injunction.

3. The Board should immediately obtain and review the debtor's chapter 13 plan to determine whether the Board's debt is provided for under the plan and, if so, whether the Board's debt is properly provided for. The Board should also calendar the date for the hearing on confirmation of the debtor's chapter 13 plan as it may be necessary for the Board to appear and object to confirmation at that time. If the Board's tax claim is not properly provided for under the debtor's plan, the Board should refer the matter to the Attorney General for the purpose of filing an objection to confirmation of the plan.
4. If the debtor owes the Board pre-petition taxes, the Board should prepare and file with the clerk of the bankruptcy court and serve on the debtor and chapter 13 trustee a proof of claim for pre-petition taxes. This should be done before the date set for the plan confirmation hearing. The Board should not wait until the claims bar date.
5. The Board should immediately begin monitoring the post-petition activity of the debtor to ensure that all post-petition tax returns are timely filed and all post-petition taxes are timely paid. In the D--- case, the Board allowed Mr. D--- to avoid paying his sales taxes for more than one year while he operated his business in chapter 13. Mr. D--- accumulated approximately \$46,000 in post-petition tax liabilities to the Board.
6. If the debtor is not timely reporting and/or paying sales taxes, the Board has two options:
 - a. It may refer the matter to the Attorney General for a motion to dismiss the chapter 13 case. Such a motion should cause dismissal of the bankruptcy case and resumption of collection action against the debtor. Alternatively, it may cause the debtor to file the tax returns and pay the taxes or to amend the plan to provide for payment of the taxes.
 - b. It may file a post-petition proof of claim for priority taxes pursuant to 11 U.S.C. section 1305. Such a claim is treated as a pre-petition claim and is entitled to priority treatment under 11 U.S.C. section 507(a)(8). Pursuant to 11 U.S.C. section 1322(a)(2), this claim is entitled to full payment. The court and the chapter 13 trustee

should require the debtor to amend the plan to provide for payment of the Board's priority claim or, if the debtor cannot make the increased payments, the case should be dismissed. If the debtor fails to amend its plan to provide for the Board's claim, the tax liability will not be discharged should the debtor receive a discharge because the tax debt is not provided for in the plan. In the D--- case, the Board filed an "Expense of Administration Claim for Taxes." This claim was not referred to the Attorney General for the filing of a motion for allowance of an administrative claim under 11 U.S.C. section 503(b). Also, it did not properly characterize the Board's claim as a post-petition priority tax claim. Filing the proof of claim in this form allowed the chapter 13 trustee to exercise discretion regarding treatment and payment of the Board's claim. It also caused the debtor's post-petition tax liability to the Board to be discharged.

7. After a chapter 13 case is filed and the plan is confirmed, and until the case is dismissed or the plan is completed, the Board should carefully monitor the case. This monitoring should include ensuring that all payments due pursuant to the plan are paid. It should also include ensuring that all post-petition returns are timely filed and all post-petition taxes are timely paid. If a debtor misses a payment or fails to timely file a return, the Board should request that the Attorney General file a motion to dismiss the case or, alternatively, the Board should file a post-petition priority claim. The Board should make a decision which strategy to employ based upon the facts of each particular case.

By establishing procedures to take the steps described above, the Board should avoid the problems illustrated in the D--- matter and increase the amount of revenue it collects in chapter 13 cases.

BAE/ef