

THIS OPINION IS NOT INTENDED
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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED

97 OCT 23 PM 3:00
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:) Case No. 96-16253
)
PERCY WILLIAMS, III,) Chapter 13
)
Debtor.) Judge Pat E. Morgenstern-Clarren
)
) **MEMORANDUM OF OPINION**
)

Two creditors, the Internal Revenue Service (“IRS”) and National City Bank (“Bank”), objected to confirmation of this Debtor’s Chapter 13 plan. (Docket 5, 9). The Court held an evidentiary hearing to resolve those objections. The Bank did not appear and prosecute its objection, as a result of which it will be overruled. For the reasons set forth below, the objection of the IRS will also be overruled.

JURISDICTION

The Court has jurisdiction to hear this matter under 28 U.S.C. § 1334 and General Order No. 84 entered on July 16, 1984 by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(L).

INTRODUCTION

Debtor filed his Chapter 13 case on November 12, 1996. This dispute centers on three parcels of real estate titled in the name of Alicia Williams, who is Debtor’s sister. The properties are located at: 3698 East 153d St., Cleveland, Ohio (the “East 153d Property”); 9810 Woodland Avenue, Cleveland, Ohio (the “Woodland Property”); and 1755 East 63d Street, Cleveland, Ohio (the “East 63d Property”) (collectively the “Property”).

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Debtor and the IRS are in agreement that Debtor owes money to the IRS for unpaid federal taxes. They disagree, however, as to how the debt should be classified under the Chapter 13 plan. The plan proposed by Debtor places the IRS debt into the category of priority debt. The IRS contends that the majority of its claim should instead be treated as secured debt. To reach this result, the IRS states that it has tax liens against Debtor stemming from the tax years ending December 1989 through December 1994. The IRS argues¹ that Debtor fraudulently transferred his interest in the Property to his sister under Ohio law and that it is subject to turnover under 11 U.S.C. § 542(a). The IRS also argues that since the property is subject to turnover, it should be brought back into the estate subject to the IRS liens. Debtor contends that the Property is not his; the IRS did not prove a fraudulent transfer; and the statute of limitations has run with respect to any fraudulent transfer recovery. Consequently, Debtor claims there is no basis for treating the IRS as a secured creditor.

¹ The arguments were made sequentially. The IRS based its initial objection to confirmation on 11 U.S.C. § 1325(a)(5) which sets forth the confirmation requirements for dealing with secured claims. (Docket 5). In its post-hearing proposed Findings of Fact and Conclusions of Law, the IRS argued that the transfers to Alicia Williams were fraudulent conveyances under Ohio Revised Code § 1336.04. (Docket 16). To insure that both parties had the opportunity to address the same legal issue, the Court asked the IRS to supplement its filing by identifying the Bankruptcy Code provisions that supported the IRS' argument. (Docket 20). The IRS did so in a timely fashion, taking the position that Debtor is the beneficial owner of and holds an equitable interest in the Property and, consequently, that the Property is subject to turnover under 11 U.S.C. § 542(a). (Docket 21).

Although the original IRS objection stated several grounds, the only evidence introduced in support relates to Debtor's asserted ownership of the Property and his treatment of the IRS secured claim with respect to that interest.

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FACTS

Debtor was the only witness at the hearing. While the testimony at the hearing was extensive, the relevant facts are few and essentially undisputed:

1. The East 153d Property was titled in Debtor's name on January 6, 1989. On April 10, 1989, he transferred it to Phyllis Williams, to whom he was married at the time; on July 6, 1990, the property was transferred back to Debtor; and on February 4, 1991, Debtor transferred the property to Alicia Williams.

2. The Woodland Property was titled to Debtor on November 15, 1988. On July 6, 1990, he transferred it to Phyllis Williams; and on February 4, 1991, this property was transferred to Alicia Williams.

3. The East 63d Property was titled to Lonnie Hawes on August 29, 1989. It was transferred to Minnie Hawes on May 31, 1994, and was then transferred to Alicia Williams on June 10, 1994. Debtor never held title to this property.

4. There was no evidence as to Debtor's overall financial condition at the time the Property was transferred.

5. The IRS filed a proof of claim for income taxes for the years 1989 through 1995. The claim consists of \$177,073.79 of secured claims; \$2,102.13 of priority claims; and \$73.57 of general unsecured claims. Additionally, the claim indicates that tax liens were filed for the tax years ending: December 31, 1989; December 31, 1990; December 31, 1991; December 31, 1992; December 31, 1993; and December 31, 1994. The earliest of these filings was September 3, 1991. (Joint Exhibit 1). No other evidence was submitted regarding these liens.

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DISCUSSION

I.

In order for the IRS to obtain the treatment that it seeks under 11 U.S.C. § 1325(a)(5), the IRS must show that its debt is secured by estate property. The Bankruptcy Code defines property of the estate to include “. . . all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). Under this section, “if the debtor holds only an equitable interest in property without legal title, the estate acquires only the equitable interest of the debtor in property and not the legal title.” Collier on Bankruptcy 15th Edition Revised ¶ 541.04 (1996).

State law determines the nature of Debtor’s interest in the Property. *Butner v. U.S.*, 440 U.S. 48 (1979). Under certain circumstances, Ohio law recognizes the existence of equitable interests in real property. See, for example, *Glick v. Dolin*, 80 Ohio App. 3d 592, 609 N.E.2d 1338 (1992), discussing constructive and resulting trusts. Although the IRS asserts that Debtor owns an equitable interest in the Property, it has not identified a legal theory that supports such a position under state law. Because the IRS did not prove that Debtor owns an equitable interest in the Property under the applicable law, there is no such interest to be included in the estate. The parties stipulated that Debtor does not hold legal title to the Property. In the absence of Debtor having either a legal or an equitable interest in the Property, the Property is not a part of the estate, and the IRS is not a secured creditor with respect to it under 11 U.S.C. § 1325(a)(5).

To support its position that property titled to a third party is subject to the payment of Debtor’s tax obligations, the IRS cites case law to the effect that the economic substance of a transaction, rather than its form, controls for federal tax purposes. *Frank Lyon Co. v. United*

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States, 435 U.S. 561 (1978). Additionally, the IRS cites authority for the proposition that when legal title is held in the name of one individual, but is actually owned by another, the title holder is a mere nominee and the property is subject to the payment of the true owner's liabilities.

United States v. Williams, 581 F. Supp. 756 (N.D. Ga. 1982) (Docket 16- IRS Proposed Conclusions of Law). These cases do not address the issue of the IRS' secured status in a bankruptcy case and are unpersuasive in the context of Chapter 13 plan confirmation. None of the case law cited by the IRS supports the proposition that it enjoys secured creditor status in a bankruptcy case based on the existence of property titled in the name of a non-debtor third party which can be held subject to its liens.

II.

IRS also asserts that its objection should be sustained because the Property is recoverable as a fraudulent transfer under Ohio law and, on recovery, the Property would be subject to the IRS liens.² Section 1325(a)(4) of the Bankruptcy Code, while not cited by the IRS, is the relevant statutory basis for this objection. 11 U.S.C. § 1325(a)(4). Under that section, a Chapter 13 debtor is required to make plan payments to unsecured creditors which are not less than they would receive in a Chapter 7 liquidation. Recovered fraudulent transfers comprise part of a Chapter 7 estate. 11 U.S.C. § 541(a)(3). If the Property transfers are avoidable in a Chapter 7, then the value of those interests must be calculated in determining how much would be paid to unsecured creditors if this were a case under Chapter 7. If the amount that would be paid in a

² The IRS does not state definitively if it is actually seeking to recover the Property for the estate, although it cites to 11 U.S.C. § 542 "Turnover of property to the estate" in support. If so, any such recovery would have to be accomplished through an adversary proceeding rather than an objection to confirmation. Federal Rules of Bankruptcy Procedure 7001.

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Chapter 7 liquidation, including the value of the transfers, is greater than the amount proposed to be paid in this Chapter 13, that would be a bar to confirmation under 11 U.S.C. § 1325 (a)(4). However, the IRS objection to confirmation based on the potential for avoidance of the transfers to Ms. Williams is unavailing for the reasons that follow.

The IRS relies on Ohio Revised Code § 1336.04(A)(2) in asserting that the transfers of the Property are avoidable as fraudulent transfers.³ That section is available in the Chapter 7 context under 11 U.S.C. § 544(b) which gives a trustee the ability to avoid transfers that are avoidable under applicable state law. The statute of limitations for § 1336.04(A)(2) requires that an action be commenced within four years after the transfer was made. Ohio Revised Code Ann. § 1336.09(B) (Banks-Baldwin 1993). In this case, the East 153d Property and the Woodland

³ Ohio Revised Code § 1336.04(A)(2) provides in relevant part that:

(A) A transfer made or an obligation incurred by a debtor is fraudulent as to a creditor, whether the claim of the creditor arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation in either of the following ways:

* * *

(2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and if either of the following applies:

* * *

(b) The debtor intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they become due.

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Property were transferred in February of 1991, which means that the statute of limitations expired prior to the filing of the Chapter 13 case on November 12, 1996. The transfers cannot, therefore, be avoided under state law because they are time-barred.

While the transfer of the East 63d Property to Alicia Williams took place in 1994 and is not time-barred, there is a more fundamental reason why this transfer cannot be successfully challenged under Ohio Revised Code § 1336.04 (A)(2). There is no evidence that Debtor ever held title to this property or transferred any interest in it.⁴ In the absence of such facts, there is no basis for a finding that Debtor made a transfer that is potentially subject to recovery as a fraudulent transfer. The IRS has not argued to the contrary.

Moreover, even if avoidance under § 1336.04(A)(2) were potentially available with respect to the Property, the IRS has not established that the transfers fall within its scope. The IRS argues that the transfers were fraudulent “because they were made without receiving reasonably equivalent value, after the debtor incurred or reasonably should have believed he would incur debts beyond his ability to pay.” (IRS Supplemental Conclusion of Law No. 13, Docket 16). There is insufficient evidence (if any) to establish Debtor’s overall financial situation at the time of the transfers or whether he reasonably believed he had the ability to pay his debts.

⁴ There was evidence that Debtor improperly claimed deductions with respect to the East 63d Property on his federal income tax returns. Viewing the evidence as a whole, this alone does not establish ownership of the property or transfer of any interest in it.

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CONCLUSION

The objections of the IRS and the Bank will be overruled. A separate judgment in accordance with this Memorandum of Opinion will be entered.

Date: 23 Oct 1997

Pat E. Morgenstern-Clarren
Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Anita Gill, Esq.
Henry Freeman, Esq.
Adam Gross, Esq.
Myron Wasserman, Trustee

By: Joyce L. Gordon, Secretary

Date: 10/23/97

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PERCY WILLIAMS, III,) Chapter 13
)
Debtor.) Judge Pat E. Morgenstern-Clarren
)
) **JUDGMENT**

For the reasons stated in the Memorandum of Opinion filed this same date,

IT IS, THEREFORE, ORDERED that the Objections of the Internal Revenue Service and National City Bank to confirmation of Debtor's Chapter 13 plan are overruled.

Date: 23 Oct 1997

Pat E. Morgenstern-Clarren
Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Henry Freeman, Esq.
Anita Gill, Esq.
Adam Gross, Esq.
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