NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In the Matter of	:	Case No. 07-13120/JHW
Marvin P. Lewis and Amanda D. Lewis	:	
	:	**OPINION**
Debtors.		

APPEARANCES: Mr. Alan A. Reuter, Esq.
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The debtors have objected to the proof of claim filed by the Internal Revenue Service. The debtors challenge the action of the IRS to apply the debtors' tax refund for 2009 to offset general unsecured debt due to the IRS. The IRS took the action following the resolution of the debtors' motion to reinstate the case, but before a written order was entered. Because the automatic stay was not in effect at the time the IRS applied the debtors' tax refund, and because no other sustainable ground has been presented by the debtors to invalidate the IRS' actions, the debtors' objection to the IRS proof of claim must be overruled.

FACTS

Marvin P. Lewis and Amanda D. Lewis filed for bankruptcy under Chapter 13 on March 6, 2007. The debtors scheduled the IRS as a priority unsecured creditor with a claim in the amount of $7,371.00. The IRS filed its initial proof of claim on March 26, 2007, asserting $5,757.21 in unsecured priority claims and $2,463.81 in general unsecured claims. To date, the IRS has amended its proof of claim four times.[1] As is relevant here, the IRS filed its second amendment on February 19, 2008, revising its claim for unsecured priority taxes to $11,825.13 for the tax periods of 2004 and 2005, and for general unsecured claims to $24,989.66 for the tax periods of 1997, 1998, and 1999.

The debtors filed their first Chapter 13 plan on March 7, 2007, proposing to pay priority claims in full. The plan was modified several times before confirmation on August 14, 2008. The plan as confirmed listed the IRS with two allowed priority claims, $5,235.79 and $4,840.29, totaling $10,076.08. A modified plan was confirmed on January 29, 2009, but the treatment of the IRS priority claims remained the same. Following a default in trustee payments, the debtors' case was dismissed on July 28, 2009. The debtors' case was reinstated on September 14, 2009, and the debtors filed another modified Chapter 13 plan on October 13, 2009. At the confirmation hearing on

[1] The four amendments were filed on May 9, 2007, February 19, 2008, June 26, 2008, and May 4, 2011.

November 18, 2009, the case was dismissed for failure to file a feasible plan, make all pre-confirmation payments, and attend the confirmation hearing. Notice of the dismissal was provided to all creditors; notice was provided electronically to the IRS.

On January 25, 2010, the debtors moved to reinstate their case. The certificate of service indicates that the Chapter 13 trustee and counsel for Wells Fargo were served by mail by the debtor. Notice was also electronically sent to other creditors, but the IRS was not served. On February 24, 2010, the Chapter 13 trustee consented to the reinstatement of the case, subject to certain subsequent conditions, including the making of a payment to the trustee, the submission of proof of emancipation of a child and the filing of amended Schedules I and J. The debtors complied with the conditions in March 2011 and submitted an order reinstating the case in April, which was entered on April 20, 2011.[2] The order vacating dismissal was sent to all creditors, including the IRS.

Eight months later, on January 11, 2011, the Chapter 13 trustee submitted a certification of default noting that the debtors had failed to make any payments since September 28, 2010 and were in default by approximately $10,445.76. The debtors objected to the certification, stating that they had

[2] On March 29, 2010, the court scheduled a hearing to determine why an order had not yet been submitted. The hearing was scheduled for April 26, 2011, but was not held because the order was submitted prior to the hearing.

just made a payment of $1,000 on January 18, 2011, and that they expected a plan credit for $9,010 because the IRS had retained a refund for 2009 taxes that the debtors were entitled to receive. The debtors claimed that the refund should have been returned to them to enable them to apply the moneys toward the IRS priority debt. Instead, the payment was applied to the general unsecured debt due to the IRS, causing the debtors to have substantial difficulty in completing their plan, which required payment of the IRS priority claim in full. The hearing on the trustee's certification of default was adjourned for several months to allow the debtors to seek to reapply the 2009 refund from the IRS.

On February 23, 2011, the debtors filed an objection to the IRS's proof of claim, seeking to amend the claim to credit the amount of the 2009 tax refund toward the IRS priority claim.[3] On April 4, 2011, the IRS amended its proof of claim. This revised claim reflects that the debtors owe $10,076.08 for unsecured priority claims for the tax periods of 2004 and 2005 and $9,225.77 in general unsecured claims for the tax period of 1999. A comparison of the amended proof of claim with the proof of claim filed prior to it reflects that the IRS applied the 2009 tax refund to its general unsecured claims based on the debtors' 1997 and 1998 tax liabilities.

[3] On March 28, 2011, the court directed the debtors to properly serve the IRS with the debtors' objection to the proof of claim. The IRS was properly served March 30, 2011.

The IRS responded to the debtor's objection, contending that because the debtors' bankruptcy had been dismissed when the refund was issued, the IRS was free to apply the 2009 refund as it would in the normal course.[4]

At issue here is whether the automatic stay was reinstated as of the date of the hearing on the debtors' motion to reinstate, February 24, 2011. If so, then the IRS's action to apply the debtors' tax refund to outstanding tax liabilities violated the automatic stay and may be considered void.

DISCUSSION

Section 362 of the Bankruptcy Code, which prohibits creditors from collecting on the debts of an individual once a bankruptcy petition has been filed, provides in relevant part:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—
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> . . .

[4] A taxpayer who makes a voluntary payment to the IRS may designate the application of such payment, and the IRS must generally abide by the designation; involuntary payments may be paid to whatever portion of the taxpayer's liability the IRS chooses. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983). The IRS has discretion to apply refunds of overpayment toward prior liabilities and may direct such payment towards whichever of the taxpayer's accounts it sees fit. Bryant v. C.I.R., No. 09-1957, 2010 WL 4251118, *2 (6th Cir. Oct. 12, 2010); Steinberg v. C.I.R., 19 Fed.Appx. 498, 499 (9th Cir. 2001); In re Ryan, 64 F.3d 1516, 1523-24 (11th Cir. 1995); Kalb v. United States, 505 F.2d 506, 509 (2d Cir. 1974), cert. denied, 421 U.S. 979, 95 S. Ct. 1981, 44 L.Ed.2d 471 (1975).

> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title.

11 U.S.C. § 362(a)(6).[5] If the automatic stay is in effect, any actions taken with respect to any property of the estate in violation of the stay will be considered void. In re Smith, 876 F.2d 524, 526 (6th Cir. 1989). See also I.C.C. v. Holmes Trans., Inc., 931 F.2d 984, 987 (1st Cir. 1991); In re 48th St. Steakhouse, Inc. 835 F.2d 427, 431 (2d Cir. 1987), cert. denied, 485 U.S. 1035, 108 S. Ct. 1596, 99 L.Ed.2d 910 (1988). Property taken in violation of the stay that the "trustee may use, sell, or lease" must be returned to the trustee pursuant to § 542(a) of the Code. Thompson v. General Motors Acceptance Corp., 566 F.3d 699, 704 (7th Cir. 2009). Applying these principles here, if the automatic stay was in effect at the time the IRS applied the debtors' 2009 tax refund to pay off other tax debts, then the IRS's actions in that regard would be void and the IRS would be required to turn over the refund.

The automatic stay generally remains in effect as against property of the estate "until such property is no longer property of the estate," and as to any act under § 362(a) until "the earliest of

> (A) the time the case is closed;

[5] Section 362 also prohibits "the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor," 11 U.S.C. § 362(a)(7), but permits the IRS to set off an income tax refund for a tax period ending before the commencement of the case against an income tax liability for a taxable period that also ended before the commencement of the case. 11 U.S.C. § 362(b)(26). In this case, the refund did not arise before the commencement of the case. Therefore, setoff is proscribed under section 362(a)(7), and not authorized under section 362(b)(26).

> (B) the time the case is dismissed; or
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> (C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied."

11 U.S.C. § 362(c)(1), (2). The IRS asserts that because the debtors' case was dismissed at the time that the refund was applied, the automatic stay was not in effect. Here, the debtors' motion for reinstatement was resolved orally on the record with the Chapter 13 trustee on February 24, 2010, but an order of reinstatement was not submitted until April 2010 and entered on April 20, 2010, after the IRS set off the debtors' refund. Typically, reinstatement restores the automatic stay. In re Diviney, 225 B.R. 762, 770-71 (10th Cir. B.A.P. 1998). The question is whether the oral resolution of the debtors' motion to reinstate the case was sufficient to reimpose the automatic stay.

Bankruptcy courts have addressed the issue of whether the automatic stay is effected immediately upon the oral reinstatement of a case after dismissal, but prior to the actual signing and docketing of the written order. See, e.g., America's Serv. Co. v. Schwartz-Tallard, 438 B.R. 313, 318 (D. Nev. 2010); In re Brown, 290 B.R. 415, 418-19 (Bankr. M.D. Fla. 2003); In re Nail, 195 B.R. 922, 923-24 (Bankr. N.D. Ala. 1996). As a general matter, the courts seem to agree that orders are not effective until written, In re Brown, 290 B.R. at 421, but that a bankruptcy judge has discretion to determine that an oral order of reinstatement is immediately effective. America's Serv. Co. v. Schwartz-Tallard, 438 B.R. at 318. Where a creditor has notice of a motion to

reinstate and an oral order granting the motion, the creditor's action to pursue foreclosure against the debtor's property before a written order is entered will be violative of the automatic stay. In re Nail, 195 B.R. at 925-26. Conversely, where no notice of a motion to reinstate and an oral ruling granting the motion is given to the impacted creditor, the oral order of the court does not necessarily void the creditor's actions to foreclose. In re Brown, 290 B.R. at 418-19.

The critical difference between the cases cited above and the circumstances presented here is that no hearing was actually held on the debtors' reinstatement motion, and no oral ruling was issued by the court. As is customary in this court, the debtors' motion for reinstatement was calendared on a day when other Chapter 13 cases are heard. On such days, the Chapter 13 trustee routinely calls each case on the record, before the judge takes the bench, determines whether the issues in the case can be resolved, and sets aside contested matters for the judge to consider. When this case was called, the trustee worked out a resolution with debtors' counsel that required the debtors to take certain actions, including making a payment through a wage order and amending Schedules I and J. No other objections had been filed and no objectors appeared in court.[6] The trustee reported on the record that an order would be submitted. Because no actual hearing was held and no oral ruling was made by a bankruptcy judge, there can be no conclusion that

[6] It is noted that the IRS had no direct notice of the debtors' motion for reinstatement or the resolution of the motion with the Chapter 13 trustee.

the automatic stay was reinstated as of the hearing date on the debtors' motion to reinstate. The case and the automatic stay were reinstated only when I was actually presented with the proposed order reinstating the case, and signed it on April 20, 2011.

A similar circumstance was presented in In re Johnson, No. 98–24882, 1999 WL 528653 (Bankr. W.D.Tenn. July 16, 1999). In Johnson, as here, no hearing was held on the debtors' motion to reinstate the case, and no oral ruling was made by a bankruptcy judge.

> All that occurred in court, if anything in fact occurred there, was an announcement that the reinstatement motion was unopposed and that the movants would submit an order. Under this particular judge's docket call and uncontested motion procedure, the judge would not have been present for the clerical announcement.

Id. at 3. The court concluded that the debtors' motion to reinstate their Chapter 13 case was not effectively granted until the entry of the written order, and that the actions of the creditor after the court hearing but before the entry of the written order would remain undisturbed.

In a final attempt to void the actions of the IRS, the debtors highlight the significant payments they have made through their Chapter 13 plan, the fact that only a few months remain to complete the plan, and the fact that a reversal by the IRS of the setoff of their 2009 tax refund and the application of that refund to the plan would substantially facilitate the completion of the

plan. Without that reversal, the prospects for successfully completing the plan are dim.

I am certainly sympathetic to the debtors' plight, and impressed by the progress they have made toward the completion of their plan. Nevertheless, I cannot overcome the opportunity of the IRS to take action to collect past due obligations in the normal course when no injunction is in effect to proscribe such action. I conclude that the action taken by the IRS to set off the debtors' 2009 tax refund, against the debtors' tax liabilities for the years 1997 and 1998, cannot be voided as violative of the automatic stay.

The debtors' objection to the IRS proof of claim is overruled. Counsel for the IRS shall submit an order in conformance with this opinion.

Dated: July 7 , 2011

JUDITH H. WIZMUR
CHIEF JUDGE
U.S. BANKRUPTCY COURT