

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION**

In re: Case No. 03-16984-8G7
Chapter 7

MITCHELL SCOTT STONE,
LILLIAN HAYDEE STONE,

Debtors.

MITCHELL SCOTT STONE
and LILLIAN HAYDEE STONE,

Plaintiffs,

vs. Adv. No. 8:05-ap-52-PMG

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,

Defendant.

**ORDER ON MOTION BY UNITED STATES
(INTERNAL REVENUE SERVICE)
TO DISMISS OR TO ABSTAIN**

THIS CASE came before the Court for hearing to consider the Motion to Dismiss or to Abstain filed by the United States of America, Internal Revenue Service.

The Debtors, Mitchell Scott Stone and Lillian Haydee Stone, commenced this adversary proceeding by filing a Complaint against the Department of Treasury, Internal Revenue Service (IRS). Generally, the Debtors seek a determination of the extent and validity of the secured portion of the claim filed by the IRS, and also seek a determination that the Debtor, Lillian Stone, is not liable for any portion of the claim based on §6672 of the Internal Revenue Code.

In the Motion under consideration, the IRS asserts that the Complaint should be dismissed, or alternatively that the Court should abstain from hearing Count II, because the relief requested is not available to Chapter 7 debtors in "no asset" liquidation cases.

Background

The Debtors filed a petition under Chapter 7 of the Bankruptcy Code on August 15, 2003. On December 16, 2003, the Debtors received their Discharge of Joint Debtors.

On May 28, 2004, the IRS filed a Proof of Claim in the Chapter 7 case. The Proof of Claim includes a secured component in the amount of \$60,502.71, and a priority component in the amount of \$36,947.81, for a total claim of \$97,450.52. It appears that the claim is based primarily on the IRS's assertion of "responsible officer" liability under §6672 of the Internal Revenue Code for the trust fund portion of unpaid withholding taxes.

On January 4, 2005, the Chapter 7 Trustee filed her Report of No Distribution. In the Report, the Trustee stated that the estate had been fully administered and that there was no property available for distribution to creditors.

On February 7, 2005, the Debtors filed a Complaint against the IRS. In the Complaint, the Debtors allege that the assets listed on their bankruptcy schedules are valued at \$7,475.00, and that the consensual liens encumbering the assets total \$13,241.00. Consequently, the Debtors assert that they possessed no equity in their assets at the time that the bankruptcy petition was filed, and therefore seek a determination of the "nature, extent and validity of the lien asserted by" the IRS. (Doc. 1, Complaint, Count I).

The Debtors also allege that the penalties asserted by the IRS under §6672 relate to a corporation known as Tourlink, Inc., but that Lillian Stone did not have the corporate authority or control required for liability as a "responsible officer" under that provision. The Debtors therefore seek a determination that Lillian Stone is not liable for the penalties claimed by the IRS under §6672 of the Internal Revenue Code. (Doc. 1, Complaint, Count II).

In response, the IRS filed the Motion to Dismiss or Abstain that is currently under consideration. The IRS contends that "a Chapter 7 debtor may not strip down a secured creditor's lien," and that the Debtors therefore are not entitled to the relief requested in Count I of the Complaint. The IRS also contends that "a debtor in a no-

asset Chapter 7 case may not object to a creditor's claim," with the result that the Debtors are not entitled to the relief requested in Count II of the Complaint.

Discussion

I. Count I – Nature, Extent, and Validity of Lien

Count I of the Debtor's Complaint is an action to determine the nature, validity, and extent of the IRS's secured claim. In Count I, the Debtors assert that the Court should determine that the IRS's lien is of no value, because no equity existed in any of their assets at the time that the bankruptcy petition was filed.

In response, the IRS contends that Count I should be dismissed because its lien "passes through" the bankruptcy case, regardless of the value of the Debtor's assets at the time of filing, and because no bankruptcy purpose would be served by valuing the lien.

The Court finds that Count I should be dismissed.

The decision in In re Carpenter, 2003 WL 1908944 (Bankr. M.D. Fla.) is directly on point. In Carpenter, the Chapter 7 debtors had filed a complaint against the IRS to determine the extent, validity, and priority of the IRS's prepetition tax liens. In Count II of the complaint, the debtors asserted that the amount of the tax liens should be limited to the value of their unencumbered personal assets at the time that the bankruptcy petition was filed.

The Court in Carpenter concluded that the debtors' Count II should be dismissed, based primarily on the decision of the United States Supreme Court in Dewsnup v. Timm, 502 U.S. 410 (1992), and the line of cases that have followed Dewsnup.

In Dewsnup, the Supreme Court held a Chapter 7 debtor may not use the provisions of 11 U.S.C. § 506 to "strip down" a mortgage lien to the judicially determined value of the property. (Citation omitted.) The Supreme Court reiterated liens on real property pass through bankruptcy unaffected. (Citation omitted.) The holding in Dewsnup has since been extended to include nonconsensual

federal tax liens, like those at issue in this case. (Citations omitted.)

Clearly under Dewsnup, relief in the form of 11 U.S.C. § 506 is not available to Debtors under the facts of this case. . . . This Court finds no support for the relief requested in Count II, and cannot envision any legal argument which would support the Debtors' assertions.

In re Carpenter, 2003 WL 1908944, at 1. Consequently, the Court dismissed Count II of the debtors' complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted. Id.

The principles discussed in Carpenter were recently adopted in In re Dippel, 2005 WL 758801 (S.D. Fla.)("[A]ny federal tax lien attaching to the Debtors' property and interests in property pass through bankruptcy unaffected," and "[a]s a matter of law, a Chapter 7 debtor is not permitted to 'strip down' the value of a creditor's lien.") and In re Phillips, 2005 WL 995001 (Bankr. M.D. Fla.)("A debtor is not permitted to 'strip down' an allowed secured claim in a Chapter 7 case.").

The rationale for these decisions was explained in In re Thomas, 260 B.R. 884 (Bankr. M.D. Fla. 2001). Generally, courts recognize the long-established rule that prepetition liens pass through bankruptcy unaffected, and therefore conclude that the lienholder should be entitled to receive the benefit of any postpetition increase in value of the property subject to the lien.

If the collateral were to subsequently appreciate, then the debtor could keep such appreciation upon post-bankruptcy sale of the collateral, resulting in a windfall.

...

It would be impermissible, pursuant to Dewsnup, for the Court today to place a cap on the value of the IRS' lien and therefore on its eventual collection

from that perhaps far-off sale, leaving any appreciation between now and that date for Debtors to enjoy.

In re Thomas, 260 B.R. at 885. In other words, pursuant to Dewsnup and its progeny, chapter 7 debtors should not be permitted to obtain a "determination of secured status" as of the petition date, since the effect of such a determination would be to "improperly freeze the creditor's secured interest at the judicially determined value." In re Phillips, 2005 WL 995001, at 1.

In this case, any lien of the IRS passes through the Chapter 7 case, and no authority exists to permit the Debtors to restrict the lien to the value of the Debtors' property as of the date that they filed their bankruptcy petition. Count I of the Complaint should be dismissed.

II. Count II – Determination of Responsible Officer Liability

Count II of the Debtors' Complaint is an action to determine the liability of the Debtor, Lillian Haydee Stone, for the portion of the IRS's claim based on penalties under §6672 of the Internal Revenue Code for unpaid withholding taxes.

The IRS contends that Count II should be dismissed, or alternatively that the Court should abstain from Count II, because the Debtors are not parties in interest entitled to contest the claim in this no-asset Chapter 7 case.

The Court finds that it should abstain from determining the issues raised in Count II of the Debtors' Complaint.

Section 505(a) of the Bankruptcy Court provides:

11 U.S.C. § 505. Determination of tax liability

(a)(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated

by a judicial or administrative tribunal of competent jurisdiction.

11 U.S.C. §505(a). The two purposes of Section 505 are (1) to provide a forum for the determination of tax claims, if the administration of the bankruptcy case would be delayed by allowing the determination to be made in other proceedings, and (2) to provide an opportunity for the trustee to contest a tax claim if the debtor had been unable or unwilling to challenge the claim prepetition. In re Beisel, 195 B.R. 378, 379-80 (Bankr. S.D. Ohio 1996).

It is generally accepted that neither of the purposes of §505(a) has any application in "no asset" Chapter 7 cases involving only the debtor and the taxing authority, and that abstention is appropriate in those circumstances. In re Beisel, 195 B.R. at 79-80. Because "there is no need for a determination of this tax issue for estate administration purposes, this Court is not the proper forum for this litigation [involving a debtor's objection to a claim filed by the IRS in a no asset Chapter 7 case.]" Id. at 380.

In In re Williams, 190 B.R. 225 (Bankr. W.D. Pa. 1995), for example, as in the case at bar, a Chapter 7 debtor filed an action against the IRS to determine her liability for unpaid employee withholding taxes. In re Williams, 190 B.R. at 226. In addressing the IRS's motion to abstain from the proceeding, the Court first noted that its authority to determine a debtor's tax liability under §505 is discretionary and not mandatory. Id. at 227. The Court then noted that the debtor's case was a "no asset" Chapter 7 case, and found that abstention was therefore warranted.

Hearing and deciding this case will not further any bankruptcy interest. No assets will be made available for distribution to creditors if debtor prevails. Conversely, no assets will be available to satisfy the debt owed to IRS should it prevail. Creditors will receive no distribution from the estate under either scenario.

Id. at 227. Consequently, the Court abstained from the proceeding, because "Congress did not intend for a bankruptcy court to provide a forum for such litigation when the outcome of the case will have no impact upon administration of the bankruptcy case." Id. at 228.

See also In re Cunningham, 278 B.R. 290, 292 (Bankr. M.D. Ga. 2002)("The weight of authority demonstrates that abstention is generally appropriate in no-asset Chapter 7 cases. This is because no bankruptcy purpose would be served by a tax determination if no distribution will be made."); and In re Gossman, 206 B.R. 264, 267 (Bankr. N.D. Ga. 1997)(The Court abstained from determining the debtor's tax liability because "Bankruptcy courts generally abstain from determining tax liability in no-asset chapter 7 case," and because "[s]etting the amount of trust fund liability would be of no use to the administration of this bankruptcy estate.").

In the case at issue, the Chapter 7 Trustee has filed her Report of No Distribution and found that no property was available for distribution to creditors. In Count II of the Complaint, the Debtors request that the Court "determine the responsible officer liability of Lillian Haydee Stone." Since the determination will have no impact on the administration of the bankruptcy case, the Court finds that it is appropriate to abstain from the issues raised in Count II.

Conclusion

The Debtors filed a two-Count Complaint against the IRS. In Count I, the Debtors seek a determination of the extent and validity of the tax lien asserted by the IRS. The Court finds that Count I should be dismissed, because any lien of the IRS "passes through" the bankruptcy case, and no authority exists to permit the Debtors to value the lien as of the date that the bankruptcy petition was filed.

In Count II, the Debtors seek a determination of the tax liability of the Debtor, Lillian Haydee Stone. The Court should abstain from hearing the issues raised in Count II, because the determination will have no impact on the administration of this "no asset" Chapter 7 case.

Accordingly:

IT IS ORDERED that:

1. The Motion by United States (Internal Revenue Service) to Dismiss or Abstain is granted as set forth in this Order.

2. Count I of the Complaint filed by the Debtors, Mitchell Scott Stone and Lillian Haydee Stone, against the Department of Treasury, Internal Revenue Service, is dismissed.

3. The Court exercises its discretion to abstain from determining the issues raised in Count II of the Complaint.

DATED this 22nd day of July, 2005.

BY THE COURT

/s/ Paul M. Glenn

PAUL M. GLENN
Chief Bankruptcy Judge