

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
RICHARD & RHONDA CHERRY,) CASE NO. BK86-83580
)
DEBTOR) CH. 7
) Fil. 102, 142

MEMORANDUM

Hearing was held on June 21, 1993, on the Motion to Determine Tax Liability filed by the debtors. Appearing on behalf of debtors was David Hahn of Hahn Law Office, Lincoln, Nebraska. Appearing on behalf of the United States of America was Virginia Lowe of the U.S. Department of Justice, Washington, D.C. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(B) and (I).

Background

This Chapter 7 case began with the filing of a voluntary petition in 1986. At the time of the filing, the debtors owed the IRS an undetermined amount for employment taxes, prepetition interest, and penalties. During the case, the trustee was successful in bringing back into the estate a net amount of approximately \$17,000.00 through various preference actions.

In 1990, the IRS filed a proof of claim in the amount of \$9,259.97. That proof of claim did not include any prepetition interest or penalties. It also did not include any post-petition interest or penalties.

After the filing of the proof of claim and before the discharge was granted to the debtors, the debtors filed a motion for determination of tax liability and a hearing was held on this motion on December 14, 1990. No representative of the IRS appeared at the hearing. The Chapter 7 trustee and counsel for the debtor appeared and the journal entry allows the claim as filed.

The trustee then paid administrative expenses, paid the IRS on its priority claim in the amount of \$9,259.97 and paid a pro

rata distribution to two other unsecured creditors. A discharge was entered and the case was closed.

Following the discharge, the IRS notified the debtors that they were responsible for prepetition interest and penalties on the tax claim and post-petition interest and penalties. The debtors then filed this motion to reopen the case for the purpose of determining issues related to the IRS claim.

The case has been reopened and the parties have submitted the issues to the Court on documentary evidence and written briefs. The parties and the Court agree that the matters before the Court consist of a question or questions of law.

Dischargeability of Tax, Interest and Penalty

The Bankruptcy Code at 11 U.S.C. § 727 provides for a discharge of most prepetition obligations. However, at Section 727(b) the Code excepts from discharge debts or claims which are treated by Section 523. Section 523 provides that nondischargeable debts include debts for a tax of the kind specified under Section 507(a)(7). At Section 507(a)(7)(C), the Code includes "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity." Employment taxes which are the subject of this motion are the type of tax included under Section 507(a)(7)(C).

In addition to the underlying tax obligation being non-dischargeable, Section 523(a)(7) provides that non-pecuniary loss penalties are nondischargeable where the penalty is computed by reference to a related tax liability which is nondischargeable.

The prepetition penalties and interest, as well as the prepetition tax obligation, are nondischargeable pursuant to the plain language of the Code at Section 523(a)(1)(A), 523(a)(7) and 507(a)(7)(c).

Post-petition penalties on nondischargeable taxes are collectible from the debtors despite a discharge in a bankruptcy case. Hanna v. United States (In re Hanna), 872 F.2d 829 (8th Cir. 1989). In addition, post-petition interest on nondischargeable taxes may be collected from the debtors despite the discharge. Bruning v. United States, 376 U.S. 358, 84 S. Ct. 906 (1964). See also Hanna, supra.

Effect of Proof of Claim Allowance

The problem in this case is that the debtors believe that by filing a motion requesting the Court to determine the amount of

the taxes owed to the IRS and by obtaining an order from the Court allowing the claim of the IRS, the IRS is barred from receiving any payment from the debtors in addition to the amount paid by the trustee pursuant to the allowed claim. The debtors also argue that had the IRS informed the trustee and the debtors that the debtors actually owed more than the amount of the proof of claim, the trustee would have had sufficient funds available to pay the IRS, thereby leaving the debtors free of any IRS claims post-discharge.

In a Chapter 7 case, the allowance of a claim deals with the claim as of the petition date. See 11 U.S.C. §§ 501 and 502. Therefore, any ruling on the allowance of the IRS proof of claim which took place on December 14, 1990, dealt with prepetition obligations of the debtors and did not deal with any post-petition taxes, interest or penalties.

With regard to the argument that the Court's determination and allowance of the IRS claim in December of 1990 is binding on the IRS, the Court finds the debtors to be incorrect. The IRS filed a proof of claim. The debtor filed a motion for a determination of the amount of the claim. That motion was served on an Assistant United States Attorney for the District of Nebraska and was served on the IRS, but was not served on the Attorney General of the United States. The notice of hearing was served on an Assistant United States Attorney for the District of Nebraska and the IRS, but was not served upon the Attorney General of the United States. Fed. Bankr. R. 7004 incorporates many of the provisions of Fed. R. Civ. P. 4 with regard to service of process. Fed. R. Civ. P. 4(d)(4) requires that a copy of the summons and complaint be served upon the Attorney General of the United States at Washington, D.C. Fed. Bankr. R. 9014 requires that a motion in a contested matter shall be served in the manner provided for service of a summons and complaint by Fed. Bankr. R. 7004. Since a motion for determination of taxes is a contested matter, the service requirements of Fed. Bankr. R. 7004 and Fed. R. Civ. P. 4(d)(4) must be complied with in order to obtain jurisdiction over the United States. Compliance with the requirements for service is a basic prerequisite for the exercise of jurisdiction over an action. See United States v. Simms (In re Simms), 33 Bankr. 792, 793 (N.D. Ga. 1983); Farmers State Bank of Superior v. Norris, (In re Norris), 90 Bankr. 424, 427 (Bankr. D. Neb. 1988).

Although the Court has found no specific Eighth Circuit decisions construing the compliance with the service requirements of Fed. Bankr. R. 7004 and the jurisdictional issue, there is published authority in this district with regard to the matter. In Wells C. Jones v. Internal Revenue Service, 63 A.F.T.R.2d 89-

1153, 1988 WL 163033 (D. Neb. 1988), the court held: "This court finds that it lacks subject matter jurisdiction over this matter as plaintiff has failed to serve his petition on the United States Attorney and the Attorney General of the United States as required by Fed. R. Civ. P. 4(d)(4)." Unreported decisions of the Bankruptcy Court in this district are in conformance with the district court ruling.

Since the United States was not properly served, the Court did not have jurisdiction over the United States and a decision in a contested matter is not binding on the United States. The result is, with regard to prepetition interest and penalties, that no determination was made by the Court. Since such amounts are nondischargeable pursuant to Section 523(a)(1)(A), whether or not a claim was filed or allowed, the IRS is permitted to seek such amounts directly from the debtors after a discharge has been entered in their Chapter 7 case.

Estoppel

Finally, the debtors argue that the IRS should be estopped from attempting to collect the amounts allegedly due because had the trustee been informed of the amount actually claimed by the IRS, payment would have been made from property of the estate. This Court does not agree. Section 726(a) of the Bankruptcy Code sets forth the order of distribution in a Chapter 7 liquidation case. It provides for distribution in a particular order. Section 726(a)(1) provides that priority claims of the kind and in the order specified in Section 507 are paid first. Second in payment are allowed unsecured claims, proof of which is timely filed. Fines or penalties arising before the petition date which are not compensation for actual pecuniary loss suffered by the holder of the claim are paid in the fourth priority. 11 U.S.C. § 726(a)(4). Therefore, the prepetition penalties would have been paid by the trustee only after a full distribution was made to unsecured claimholders. In this case, there were two relatively large unsecured claimholders who shared a pro rata distribution of the net funds available after payment of the tax claim. There were no funds available for prepetition penalties to be paid by the trustee.

The motion pending before the Court and the preliminary pretrial statement appear to request the Court to make a determination of the actual amount due to the IRS at this time. However, the Court has insufficient evidence to make such a determination. Therefore, if the parties actually want the Court to make further determination of the amount due, they may submit supplementary materials within twenty-one days, or may direct the Court to the materials which have been previously submitted that

they desire the Court to consider in making such a determination. Since it is likely that there continues to be some accrual of interest since this motion was filed, the Court assumes the IRS would be required to provide additional information so that a final determination of the amount due could be made. On the other hand, it would appear that the debtors could use the administrative process with the IRS to come to some conclusion with regard to the amount due, rather than resorting to a determination by this Court in a case in which the debtors have been discharged and left with nondischargeable debt to deal with outside of the bankruptcy case.

Conclusion

The Court finds that the prepetition penalties and interest and post-petition penalties and interest are nondischargeable and are the personal obligation of the debtors. Unless further materials are submitted to the Court within twenty-one days, the Court will consider this a final order and the case will be closed. If additional materials are submitted, this order is not a final order and not appealable until a final determination is made with regard to the amount owed by the debtors to the IRS.

Separate journal entry to be entered.

(X) Clerk to give immediate notice of the Court's ruling to counsel appearing at the hearing.

DATED: July 30, 1993.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
RICHARD & RHONDA CHERRY,)	CASE NO. BK86-83580
)	A
<u>DEBTOR(S)</u>)	
)	CH. 7
)	Filing No. 102, 142
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	
)	
)	DATE: July 30, 1993
<u>Defendant(s)</u>)	HEARING DATE: June 21,
)	1993

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Determine Tax Liability filed by debtors.

APPEARANCES

David Hahn, Attorney for debtor
Virginia Lowe, Attorney for USA

IT IS ORDERED:

The prepetition penalties and interest and post-petition penalties and interest are nondischargeable and are the personal obligation of the debtors. Unless further materials are submitted to the Court within twenty-one days, the Court will consider this a final order and the case will be closed. If additional materials are submitted, this order is not a final order and not appealable until a final determination is made with regard to the amount owed by the debtors to the IRS. See memorandum entered this date.

(X) Clerk to give immediate notice of the Court's ruling to counsel appearing at the hearing.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge