

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

In re:

ALFRED KELLY CARPENTER and
JUANITA SUE CARPENTER,

Case No. 6:05-bk-03334-ABB
Chapter 7

Debtors.

ORDER

This matter came before the Court on the: (i) Trustee's Final Report (Doc. Nos. 229, 230) filed by the Chapter 7 Trustee Marie E. Henkel ("Trustee"); (ii) the Joint Objection thereto (Doc. No. 231) filed by the Debtors Alfred Kelly Carpenter ("Mr. Carpenter") and Juanita Sue Carpenter (collectively, "Debtors") and the City of Columbus, Ohio ("City"); and (iii) the Trustee's Objection to the City's proof of claim (Doc. No. 234). Evidentiary hearings were held on October 26 and November 23, 2009 at which the Trustee, her counsel, and counsel for the Debtors appeared. The parties, pursuant to the Court's directive, filed post-hearing briefs (Doc. No. 240).

The Trustee's objection to the City's proof of claim is due to be sustained and the City's objection to the Trustee's Final Report is due to be overruled. The Court makes the following findings and conclusions after reviewing the pleadings and evidence, hearing proffers and argument, and being otherwise fully advised in the premises.

Case Events

Whitehouse Franklin, LLC ("Whitehouse") and Mr. Carpenter, who was an officer of Whitehouse, were involved in a construction project in the City in 1999. The City, through its Division of Income Tax, instituted a civil action in the Ohio State Courts

on January 3, 2003 against Whitehouse and Mr. Carpenter for the collection of 1999 municipal income taxes pursuant to an employer's quarterly tax return for the fourth quarter 1999 filed by Whitehouse on or about September 17, 2001 (Debtors' Ex. 1).¹ The City sought recovery of a tax liability of \$8,373.59 plus penalties, interest, and a late return filing fee. Mr. Carpenter participated in the litigation, but did not appear for trial. A Decision and Judgment Entry was entered on April 30, 2004 ("Judgment") by default against Mr. Carpenter for \$14,520.70 with interest at 10% per annum from the date of judgment plus costs of \$98.00 (Debtors' Ex. 2).

The Debtors filed this case on April 1, 2005 ("Petition Date") and they listed the City and its Assistant City Attorney in their original matrix and Schedule F for Mr. Carpenter's "1999 Possible personal liability on business debt (occupational license fees not paid)" of \$25,000.00 (Doc. Nos. 1, 17). The City and its counsel received notice of the Debtors' bankruptcy case in April 2005 pursuant to the Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines ("Notice") issued by the Court on April 6, 2005 (Doc. No. 8). The Notice set forth a claims bar date for governmental units of 180 days from the Petition Date, September 28, 2005. The City is a governmental unit and did not file a proof of claim by the bar date.

The Debtors received a Discharge on June 29, 2007 (Doc. No. 197) and the City received notice of the Discharge on or about July 1, 2007 (Doc. No. 198). The City, post-discharge, attempted to collect taxes and penalties of \$17,422.28 from Mr. Carpenter asserting the Judgment debt is nondischargeable and was not discharged. The Debtors, on behalf of the City, filed on July 24, 2009 an 11 U.S.C. Section 507(a)(8) unsecured

¹ The City timely instituted its civil action against Mr. Carpenter and Whitehouse within three years of the filing of the 1999 return. OHIO REV. CODE ANN. § 718.06(A).

priority claim, Claim No. 7-1, for \$17,422.28 for “income tax” with no supporting documentation. The Trustee filed her Final Report on September 10, 2009 proposing to pay the City \$0.00 because Claim No. 7-1 was untimely filed and unsubstantiated.

The only creditor to timely file a claim which is provided for in the Final Report is Travelers Casualty & Surety Company (“Travelers”).² Travelers holds an allowed general unsecured claim of \$2,025,731.08, Claim No. 6-1. National City Bank untimely filed a general unsecured claim of \$824,657.98, Claim No. 5-1. Orders were entered sustaining the Trustee’s and Traveler’s objections to National City Bank’s claim and subordinating the claim to Traveler’s claim pursuant to 11 U.S.C. Section 726(a)(3) (Doc. Nos. 187, 188). The Trustee proposes to pay \$0.00 to National City Bank. The Trustee, after payment of the estate’s administrative costs, proposes to distribute the balance of \$217,765.33 to Travelers.

The Debtors and the City object to the Final Report asserting the City’s claim should be paid as a matter of equity. They contend the Judgment debt constitutes a nondischargeable debt and the estate funds should be used to pay the City’s claim before any funds are distributed to Travelers.

The City, on December 11, 2009, filed an amended claim, Claim No. 7-2 for \$17,422.28, which was executed by the City’s counsel and has supporting documentation. The basis for the claim was amended to “withholding taxes.” The amended claim was filed after the evidentiary hearing and reclassifies the claim from “income taxes” to “withholding taxes.”

² The claims filed by the Debtors and Preventative Maintenance & Control, LLC were withdrawn (Doc. Nos. 78, 194). The Internal Revenue Service was adjudicated to have a right of setoff of \$28,835.00 and its amended secured claim for \$28,835.00, Claim No. 3-2, was allowed pursuant to the Memorandum Opinion and Judgment entered on December 28, 2006 in *Marie E. Henkel, Trustee v. United States of America*, AP No. 6:05-ap-00312-ABB.

Analysis

Threshold Issue and Governing Law

The threshold issue for determination is the nature of the Judgment debt. The Debtors and the City assert the Judgment debt constitutes a withholding tax for “a tax required to be collected or withheld and for which the debtor is liable in whatever capacity” pursuant to 11 U.S.C. Section 507(a)(8)(C). The Trustee asserts the Judgment debt constitutes an income tax pursuant to 11 U.S.C. Section 507(a)(8)(A) or an excise tax pursuant to 11 U.S.C. Section 507(a)(8)(E) for which a priority status only exists for the three years preceding the Petition Date. The categorization of the Judgment debt has dischargeability ramifications pursuant to 11 U.S.C. Section 523(a)(1).

The Debtors filed this bankruptcy case on April 1, 2005 and the case is governed by the Bankruptcy Code as it existed on April 1, 2005, which was prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). BAPCPA was enacted on April 20, 2005 and was effective on October 17, 2005. Certain provisions were effective upon enactment, but most of the provisions were effective upon the effective date. The BAPCPA amendments are not applicable to this case.³

The operative provisions in the determination of this matter are Sections 507(a)(8)(A) and 726(a)(1) of the Bankruptcy Code as they were enacted pursuant to the Bankruptcy Reform Act of 1994 and in effect on the Petition Date. The Debtors and the City in their post-hearing brief erroneously rely on Section 726(a)(1) as it was amended by BAPCPA.

³ Pub. L. No. 109-8, 119 Stat. 23 (April 20, 2005); *see* §§ 1501(b)(1), (2) (uncodified): “Except as otherwise provided in this Act and paragraph (2), the amendments made by this Act shall not apply with respect to cases commenced under title 11, United States Code, before the effective date of this Act . . . The amendments made by sections 308, 322, and 330 shall apply with respect to cases commenced under title 11, United States Code, on or after the date of enactment of this Act.”

Classification of Claim No. 7-1

The Judgment is based upon Section 361.24 of the City of Columbus Municipal Code which provides:

361.24 Collection at source.

(a) Each employer within or doing business within the City, shall deduct at the time of payment of such salaries, wages, commissions or other compensation as defined in Section 361.16 of this Chapter, the tax of two (2) percent of the gross salaries, wages, commissions or other compensation earned by said employee on or before September 30, 2009 and the tax of two and one-half percent (2.5%) of the gross salaries, wages, commissions or other compensation earned by said employee on or after October 1, 2009, and due by the said employer to said employee and shall, on or before the last day of the month following the close of each calendar quarter, make a return showing the amount of taxes so deducted and a record of payments showing that all taxes deducted during the quarter have been paid to the City in accordance with the payment schedule prescribed by subsection (c) hereof. Such employer shall be liable for the payment of the tax required to be deducted and withheld, whether or not such taxes have in fact been withheld. Every employer or officer of a corporation is deemed to be a trustee for this municipality in collecting and holding the tax required under the ordinance to be withheld and the funds so collected by such withholding are deemed to be trust funds.

...

(c) Employers shall pay to the city *all income taxes* withheld or required to be deducted and withheld on either a semimonthly, monthly or quarterly basis depending on the amount of taxes involved according to the following payment schedule.

...

City of Columbus Municipal Code, Art. IX, Chp. 361, § 361.24 (2009) (*emphasis added*).⁴ Section 361.24 is contained within Title 3, Article IX, Chapter 361 of the Municipal Code. Article IX is entitled “Current Income Tax”; Chapter 361 is entitled “Income Tax.” Section 361.19, entitled “Imposition of Tax” and contained within the introductory portion of Article IX, provides:

⁴ The statute was amended in 2009 to increase the tax rate from two percent to two and one-half percent. The tax rate in effect when the Whitehouse 1999 return was filed and the Judgment was entered was two percent.

To provide for the purposes of general municipal operations, maintenance, new equipment, and capital improvements of the city there is hereby levied a tax at the rate of two and one-half percent (2.5%) per annum upon the following:

(a) On all salaries, wages, commissions, and other compensation earned by residents of the city.

(b) On all salaries, wages, commissions, and other compensation earned by nonresidents of the city for work done or services performed or rendered in the city.

Id. §§ 361.19(a), (b). The Ohio Courts define the Article IX taxes as “municipal income taxes.” Columbus Div. of Income Tax v. Boles, 605 N.E.2d 981, 985 (Ohio App. 10th 1992); City of Columbus, Ohio v. White, No. 80AP-58, 1980 WL 353457, at *2 (N.E.2d May 15, 1980).

The statutory language throughout Article IX of the Municipal Code reflects the taxes levied pursuant to Section 361.24 constitute income taxes. “It is a cardinal rule [of statutory construction] that a court must first look to the language of the statute itself to determine the legislative intent.” Provident Bank v. Wood, 304 N.E.2d 378, 381 (Ohio 1973). The tax payments required by Section 361.24 constitute income taxes pursuant to the clear, unequivocal and definite language of the Municipal Code. The Judgment debt constitutes an income tax claim pursuant to Section 507(8)(A) of the Bankruptcy Code.

The underlying tax debt was incurred in 1999 and was due more than three years before the Petition Date. Whitehouse filed its 1999 fourth quarter tax return with the City in 2001. The City obtained the Judgment on April 30, 2004. The tax was assessed more than 240 days before the Petition Date. The Judgment debt is not entitled to priority treatment pursuant to 11 U.S.C. Section 507(a)(8)(A).

Timeliness of Filing

The claims bar date for governmental units was September 28, 2005, 180 days after the Petition Date. Claim No. 7-1 was filed more than three years after the claims bar date expired. The City had notice of the bar date from the onset of this case and failed to timely file a claim. Claim No. 7-1 is a tardily filed claim.

Section 726(a) of the Bankruptcy Code sets forth property of the estate is to be distributed first in payment of Section 507 claims. A claimant who tardily files a Section 507 claim is entitled to distribution where the claim was “tardily filed before the date on which the trustee commences distribution under this section.” 11 U.S.C. § 726(a)(1). The Trustee commenced distribution of the Debtors’ estate in January 2008 and the City’s claim was not filed prior to such distribution.

The Trustee filed a Motion for Authority to Make Interim Distribution on November 15, 2007 (Doc. No. 211) in which she sought authority to distribute collected funds of \$691,696.22. She proposed to pay the IRS’ secured claim of \$28,835.00 in full to cease the accrual of interest and to make a partial payment of Traveler’s claim. A hearing on the motion was held on December 17, 2007 at which the Trustee, her counsel, and counsel for the Debtors appeared. The motion was unopposed and the Order Granting Trustee’s Motion for Authority to Make Interim Distribution was entered on January 8, 2008 (Doc. No. 215) approving the motion.

The Trustee commenced distribution of the estate in January 2008 pursuant to the January 8, 2008 Order. She made distributions of \$28,835.00 to the Internal Revenue Service, in payment in full of its allowed secured claim, and \$371,165.00 to Travelers as partial payment of its allowed general unsecured claim. The City’s Claim No. 7-1 was

filed on July 24, 2009, after the commencement of distribution, and is not entitled to a priority distribution pursuant to 11 U.S.C. Section 726(a)(1).⁵

The Trustee's Objection to Claim No. 7-1 is due to be sustained. Claim No. 7-1 is due to be subordinated to Traveler's timely proof of claim pursuant to 11 U.S.C. Section 726(a)(3). The City's amended Claim No. 7-2 is due to be disallowed. The objection to the Trustee's Final Report is due to be overruled.

Accordingly, it is

ORDERED, ADJUDGED and DECREED that the Trustee's Objection to Claim No. 7-1 (Doc. No. 234) is hereby **SUSTAINED** and Claim No. 7-1 is subordinated to the timely proof of claim filed by Travelers pursuant to 11 U.S.C. Section 726(a)(3); and it is further

ORDERED, ADJUDGED and DECREED that the City of Columbus is not entitled to any distribution on Claim No. 7-1 until after the timely filed claim of Travelers is paid in full, with the City of Columbus and National City Bank to share *pro rata* in any such distribution; and it is

ORDERED, ADJUDGED and DECREED that the City of Columbus' amended Claim No. 7-2 is hereby **DISALLOWED**; and it is further

⁵ The Debtors and the City cite I.R.S. v. Davis (In re Davis), 81 F.3d 134 (11th Cir. 1996) in support of their assertion the "distribution" for Section 726(a)(1) purposes must be a final distribution and not an interim distribution. Their assertion is contrary to In re Davis, which was based upon the Bankruptcy Code in effect prior to the 1994 amendments (in which Section 726(a)(1) made no distinction between late and timely claims) and the plain, unambiguous language of Section 726(a)(1), as it governs this case. The case Security State Bank v. I.R.S. (In re Van Gerpen), 267 F.3d 453 (5th Cir. 2001) cited by the Debtors and the City is inapposite in that the payment by the Chapter 7 trustee of administrative expenses (interim attorneys' fees) was not deemed to constitute a "distribution."

ORDERED, ADJUDGED and DECREED that the Debtors' and the City of Columbus' Joint Objection to the Trustee's Final Report (Doc. No. 231) is hereby **OVERRULED**.

Dated this 28th day of December, 2009.

/s/ Arthur B. Briskman
ARTHUR B. BRISKMAN
United States Bankruptcy Judge