

UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

IN RE)
) **Case No. 03-01469-TLM**
AARON THAIN, dba)
Assisted Living of Idaho,)
) **Chapter 11**
Debtor.)
_____)

MEMORANDUM OF DECISION

I. INTRODUCTION

Before the Court are cross motions for summary judgment filed by Debtor Aaron Thain and the Internal Revenue Service, an agency of the United States of America (“IRS”). *See* Doc. Nos. 92 and 95, respectively (“Motions”). Each party requests that summary judgment be entered in its favor on Debtor’s underlying “Motion to Determine Compliance with Plan and Motion for Determination of Contempt and Sanctions,” Doc. No. 77 (“Contempt Motion”), in which Debtor alleges the IRS violated § 524¹ and requests an order directing the IRS to refund

¹ Unless otherwise indicated, all statutory and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1330, in effect prior to the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), Pub. L. 109-8, 119 Stat. 23 (Apr. 20, 2005), and to the Federal Rules of Bankruptcy Procedure, Rules 1001–9036.

levied funds and pay Debtor's costs and attorney's fees. Briefing was completed on June 4, 2010, at which time the Court took the matter under advisement without hearing oral argument, per the parties' agreement and request. *See* Doc. No. 90. The Court, having considered the record, the briefing, and the applicable authorities, will grant the IRS's motion and deny Debtor's motion.

II. SUMMARY JUDGMENT STANDARD

As a contested matter, Debtor's Contempt Motion is governed by Fed. R. Bankr. P. 9014, which in turn makes applicable Fed. R. Bankr. P. 7056. Rule 7056 incorporates the familiar summary judgment standard established in Federal Rule of Civil Procedure 56. Summary judgment is proper when "the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c)(2). An issue is "genuine" only if there is a sufficient evidentiary basis on which a reasonable fact finder could find for the nonmoving party, and a dispute is "material" only if it could affect the outcome of the suit under the governing law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). The party moving for summary judgment has the burden of showing the absence of a genuine issue of material fact. *Id.* at 256.

Here, the Court finds that the facts material to resolving the legal issues presented are not in dispute, and that the IRS is entitled to judgment as a matter of

law.

III. FACTS

Debtor filed a voluntary petition for chapter 11 relief on April 22, 2003. Shortly thereafter the IRS filed a proof of claim in Debtor's case for federal tax liabilities Debtor owed as of the petition date. Claim No. 7-1. The proof of claim listed a secured claim of \$70,506.91, unsecured priority claims of \$168,450.78, and an unsecured general claim of \$6,316.81. *See id.* The IRS later filed a second proof of claim which amended its initial claim by reducing the general unsecured amount to \$4,658.97. Claim No. 12-1.

On October 17, 2003, Debtor filed a chapter 11 plan of reorganization. Doc. No. 35. Debtor filed an amended plan on December 3, 2003, Doc. No. 43, which he later modified, in part, on February 10, 2004, *see* Doc. No. 51. On March 19, 2004, the Court confirmed Debtor's amended plan as so modified. *See* Doc. No. 59 (the "Plan").

The Plan provided for 60 monthly payments to the IRS of \$4,509.43, plus one additional payment of \$4,658.97 to satisfy the IRS's general unsecured claim. Debtor made all of the payments to the IRS required under the Plan. These payments paid in full the amounts listed in the IRS's proof of claim with five percent interest per annum accrued from the date of confirmation.

On April 7, 2009, Norma Marroquin, a bankruptcy specialist in the IRS's

Boise office, sent a letter advising Debtor that, despite his payments under the Plan, he still owed the IRS \$34,734.74 for post-petition, pre-confirmation interest and post-confirmation penalties that had accrued on Debtor's unpaid federal tax liabilities. Debtor objected to the IRS's assessment on the basis that any obligation related to his unpaid prepetition taxes was treated under the terms of the Plan and had been discharged.

Notwithstanding Debtor's repeated objections, the IRS issued a "Final Notice of Intent to Levy" on Debtor's assets on August 3, 2009. In response, on August 11, 2009, Debtor submitted a "Request for a Collection Due Process Hearing" to contest the IRS's intended levy. However, Debtor was never afforded a hearing, and on October 14, 2009, the IRS levied Debtor's bank accounts, obtaining \$7,460.18 in funds.

In November 2009, Debtor reopened this case and filed his Contempt Motion against the IRS.

IV. DISCUSSION AND DISPOSITION

Debtor seeks an order finding the IRS in contempt and directing the IRS to refund the levied funds and pay Debtor's costs and attorney's fees. As the basis for requesting such relief on summary judgment, Debtor advances three primary arguments: First, 26 U.S.C. § 6658 prohibits the continued post-confirmation accrual of penalties on unpaid, prepetition taxes. Second, even if the IRS may

assess penalties accrued post-confirmation, doing so in this case violated the terms of Debtor's Plan. And third, the IRS misapplied Debtor's payments under the Plan. In turn, the IRS asserts three arguments in support of its Motion for summary judgment: First, as a matter of law Debtor's Plan is not binding on the IRS with respect to Debtor's tax liabilities. Second, even if the Plan could bind the IRS, this Plan did not because it was ambiguous as to whether post-petition accruals would be discharged. And third, this Court lacks jurisdiction to provide Debtor the relief requested because he has failed to exhaust his administrative remedies.

The Court finds that because Debtor has failed to exhaust his administrative remedies the IRS is entitled to summary judgment.

A. Discharge and the IRS

Prior to BAPCPA, the confirmation of a chapter 11 plan discharged a debtor from all prepetition debts, save those excepted from discharge under § 523, unless the plan or the order confirming the plan provided otherwise. *See* § 1141(d).² Such a discharge under the Bankruptcy Code “operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any [debt discharged

² Post-BAPCPA, the court may grant a discharge to an individual debtor only on completion of all payments under the plan. *See* § 1141(d)(5) (2010).

under § 1141] as a personal liability of the debtor[.]” § 524(a)(2). Generally, courts utilize their contempt and sanctioning powers under § 105(a) to enforce this injunction. *See, e.g., Renwick v. Bennett (In re Bennett)*, 298 F.3d 1059, 1069 (9th Cir. 2002). Under § 106(a), the United States and its various agencies are subject to actions to enforce the discharge injunction, having waived sovereign immunity with respect to issues arising under § 524.

But, where the party allegedly violating the discharge injunction is the IRS, the Internal Revenue Code (“IRC”) provides that a debtor’s remedy for damages is limited to a petition with the bankruptcy court under 26 U.S.C. § 7433(e). *See* 26 U.S.C. § 7433(e)(2). Section 7433(e)(2)(a) of the IRC provides that, § 105 of the Bankruptcy Code notwithstanding, a petition under 26 U.S.C. § 7433(e) “shall be the exclusive remedy for recovering damages” resulting from any willful violation of § 524 by the IRS.

Principles of statutory construction dictate that the Court construe § 106(a) and 26 U.S.C. § 7433 harmoniously, interpreting the more specific provisions of 26 U.S.C. § 7433 as qualifying and supplying exceptions to the more general provisions of § 106(a). *See Santiago Salgado v. Garcia*, 384 F.3d 769, 773–74 (9th Cir. 2004) (“[G]eneral and specific provisions, in apparent contradiction, whether in the same or different statutes, and without regard to priority of enactment, may subsist together, the specific qualifying and supplying exceptions

to the general.”); *Voting Integrity Project, Inc. v. Keisling*, 259 F.3d 1169, 1176 (9th Cir. 2001) (stating that a court has a duty to construe statutes harmoniously where it can reasonably be done). Accordingly, a bankruptcy court’s authority to award damages against the IRS for violations of § 524 must be exercised within the parameters set forth by 26 U.S.C. § 7433.

Section 7433 of the IRC contains certain limitations on a debtor’s ability to recover damages from the IRS for violations of § 524. For example, subsection (b) provides for damages in a proceeding initiated under 26 U.S.C. 7433(e), but caps those damages at either the amount equal to the sum of actual, direct economic damages sustained by the plaintiff and the costs of the action, or \$1,000,000 (or \$100,000 in the case of negligence), whichever is less. *See* 26 U.S.C. § 7433(b). In addition to this monetary cap, the statute requires a plaintiff to first exhaust his administrative remedies before the bankruptcy court can award him a judgment for damages under § 7433(b). 26 U.S.C. § 7433(d)(1).

B. Exhaustion of Administrative Remedies

The Treasury Regulations set forth the administrative processes for seeking redress for violations of § 524 by the IRS. *See* 26 C.F.R. § 301.7433-2. A debtor must send a written administrative claim for damages to the Chief, Local Insolvency Unit, for the judicial district in which the debtor filed the underlying bankruptcy case. 26 C.F.R. § 301.7433-2(e)(1). The administrative claim is to

include, among other things, a description of the alleged violation and the injuries incurred by the debtor. 26 C.F.R. § 301.7433-2(e)(2). With one exception not applicable to this case,³ no action is to be maintained in the bankruptcy court for violation of § 524 before either a decision is rendered on the administrative claim or six months have passed since the administrative claim was filed. 26 C.F.R. § 301.7433-2(d).

Exhaustion of these administrative processes is also required before Debtor can receive an award for attorney's fees. Section 7433 of the IRC does not provide for the recovery of litigation and administrative costs, unless those costs qualify as "costs of the action" as defined by 26 C.F.R. § 301.7433-1(c). 26 C.F.R. § 301.7433(b)(2) & (c). "Costs of the action," as that term is defined by 26 C.F.R. § 301-7433-1(c), does not include attorney's fees. However, attorney's fees, as either litigation or administrative costs, may be recoverable under 26 U.S.C. § 7430. 26 C.F.R. § 301.7433-2(b) & (h). To receive an award of attorney's fees under 26 C.F.R. § 7430, a party must first exhaust all administrative remedies available to him within the IRS. 26 U.S.C. § 7430(b)(1). And, as previously noted, a party asserting violations of § 524 has not exhausted his administrative

³ If the administrative claim is filed in the last six months of the 2-year period of limitations for filing a petition under 26 U.S.C. 7433(e), *see* 26 U.S.C. § 7433(d)(3), the debtor may petition the bankruptcy court any time after the administrative claim is filed. 26 C.F.R. 301.7433-2(d)(2). At the earliest, the events giving rise to Debtor's allegations under § 524 began in April 2009. Debtor filed his Contempt Motion on November 12, 2009, some seven months later. *See* Doc. No. 77.

remedies within the IRS unless he files an administrative claim for damages or relief pursuant to 26 C.F.R. § 301.7433-2(e) prior to filing an action with the bankruptcy court. *See* 26 C.F.R. § 301.7430-1(e).

The undisputed facts establish that Debtor failed to exhaust his administrative remedies before filing the Contempt Motion with this Court. Although Debtor communicated his objections to the IRS and requested a collection due process hearing (“CDP hearing”) prior to the levy of his assets, he did not send a written administrative claim to the IRS, pre- or post-levy. He is required to do so before proceeding with an action for damages under § 524 in this Court.⁴

Debtor attempts to elide the exhaustion requirement of 26 U.S.C. § 7433 by arguing that his claim is not one for damages, but rather one for a refund of the levied funds. However, even if the Court were to accept Debtor’s characterization of the relief requested, 26 U.S.C. § 7422, like 26 U.S.C. § 7433, requires that a taxpayer file an administrative claim for refund or credit before a suit or

⁴ Debtor appears to equate his request for a CDP hearing with the filing of an administrative claim under 26 C.F.R. § 301.7433-2(e). He thus contends that his pre-levy request satisfied any exhaustion requirements at issue in this case. The Court disagrees. A request for a CDP hearing and an administrative claim are two distinct processes under the IRC and applicable regulations. Debtor’s frustration with the IRS’s failure to conduct a hearing pre-levy does not excuse him from the statutorily mandated exhaustion requirement of 26 U.S.C. § 7433. His perception of the futility of the IRS process is not the equivalent of the administrative remedy being unavailable.

proceeding for refund may be pursued in court. *See* 26 U.S.C. § 7422(a).⁵ There is no more evidence in the record that Debtor filed an administrative claim for refund than there is that he filed such a claim for damages. Therefore, just as the Court lacks jurisdiction to consider a claim for damages, it too lacks jurisdiction over any claim for refund. *See Eckwortzel v. Crossman*, 561 F. Supp.2d 1144, 1150–51 (D. Idaho 2008) (finding that court lacked subject matter jurisdiction because there was no evidence taxpayer filed an administrative action for refund as required by 26 U.S.C. § 7422).

Finally, Debtor urges the Court to determine at this time whether the post-petition penalties were discharged by Debtor's Plan after which, if necessary, Debtor could pursue an administrative claim for damages and attorney's fees. To buttress his argument, Debtor cites *Rowan v. Morgan (In re Rowan)*, 15 B.R. 834 (Bankr. N.D. Ohio 1981). First, the Court finds the facts in this case distinguishable from those in *Rowan* and is thus unpersuaded. Furthermore, Debtor's suggested approach would render the exhaustion doctrine purposeless.

⁵ Section 7422(a) of title 26, U.S. Code, provides:

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

The U.S. Supreme Court has explained the utility of and reasons for the doctrine of exhaustion of administrative remedies:

First, exhaustion protects “administrative agency authority.” Exhaustion gives an agency “an opportunity to correct its own mistakes with respect to the programs it administers before it is haled into federal court,” and discourages “disregard of [the agency’s] procedures.”

Second, exhaustion promotes efficiency. Claims generally can be resolved much more quickly and economically in proceedings before an agency than in litigation in federal court. In some cases, claims are settled at the administrative level, and in other, the proceedings before the agency convince the losing party not to pursue the matter in federal court. “And even where a controversy survives administrative review, exhaustion of the administrative procedure may produce a useful record for subsequent judicial consideration.”

Woodford v. Ngo, 548 U.S. 81, 89 (2006) (internal citations omitted). Here, Debtor would have the IRS brought before this Court *before* providing it an opportunity to correct any perceived violations of § 524 through the proper use of the IRS’s administrative processes. Such an approach runs counter to the rationale for the exhaustion requirement and cannot be sanctioned by this Court.

Debtor must exhaust his administrative remedies before seeking damages and attorney’s fees for the IRS’s alleged violation of § 524. His failure to do so deprives this Court of jurisdiction. *See Conforte v. United States*, 979 F.2d 1375, 1377 (9th Cir. 1992). Accordingly, the Court does not reach the parties’ additional arguments.

V. CONCLUSION

Based on the reasons set forth above, the IRS's Motion for Summary Judgment, Doc. No. 95, will be granted and Debtor's Motion for Summary Judgment, Doc. No. 92, will be denied.

Counsel for the IRS shall submit the appropriate order.

DATED: July 30, 2010



A handwritten signature in black ink, appearing to read "Terry L. Myers".

TERRY L. MYERS
CHIEF U. S. BANKRUPTCY JUDGE