

The court incorporates by reference in this paragraph and adopts as the findings and orders of this court the document set forth below. This document has been entered electronically in the record of the United States Bankruptcy Court for the Northern District of Ohio.



Dated: March 03 2006

Mary Ann Whipple
United States Bankruptcy Judge

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION**

In Re:) Case No. 02-30182
)
Juan M. Espinoza,) Chapter 7
)
Debtor.)
)
) JUDGE MARY ANN WHIPPLE

ORDER DENYING MOTION FOR ORDER DIRECTING DEBTOR TO SIGN SETTLEMENT CHECK OR PERMIT TRUSTEE ENDORSEMENT OF SAME

This matter is before the court on the Chapter 7 Trustee’s Motion for Order Directing Debtor to Sign Settlement Check or Permit Trustee Endorsement of Same (“Motion”) [Doc. # 97]. The court held a hearing on the Motion on March 2, 2006, at which Debtor, the Trustee, and counsel for Debtor’s employer attended in person. For the reasons that follow, the Motion will be denied.

On March 31, 2005, the court approved the Chapter 7 Trustee’s motion to compromise a prepetition employment discrimination claim that became property of the bankruptcy estate. [Doc. # 73]. Under the Settlement Agreement approved by the court, Debtor’s employer (“the Company”) agreed to pay a total of \$20,000 less applicable taxes to the Trustee. Because the damages sought were lost wages, including future wages that would encompass both prepetition and postpetition time frames, the Trustee moved the court to apportion the damages between Debtor and the bankruptcy estate. [Doc. # 34]. The court found the Trustee’s proposed methodology of dividing the proposed settlement amount reasonable and ordered that

the net recovery, after attorney fees and costs, be apportioned as follows: 53.4% to be paid to the Trustee as prepetition lost wages and 46.6% to be paid to Debtor as postpetition lost wages. In attempting to consummate the Settlement Agreement, the Company issued, as directed by the Trustee, two checks. The first, in the amount of \$7,664.70, was issued in the name of Kollin L. Rice & Associates, as payment of attorney fees and costs for counsel employed by the estate to handle the claim. The second check is a payroll check made payable to Debtor and the Trustee jointly. The attached payroll statement indicates current earnings of \$12,335.30, which represents the net recovery under the settlement after attorney fees and costs, and withholding taxes in the amount of \$4,644.25. The net pay, and the amount of the second check, is \$7,691.05 (current earnings less withholding taxes). Although the check is made payable jointly to Debtor and the Trustee, it is reported entirely under Debtor's social security number. As the court has not yet approved the Application for Compensation of Kollin Rice, the Trustee has not yet delivered the first check to counsel. And Debtor has refused to endorse the second check.

When an individual files a Chapter 7 bankruptcy case, the bankruptcy estate becomes a separate tax entity from the individual. Under the Internal Revenue Code “[t]he gross income of the [bankruptcy] estate for each taxable year shall include the gross income of the debtor to which the estate is entitled under title 11 of the United States Code.” 26 U.S.C. § 1398(e)(1). In turn, “[t]he gross income of the debtor for any taxable year shall not include any item to the extent that such item is included in the gross income of the estate.” 26 U.S.C. § 1398(e)(2). Thus, “wages earned by a cash basis debtor prior to the commencement of a case, but not received until after the commencement, would be deemed gross income of the bankruptcy estate.” 1-TX2 Collier on Bankruptcy Taxation P TX2.04[3] (2006).

In light of § 1398(e)(1) and (2), the court finds the manner in which the net recovery under the Settlement Agreement was paid and reported is erroneous. As currently issued and reported, no estate income is being reported to Internal Revenue Service. The entire \$12,335.30 is reported as Debtor's income, instead of dividing it as apportioned by prior order of the court and as contemplated by 26 U.S.C. § 1398(e). The Trustee assures the court that undoing the payment of net settlement proceeds under the existing single check will increase the costs of administration and delay further distribution to creditors in a case already nearly four years old, because an accountant will have to be engaged, a return will likely have to be filed and a refund sought. The court does not know whether the funds ultimately retained by Debtor or the bankruptcy estate after payment of apportioned settlement proceeds, deduction of applicable taxes, filing of returns and the seeking of refunds will increase or decrease if the Company issues two checks instead of one. The end result does not, however, matter at this point. Congress' directive in Internal

Revenue Code § 1398 is clear. The court will not either compel endorsement of a check or authorize the deposit of a check without complete endorsement when that check does not comport with § 1398(e). The court cannot ignore § 1398(e) because of administrative inconvenience or considerations of estate expense. Given the complicated circumstances of this settlement, it is not acceptable to the court to tell an individual consumer debtor to sort things out with and explain to Internal Revenue Service that he did not actually receive income reported by his employer as his. The Trustee's Motion will, therefore, be denied.

The two checks issued by the Company shall be returned and reissued in three checks pursuant to the terms approved by the court as follows: (1) to Kollin L. Rice & Associates, in the amount of \$7,664.70; (2) to Louis Yoppolo, Trustee, in the amount of \$6,587.05 ($\$12,335.30 \times 53.4\%$), less applicable withholding taxes; and (3) to Juan Espinoza, in the amount of \$5,748.25 ($\$12,335.30 \times 46.6\%$), less applicable withholding taxes .

The court wants to remind Debtor that he has a duty under 11 U.S.C. § 521(3) to cooperate with the Chapter 7 Trustee in finalizing administration of the estate's portion of the settlement proceeds. The bankruptcy estate inherits certain tax attributes from the individual debtor. The Trustee's accountant may very well need to review Debtor's tax returns for certain tax years. If so, Debtor must turnover copies of requested returns to the Chapter 7 Trustee.

Therefore, in light of the foregoing, good cause appearing,

IT IS ORDERED that the Trustee's Motion [Doc. #97] be, and hereby is, **DENIED**; and

IT IS FURTHER ORDERED that the checks issued by the Company pursuant to the Settlement Agreement be returned to the Company and reissued as set forth in this opinion.