

INTERNAL REVENUE SERVICE

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MEMORANDUM TO KENTUCKY-TENNESSEE DISTRICT COUNSEL

FROM: Lawrence H. Schattner
Chief, Branch 3 (General Litigation)

SUBJECT: Erroneous Refund and Request for Repayment

This Service Center Advice is in response to your memorandum dated August 14, 1998, received by the Office of Chief Counsel (General Litigation) on August 27, 1998. This document is not to be relied upon or otherwise cited as precedent.

ISSUE:

If a debtor in a Chapter 13 bankruptcy has received an erroneous refund for a post-bankruptcy petition tax year, can the Memphis Service Center request repayment of the erroneous refund without violating the automatic stay imposed by the bankruptcy?

CONCLUSION:

The Internal Revenue Service can request repayment of an erroneous refund attributable to post-chapter 13 petition tax liabilities without violating the automatic stay because such erroneous refund is not necessary for or committed to the funding of the taxpayer-debtor's chapter 13 plan.

FACTS:

The debtor filed a chapter 13 bankruptcy petition in 1995, in federal court. At the time the debtor filed his bankruptcy petition, he had an outstanding income tax liability for the 1994 tax year. Upon learning of the debtor's bankruptcy, the Internal Revenue Service (Service) placed a bankruptcy freeze, code 520, on the debtor's account and filed a pre-petition proof of claim for the 1994 tax year. For the 1995 and 1996 post-petition tax years, the debtor received refunds from the Service. For the 1997 post-petition year, the debtor was issued a manual refund. A few days later, the debtor was also issued a computer-generated refund for the same amount, resulting in an erroneous refund.

There are a significant number of these erroneous refund/bankruptcy cases within the Memphis Service Center. In addition, because the Memphis Service Center serves more than one state, these other cases are not limited to one bankruptcy district, but

rather involve bankruptcy districts across several states.

The Memphis Service Center requests advice as to whether it can contact the debtor, by letter or other means, and request repayment of the erroneous refund without violating the automatic stay.

LAW AND ANALYSIS:

The filing of a bankruptcy petition creates an estate which includes generally “any legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). The filing of a bankruptcy petition also automatically stays or enjoins creditors from taking action or continuing action to collect their prepetition claims or enforce their liens. 11 U.S.C. § 362. It also stays a wide range of actions that would affect or interfere with property of the estate, property of the debtor, or property in the custody of the estate. The courts have uniformly held that the stay of section 362 is extremely broad in scope and, aside from the limited statutory exceptions in 11 U.S.C. § 362(b), applies to almost any type of formal or informal action taken against the debtor or the property of the estate. Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 , 503 (1986); Association of St. Croix Condominium Owners v. St. Croix Hotel Corp., 682 F.2d 446 (1st Cir. 1982); Wedgewood Investment Fund, Ltd. v. Wedgewood Realty Group, Ltd., 878 F.2d 693 (3d Cir. 1989); Ingersoll-Rand Financial Corp. v. Miller Mining Co., 817 F.2d 1424 (9th Cir. 1987). This is consistent with the legislative history:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 54-55 (1978).

11 U.S.C. § 362(c) provides that the automatic stay continues until the subject property is no longer the property of the estate, or until the case is either dismissed, closed, or a discharge is granted. In a chapter 13 case, the discharge is not granted and the case is not closed until completion of payments under the plan. 11 U.S.C. §§ 350(a), 1328(a). Thus, an analysis of what constitutes property of the estate is essential to determining whether the Service can request the taxpayer-debtor to remit the amount of the erroneous refund stemming from a post-petition tax year.

The law is clear that property acquired before the petition becomes the property of the estate for distribution to creditors and subject to the automatic stay. Thus, prepetition tax refunds are property of the bankruptcy estate and subject to the automatic stay. In re Barowsky, 946 F.2d 1516 (10th Cir. 1991); Turshen v. Chapman, 823 F.2d 836 (4th

Cir. 1987); In re Larish, 149 B.R. 117 (Bankr. M.D. Tenn. 1993); In re Lancaster, 161 B.R. 308 (Bankr. S.D. Fla. 1993); Taborski v. United States, 141 B.R. 959 (Bankr. N.D. Ill. 1992). However, generally property acquired after the bankruptcy petition, including postpetition tax refunds, remains the property of the debtor and not subject to the automatic stay.

The law is not as clear concerning a Chapter 13 post-petition tax debt, including a claim against the debtor for an erroneous refund, because the courts have split over whether the subject property is property of the Chapter 13 bankruptcy estate. A particular feature of Chapter 13 cases is that property of the estate, as defined by 11 U.S.C. § 541, is supplemented by 11 U.S.C. § 1306. Section 1306(a) provides that property of the Chapter 13 estate also includes (1) all property listed in section 541 that the debtor acquires after the commencement of the case, but before the case is closed, dismissed, or converted, and (2) earnings from services performed by the debtor after the commencement of the case, but before the case is closed, dismissed, or converted. Section 1306(b) provides that, except as provided in a confirmed plan, the debtor shall remain in possession of all property of the estate. Viewed in isolation, this provision arguably renders all property owned or acquired by the debtor during the pendency of the case as property of the estate, thus precluding any post-confirmation action against the debtor. This provision, however, must be read in conjunction with 11 U.S.C. § 1327(b), which provides: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." Whether the Service can pursue post-confirmation actions depends in part on the scope of section 1306(a) and the extent to which section 1327(b) modifies or supercedes section 1306(a).

Although the lower court cases addressing this issue are conflicting, many courts have agreed that after confirmation of the chapter 13 plan, all property reverts in the debtor, except property that is specifically retained as property of the estate in the plan or in the order confirming the plan. Shell Oil Co. v. Capital Financial Services, 170 B.R. 903 (S.D. Tex. 1994); Laughlin v. United States, 98 B.R. 494 (D. Neb. 1989), aff'd on other grounds, 912 F.2d 197 (8th Cir. 1990), cert. denied, 498 U.S. 1120 (1991); In re Lambright, 125 B.R. 733 (Bankr. N.D. Tex. 1991); In re Petruccelli, 113 B.R. 5 (Bankr. S.D. Cal. 1990); In re Walker, 84 B.R. 888 (Bankr. D. D.C. 1988); In re Mason, 45 B.R. 498 (Bankr. D. Ore. 1984), aff'd, 51 B.R. 548 (D. Ore. 1985); In re Johnson, 36 B.R. 958 (Bankr. D. Utah 1983); In re Lewis, 33 B.R. 98 (Bankr. W.D.N.Y. 1983). Under these authorities the automatic stay is inapplicable to post-petition assets that are not specifically designated as property of the estate in the plan.

A minority of courts take the position that based on the language of section 1306(a), all property of the debtor remains property of the estate during the pendency of the chapter 13 case, and creditors cannot take any collection action against the debtor without obtaining relief from the stay pursuant to section 362(d). Matter of Schewe, 94 B.R. 938 (Bankr. W.D. Mi. 1989); In re Aneiro, 72 B.R. 424 (Bankr. S.D. Calif. 1987). Under this line of authority, the protection of the automatic stay is extended to all post-petition property for the entire life of the plan.

Some courts, however, have taken a compromise approach by permitting collection action only against property which is not committed to the funding of the plan. These courts conclude that property which funds the plan (such as the portion of the debtor's wages to be paid to the trustee each month) constitutes property of the estate pursuant to section 1306(a), which brings post-petition property into the estate, and section 1322(a)(1), which states that the plan shall provide for submission of future income of the debtor to the control of the trustee as is necessary for execution of the plan. See, e.g., In re Leavell, 190 B.R. 536 (Bankr. E.D. Va. 1995); In re Markowicz, 150 B.R. 461 (Bankr. D. Nev. 1993); In re Thompson, 142 B.R. 961 (Bankr. D. Colo. 1992); In re McKnight, 136 B.R. 891 (Bankr. S.D. Ga. 1992); In re Ziegler, 136 B.R. 497 (Bankr. N.D. Ill. 1992); In re Clark, 71 B.R. 747 (Bankr. E.D. Pa. 1987). These courts would, accordingly, permit the Service to take collection action against post-petition property of the debtor so long as the property is not necessary for funding the plan and is not committed to the plan.

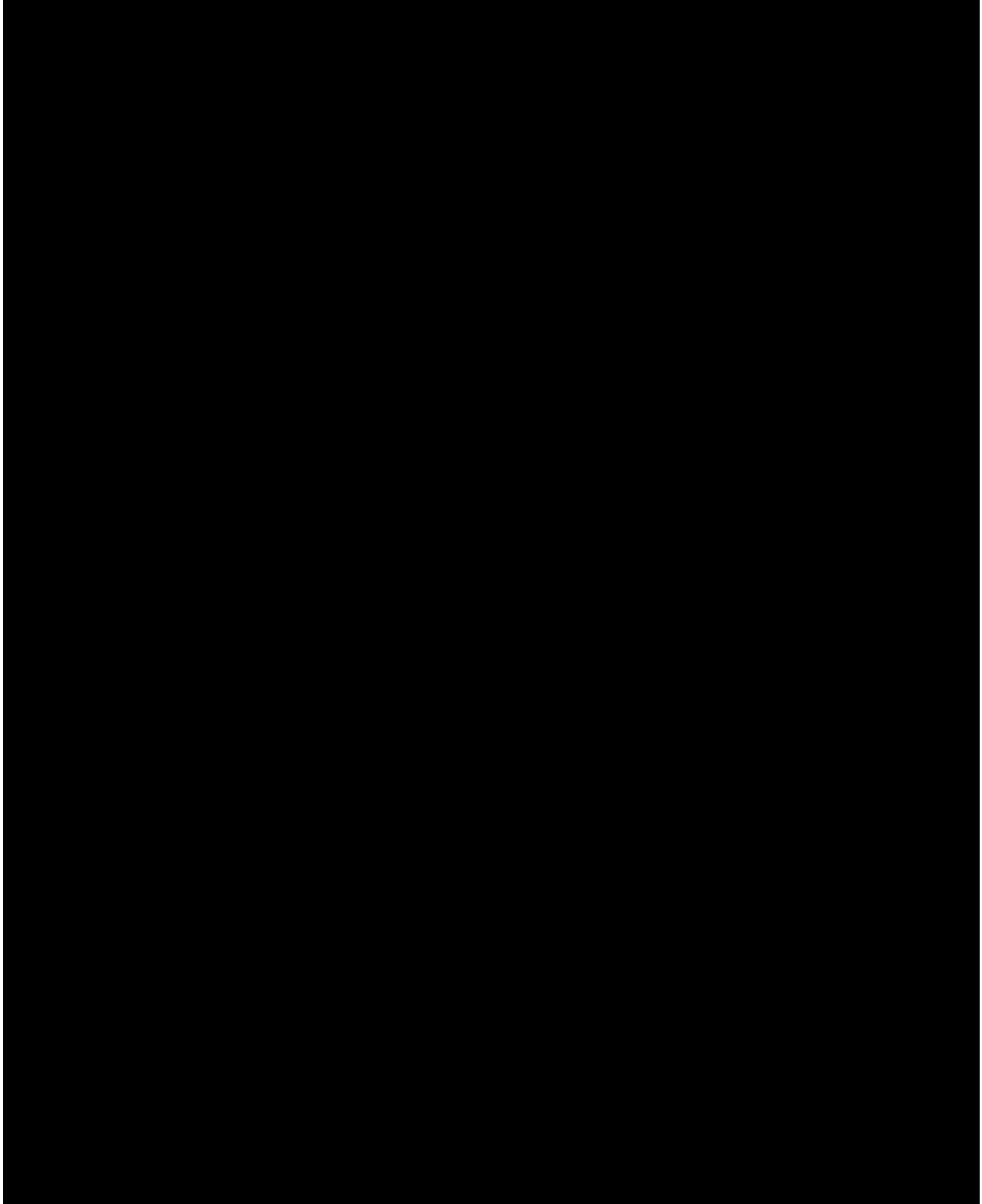
The only appellate decision to address the issue was decided by the Eighth Circuit in Security Bank of Marshalltown, Iowa v. Neiman, 1 F.3d 687 (8th Cir. 1993). The issue in this case was whether debts incurred by the chapter 13 debtors post-confirmation but before conversion to chapter 7 should be considered administrative expenses afforded higher priority distribution status in the subsequent chapter 7 case. This issue turned on whether the chapter 13 estate continued to exist after confirmation of the chapter 13 plan.

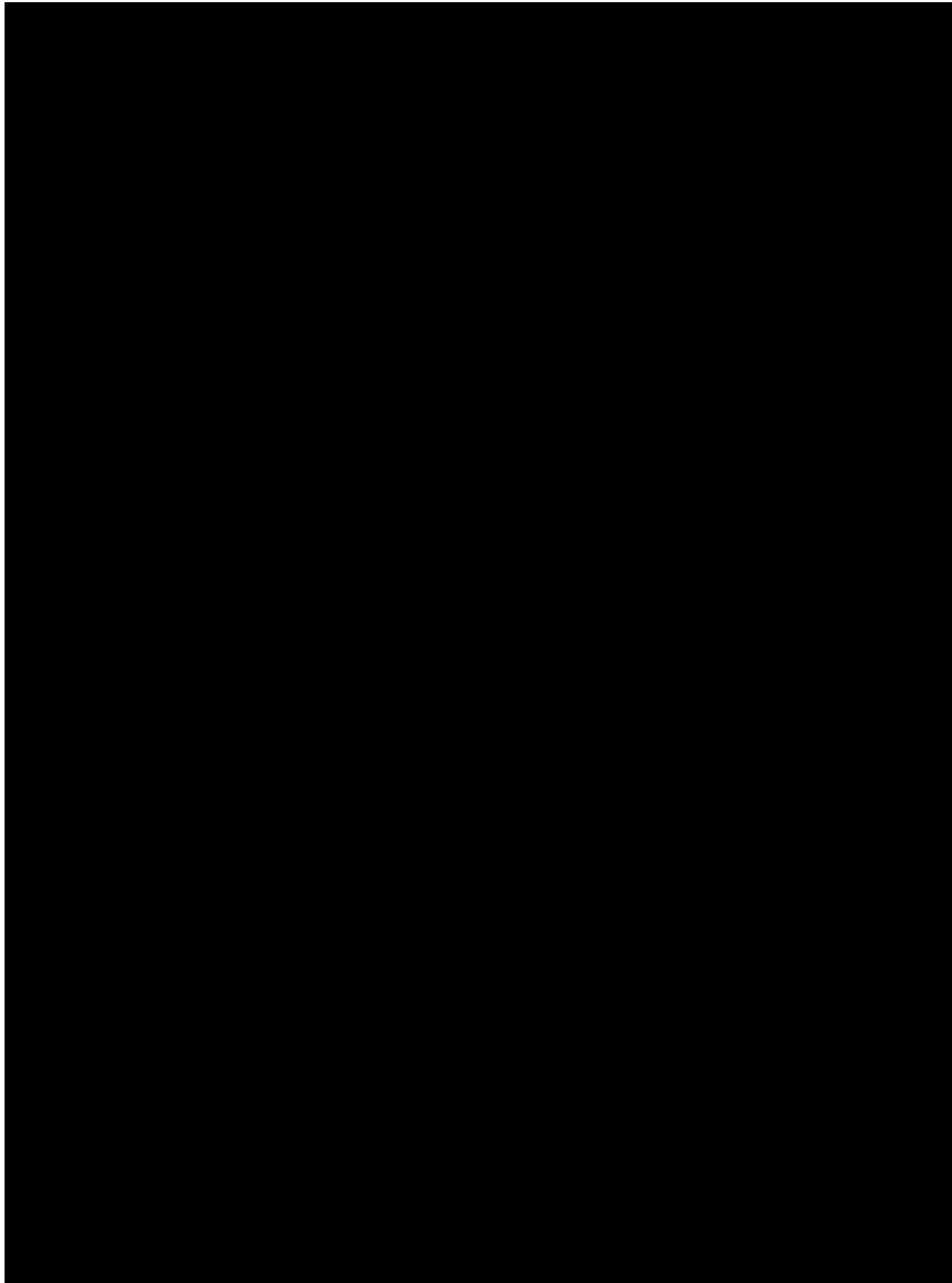
The court held that the bankruptcy estate continued to exist. The court reasoned that there must be an estate post-confirmation so that the trustee has something to administer. Id. at 690-691. The court accordingly held that the debts were incurred to preserve the chapter 13 estate and should be given administrative expense status under 11 U.S.C. § 503(b)(1)(A). However, since the only issue presented to the court was whether an estate continues to exist post-confirmation, the court did not expressly address the issue of exactly what property is in the post-confirmation estate. In fact, the court favorably cited to both Root, which holds that the estate is limited to property necessary for funding the plan, and Aneiro, which holds that all property is in the estate. Id. at 691. Thus, it is not clear exactly where the Eighth Circuit stands on the issue of what property is in the post-confirmation estate.

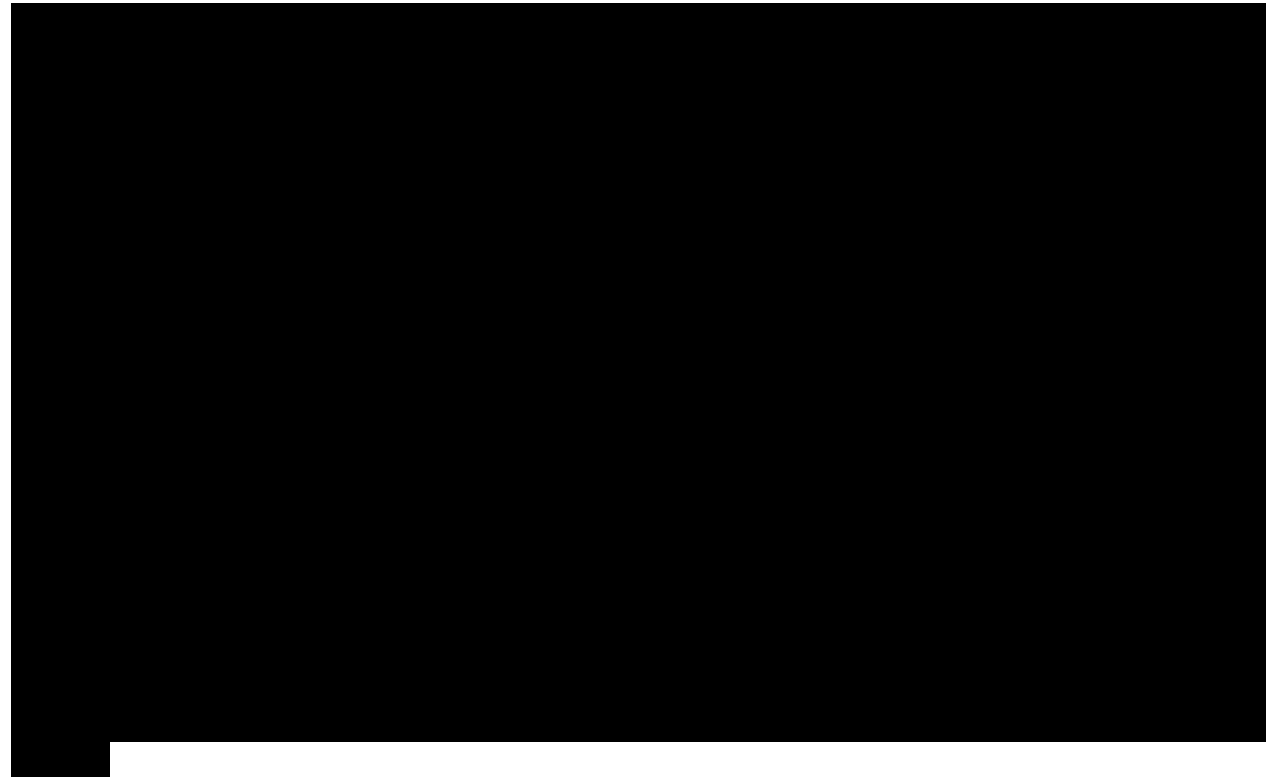
The Service's position is that there is an estate post-confirmation, but it is limited to funds necessary for or committed to the funding of the plan (e.g., the portion of the debtor's monthly wages to be paid over to the trustee). See, e.g., Leavell, supra, 190 B.R. at 540-41. Our position is that the after-acquired property provision of section 1306(a) should be read in conjunction with sections 1327(b) and 1322(a)(1). Pursuant to section 1327(b), title to property is generally vested in the debtor upon confirmation, thus removing property of the debtor from the estate. However, section 1306(a) establishes a limited post-confirmation estate consisting of after-acquired property described in section 1322(a)(1), i.e., the portion of the debtor's future earnings or other income to be submitted to the trustee to execute the plan. This interpretation serves to protect those assets necessary for the effectuation of the chapter 13 plan, while also

vesting all other property in the debtor so as not to impair the debtor's ability to obtain post-confirmation credit and resume normal financial activities.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:







If you have any further questions, please telephone the attorney in this branch assigned to this case at (202) 622-3630.

cc: Assistant Regional Counsel (GL), Southeast Region
Assistant Chief Counsel (Field Service)
Director, Executive Office for Service Center Operations