

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of
PROFESSIONAL BUILDING
SERVICES, LTD.,

Debtor.

Case No. 85-2693-C
Chapter 11

ORDER - OBJECTION TO IRS CLAIM

On February 9, 1988, a hearing was held on Debtor's objection to the claim filed by the Internal Revenue Service (hereinafter "IRS"). Jerrold Wanek appeared on behalf of Debtor and Kevin R. Query appeared on behalf of IRS.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(B). The Court, upon review of the arguments of counsel and briefs submitted, now enters its findings and conclusions pursuant to F.R. Bankr. P. 7052.

FINDINGS OF FACT

1. The Debtor, Professional Building Services, Ltd. (hereinafter "PBS"), filed its voluntary Chapter 11 petition on December 9, 1985.
2. PBS has operated as Debtor-in-possession since that date.
3. The IRS filed a proof of claim in the amount of \$48,095.12 on June 20, 1986. This claim was docketed as Claim No. 2. This claim has been amended and is now docketed as Claim No. 5 in the amount of \$48,199.13. PBS'S objection pertains to this most recent amendment.

4. The Debtor's plan was filed on September 24, 1987. This plan distinguishes between the tax claims for which the corporate debtor is solely liable, and the claims for which the corporate debtor and Mathew D. Sanders, corporate president, are jointly liable.

5. Pursuant to the Internal Revenue Code, Mathew D. Sanders, as president and treasurer of Debtor, is a responsible person, and is 100% personally responsible when the Debtor failed to pay over the "trust fund tax," e.g., the withheld income and social security taxes from the wages paid to Debtor's employees. 26 U.S.C. §§ 3102(b), 3403, 6672, 7501(a).

6. During 1984-85, PBS failed in its payment of its tax liability principally because its chief executive officer, Mathew D. Sanders, suffered from a substance abuse problem and PBS lacked management. Consequently, it is admitted that the taxes were not paid.

7. The original IRS claim (Claim No. 2) was filed on June 20, 1986. It itemized the secured, unsecured priority, and unsecured general claims. It also gave the dates and location of filing of the tax liens. This claim did not contain the writing or duplicate of the writing underlining the claim. Attached to the claim were photostatic copies of notices of federal tax liens filed with the Iowa Secretary of State and the Polk County, Iowa, Records Office. These notices gave notice that withholding and FICA taxes,

including interest and penalties, had been assessed against Debtor for the third quarter 1984, the fourth quarter 1984, the first quarter 1985, and the second quarter 1985. The notice for the third quarter 1984 was filed with the Secretary of State only, but the other notices were filed in both offices.

8. The amended claim, Claim No. 5, filed on January 19, 1988, merely updated the amounts contained in the original claim but did not provide any further documentation.

9. The secured claim consisted of withholding and FICA taxes for the 3rd and 4th quarters of 1984, and the 1st and 2nd quarters of 1985, in the total amount of \$30,552.97, which includes tax due, penalty to petition date, and interest to petition date.

10. The unsecured priority claim was divided into withholding and FICA for the 4th quarter of 1985; corporate income tax for the tax period due in October, 1984, and October, 1985; and federal unemployment tax (FUTA) for 1985 in the total amount of \$17,061.10, which includes interest to petition date in the amount of \$291.71.

11. The unsecured general claim was for penalty to date of petition on the unsecured priority claims in the amount of \$585.06.

12. The total amount of the amended claim was \$48,199.13.

13. There is no dispute that the corporate income taxes for the tax period ending October, 1984, in the amount of \$2,089.49, plus interest to petition date in the amount of \$291.71, has not been paid and PBS is liable for said tax and interest.

14. There is also no dispute that the corporate income taxes for the tax period ending October, 1985, in the amount of \$6,907.69 has not been paid (Exhibit No. 2).

15. There is a dispute over whether PBS should receive credit for the alleged 1984 estimated tax payment of \$1,800.00 as shown on Exhibit No. 2, line 32(b). PBS's proof of payment of the \$1,800.00 for the 1984 estimated tax payment is Exhibit No. 2.

16. On or about October 29, 1984, PBS filed its Form 941, Employer's Federal Tax Return, for the third quarter, 1984 (Exhibit No. 15). This return showed a tax liability of \$7,666.59 for income tax and social security withheld. The IRS accepted this figure. PBS now contests this figure and contends that the initial liability is \$7,320.80. PBS did not show how this discrepancy occurred.

17. On or about January 23, 1985, PBS filed its Form 941 for the fourth quarter, 1984 (Exhibit No. 16). This return showed a tax liability of \$12,504.33. IRS accepted this figure. PBS now contests this figure and contends that the initial liability should be \$9,884.82, without a showing of how the discrepancy occurred.

18. There is no dispute that the tax liability for income tax and social security withheld for the 1st quarter, 1985, is \$10,108.30.

19. There is also no dispute that the tax liability for the income tax and social security withheld for the 2nd quarter, 1985, is \$11,500.31.

20. On or about January 21, 1986, PBS filed Form 941 for the 4th quarter, 1985 (Exhibit No. 18). This return showed a balance due of \$6,548.05 for the quarter.

21. The IRS did not make a claim for the 3rd quarter, 1985, withholding and social security tax.

22. On October 31, 1985, PBS made a payment to IRS in the amount of \$700.00. This payment was credited to the payment for the 3rd quarter of 1984. This payment was not applied in calculating the IRS claim filed January 19, 1988, Claim No. 5.

23. PBS has been making monthly payments of \$700.00 to the IRS commencing in February, 1984. PBS contends that all of these payments should be applied to the withholding and social security withholding portion of PBS's tax obligation (Exhibit No. 11). All 12 payments totaling \$8,400.00 have been received by the IRS, but the May 4, 1987 payment of \$700.00 and the 12th payment of \$700.00 have not been credited to PBS's account.

24. Mathew and Sheri Sanders filed an individual tax return for the 1986 calendar year (Exhibit No. 12). This

return claims a refund of \$459.00. This refund was credited to the personal penalty assessed to Mathew Sanders and was not credited to the trust fund of PBS because a personal refund cannot be credited to the corporation.

DISCUSSION

1. Burden of Proof. Bankruptcy Code section 502(a) provides, in part, that “[a] claim ..., proof of which is filed under section 501 ..., is deemed allowed, unless a party in interest ... objects.” In interpreting section 502(a), the Court in In re Distrigas Corporation, 75 B.R.

770,772–73 (Bankr. D. Mass 1987) stated:

A party objecting to a claim has the initial burden of presenting factual evidence tending to defeat the prima facie validity of a proof of claim, but not the burden of ultimate persuasion. The burden of persuasion always remains on the claimant and, therefore, once there is evidence as to the invalidity of the claim, the burden rests on the claimant. [citation omitted]

Accord, In re Friedman, 436 F.Supp. 234, 236–38 (D.C. Md.

1977); In re Greene, 71 B.R. 104, 106 (Bankr. S.D. N.Y.

1987)

2. Proof of Claim. Bankruptcy Rule 3001 provides in part:

Rule 3001. Proof of Claim.

(a) Form and Content. A proof of claim is a written statement setting forth a creditor’s claim. A proof of claim for wages, salary, or commissions shall conform substantially to Official Form No. 20 or No. 21 [Form 501:3 or 501:4, Forms Volume]; any other proof of claim shall conform substantially to Official Form No. 19 [Form 501:1, Forms Volume].

(b) Who May Execute...

(c) Claim Based on a Writing. When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim.

(d) Evidence of Perfection of Security Interest. If a security interest in property of the debtor is claimed, the proof of claim shall be accompanied by evidence that the security interest has been perfected.

(e) Transferred Claim...

(f) Evidentiary Effect. A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim....

The advisory committee notes state that the original or duplicate form of any writing upon which a claim is based must be filed with the proof of claim under Rule 3001

(c) and evidence of the perfection of any claim security interest must likewise accompany the claim pursuant to Rule 3001(d). Satisfactory evidence of a perfected interest would include a duplicate of an instrument filed or recorded. The notes further state that these filing requirements are meant to facilitate the determination whether the claim has been secured and properly perfected so as to be valid against the trustee.

The claims of the IRS depend upon either the tax returns of the Debtor or the written assessment of the IRS.

26 U.S.C. §6201. The IRS did not file either the tax returns or an assessment with its claim. Accordingly, the IRS has not properly filed its proof of claim. However, the IRS did attach proof of perfection of filed liens.

At the time of the hearing, PBS, through the testimony of its president, Matthew D. Sanders, admitted that money was due and owing to the IRS and testified as to the filing of tax returns. The proof shows that both parties admit that the corporate income tax due on October 31, 1984, in the sum of \$2,089.49 is a provable claim.

Both parties also admit that the corporate income tax due on October 31, 1985, was also not paid in the total amount of \$6,907.79. PBS's corporation tax return (Exhibit No. 2) shows that an estimated tax payment was made in the amount of \$1,800.00 and PBS contends that there is a net tax due in the amount of \$5,107.69. The IRS records produced in Court show a payment of \$1,800.00 but not as an estimated tax payment for 1984. The weight of the evidence favors PBS and the corporate income tax due and payable for 1984 should be set in the amount of \$5,107.69.

The evidence is uncontradicted that the FUTA tax for 1985 is in the amount of \$1,224.16.

PBS's tax returns also show the following tax liabilities:

Withholding & FICA 3rd Quarter '84	\$ 7,666.59
Withholding & FICA 4th Quarter '84	12,504.33
Withholding & FICA 1st Quarter '85	10,108.30
Withholding & FICA 2nd Quarter '85	11,500.31
Withholding & FICA 4th Quarter '85	6,548.05

The record is devoid of any proof that would impose liability upon PBS for penalties. The Court therefore holds that the IRS has failed to prove its claim for penalties.

The IRS has failed to address the issue of interest and show how the interest is to be determined. 26 U.S.C. §§6601 and 6621 provide for the interest on the underpayment and nonpayment of tax and the determination of the rate of interest. This rate varies, but the present rate is approximately 11% per annum, and this rate may be used for purposes of calculation of the interest.

PBS has made payments since the commencement of the bankruptcy case, and the IRS acknowledges receipt of these payments (Exhibit No. 11). PBS objects to the claim in that the IRS failed to credit one payment as PBS desired. Further, PBS, in its Plan, distinguishes between the trust and non-trust portion of the tax claim.

Payments made by PBS after the filing of the petition, but prior to confirmation of the plan, are involuntary and

this Court does not have equitable jurisdiction to order how these payments will be applied by the IRS. In re Technical Knockout Graphics. Inc., 833 F.2d 797, 801-03 (9th Cir. 1987); Matter of Ribs-R-Us. Inc., 828 F.2d 199,204 (3rd Cir. 1987). As a result, PBS is not free to designate how its payments are to be applied by the IRS. The IRS may apply the payments as it sees fit in order to pursue its rights under 26 U.S.C. §6672.

PBS cannot claim the individual tax refund for the 1986 calendar year in the amount of \$459.00. This refund was credited to the personal penalty assessed to Mr. Sanders and may not be credited to the corporate tax liability.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes that PBS's objections should be sustained in part and overruled in part as set forth above.

FURTHER, PBS should amend its Plan to incorporate the above modifications and file the modified plan for further proceedings herein.

IT IS SO ORDERED.

Dated this _____ day of July, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)
for Internal Revenue Service,) CIVIL NO. 89-606-A
)
Appellant,)
)
vs.) ORDER
)
PROFESSIONAL BUILDING)
SERVICES, LTD.,)
)
Appellee.

The Internal Revenue Service (IRS) appeals the bankruptcy court's July 8, 1988 core proceeding order and its July 28, 1989 amendment of that order. The IRS specifically challenges the bankruptcy court's finding that 1) establishes Professional Building Services, Ltd.'s (PBS) corporate income tax for the fiscal year ending October 31, 1985 at \$5,107.69 instead of \$6,907.69, and 2) denies the assessment of \$5,198.27 in penalties on taxes in this case.

In this appeal, the bankruptcy court's findings of fact shall not be set aside unless clearly erroneous, but the district court has the obligation to correct errors of law. See United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). The court accepts the findings of fact in the bankruptcy court's orders, there being no clearly erroneous findings. The bankruptcy court correctly applied applicable law. The bankruptcy court orders are affirmed.

There is no dispute that the total corporate income tax

due for the period ending October 31, 1985 was \$6,907.69. PBS presented evidence that it made payments in the sum of \$1,800.00, for which it should be credited. The bankruptcy court subsequently found "[t]he weight of the evidence favors PBS" and set the amount due and payable at \$5,107.69. The IRS contends the bankruptcy court erred in its burden of proof assessment because "the government witness clearly showed that the debtor did not have credible evidence sufficient to shift the burden of proof." The court has reviewed the record and has given due regard to the bankruptcy court's opportunity to judge the credibility of the witnesses. See Bankruptcy Rule 8013. The court concludes the bankruptcy court's finding was not clearly erroneous and that the court did not place an improper burden of proof on the IRS.

There is no dispute that the IRS assessed penalties against PBS. Missing from this record, however, is evidence supporting those assessments. The bankruptcy court correctly applied the facts in this case to the governing law.

The court affirms the bankruptcy court's orders entered July 8, 1988 and July 28, 1989.

IT IS SO ORDERED.

Dated this 4TH day of December, 1989.

CHARLES R. WOLLE, JUDGE
UNITED STATES DISTRICT COURT

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

PROFESSIONAL BUILDING
SERVICES, LTD.,

Case No. 85-2693-C H
Chapter 11

Debtor

ORDER--AMENDMENT AND CLARIFICATION OF ORDER OF JULY 8, 1988

This case pends upon Debtor's Motion for Amendment and Clarification of Order on Objection to Claim of the IRS. The Court having reconsidered Debtor's objection to the amended claim of IRS, the evidence, the arguments and briefs of the parties, said motion for amendment and clarification, and the resistance thereto, now enters its ruling and order thereon.

On July 8, 1988, the order on Debtor's objection to the IRS claim was entered. This order sustained in part and overruled in part Debtor's objection to said claim and provided that Debtor should amend its Plan of Reorganization to conform to the ruling and order.

Debtor is unclear as to the nature of the modification required. Debtor's prayer for clarification is reasonable and the order of July 8, 1988, should be enlarged accordingly. Debtor has also expanded its objection to the IRS claim, but the expanded objection is untimely and will not be considered. The Court

concludes that the Order of July 8, 1988, should be amended and supplemented to provide that the following portions of the IRS claim are allowed as proved; all other portions are disallowed.

IRS claim allowed as proved:

	<u>Tax Due</u>	<u>Int. to Pet. Date</u>
Secured Claims		
Withhold & FICA 1984 (3Q)	\$ 1,937.64	\$ 1,257.30
Withhold & FICA 1984 (4Q)	3,104.36	597.42
Withhold & FICA 1985 (1Q)	6,481.57	590.36
Withhold & FICA 1985 (2Q)	<u>\$11,487.80</u>	<u>483.31</u>
	\$23,011.37	\$ 2,928.39
Unsecured Priority Claims		
Withhold & FICA 1985 (4Q)	6,548.05	
Corp. Income Oct. 1984	2,089.49	291.71
Corp. Income Oct. 1985	5,107.69	
FUTA 1985	<u>1,224.16</u>	
	\$14,969.39	\$291.71
TOTAL:		\$41,200.86

IT IS SO ORDERED.

Dated this 28TH day of July, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA - CENTRAL DIVISION

U.S.A.

JUDGMENT IN A CIVIL CASE

V.

PROFESSIONAL BUILDING
SERVICES, LTD.

CASE NUMBER: 89-606-A
85-2693

Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

Decision by Court. This action came to consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the bankruptcy court's orders entered July 8, 1988 and July 28, 1989 are hereby affirmed.

December 4, 1989
Date

James R. Rosenbaum
Clerk

Pam Hamilton
(By) Deputy Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)	
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The court affirms the bankruptcy court's orders entered July 8, 1988 and July 28, 1989.

IT IS SO ORDERED.

Dated this 4th day of December, 1989.

CHARLES R. WOLLE, JUDGE
UNITED STATES DISTRICT COURT