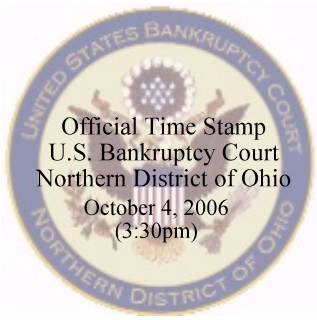
UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 98-13277
	)	
KENNETH HARCHAR and ANDREA HARCHAR,	)	Chapter 13
	)	
	)	Judge Pat E. Morgenstern-Clarren
Debtors.	)	
_____	)	
	)	
KENNETH HARCHAR and ANDREA HARCHAR,	)	Adversary Proceeding No. 00-1184
	)	
Plaintiffs,	)	
	)	
v.	)	**MEMORANDUM OF OPINION**
	)	
UNITED STATES OF AMERICA,	)	
	)	
Defendant.	)	

Following remand from the district court, the defendant United States of America, acting through the Internal Revenue Service, moves to dismiss[1] the plaintiff-debtors' third amended complaint (the complaint).[2] The debtors oppose the motion.[3] For the reasons stated below, the

[1] Docket 125, 126, 140. The IRS motion alternatively asks for summary judgment if the court elects to consider matters outside the pleadings and convert the motion to one for summary judgment. The court has advised the parties that it declines to do that. *See* court's order of March 27, 2006. (Docket 134). Among other reasons, this is appropriate because the IRS's motion does not set out the summary judgment standard, state the uncontested material facts, or provide legal argument under rule 56.

[2] The court instructed the plaintiffs to file a third amended complaint which was identical to the one attached to their motion to amend. (Docket 119). The third amended complaint referred to in this opinion is that pleading. (Docket 122).

[3] Docket 139.

motion is granted in part and denied in part.

DISCUSSION[4]

The debtors Kenneth and Andrea Harchar filed their chapter 13 case in 1998. This adversary proceeding involves a postpetition dispute between the debtors and creditor United States of America, acting through the Internal Revenue Service (the IRS). The controversy arises out of the IRS's decision to impose a computer freeze on the debtors' account, which had the intended effect of preventing the debtors for a period of time from receiving tax refunds claimed by them first for tax year 1999 and then for tax year 2000. The complaint alleges that the IRS did not tell the debtors that it had frozen the account, did not advise them how to challenge the freeze, and did not manually process the refunds within a reasonable time, in addition to telling the debtors after some time had passed that the postpetition refund would be applied to their prepetition tax debt. The debtors, who have three children and a gross annual income in the range of $18,000.00, allege harm resulting from the IRS's withholding of the refunds for these two consecutive tax years and seek various forms of relief.

The Complaint

The complaint makes extensive factual allegations and states these seven claims:[5]

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[4] The debtors filed their chapter 13 case before the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). All references in this opinion, therefore, are to the version of the bankruptcy code and rules in effect when the case was filed. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501(b)(1), 119 Stat. 23, 216 (stating that unless otherwise provided, the amendments do not apply to cases filed before the October 17, 2005 effective date of BAPCPA). Although both parties refer to BAPCPA in their briefs, the court does not find the references applicable or relevant since the scant legislative history does not shed light on why Congress adopted the changes that it did.

[5] Docket 122.

1. The debtors are entitled to receipt of their full refund with interest under 26 U.S.C. § 6611(e);

2. The IRS's imposition of and refusal to release the freeze on the debtors' tax refunds during the pendency of the chapter 13 case violated 11 U.S.C. §§ 362(a)(3) and(6),[6] and is a willful and deliberate violation of the automatic stay;

3. The IRS's actions in seizing the debtors' (and other debtors') postpetition tax refunds and earned income tax payments without notice or an opportunity to object violated the procedural due process requirements of the Fifth Amendment to the United States Constitution;

4. The IRS's automatic freezing of the postpetition tax refund and earned income tax credit payments of all debtors violates the anti-discrimination provisions of 11 U.S.C. § 525, as does the IRS's freezing and refusal to release the debtors' refunds for year 2000;

5. The IRS's conduct violates the debtors' confirmed chapter 13 plan;

6. As a result of the IRS's conduct, the debtors are entitled to compensatory, consequential, and punitive damages, as well as to declaratory and injunctive relief;[7] and

7. The IRS is liable for the debtors' costs, expenses, and attorney fees incurred in this proceeding under 11 U.S.C. §§ 362(h) and 105(a), and 28 U.S.C. § 2412.

The IRS's Motion to Dismiss

The complaint alleges that the IRS violated a number of bankruptcy code provisions and constitutional due process requirements by the manner in which it processed the debtors'

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[6] The debtors withdrew their assertion that the IRS also violated 11 U.S.C. § 362(a)(7). *See* debtors' response at 12. (Docket 139).

[7] The district court held in an interlocutory appeal that the debtors' claim for emotional distress damages does not state a claim, regardless of whether the debtors can prove economic damage resulting from the IRS's alleged violation of the automatic stay. *See United States v. Harchar*, 331 B.R. 720 (N.D. Ohio 2005).

postpetition tax returns for 1999 and 2000.[8] The bankruptcy code sections at issue are the § 362 automatic stay, the § 525(a) anti-discrimination provision, and the § 1327 provisions regarding the effect of chapter 13 plan confirmation. *See* 11 U.S.C. §§ 362, 525(a), and 1327. The debtors request damages, attorney fees, and interest, together with declaratory and injunctive relief as to those violations, and the imposition of sanctions. The IRS asserts that sovereign immunity bars jurisdiction as to much of the relief sought and moves to dismiss parts of the complaint on that basis. The IRS also argues that the complaint should be dismissed in its entirety for failure to state a claim for relief. Because the arguments of both parties are somewhat convoluted, the court will address them in a different structure than that used in either party's briefs.

I. Federal Civil Rule 12(b)(1)

Federal civil rule 12(b)(1) provides that a complaint may be dismissed for lack of subject matter jurisdiction. FED. R. BANKR. P. 7012(b) (incorporating FED. R. CIV. P. 12(b)). Under rule 12(b)(1):

> [a] motion can either attack the claim of jurisdiction on its face, in which case all allegations of the plaintiff must be considered as true, or it can attack the factual basis for jurisdiction, in which case the trial court must weigh the evidence and the plaintiff bears the burden of proving that jurisdiction exists.

DLX, Inc. v. Kentucky, 381 F.3d 511, 516 (6th Cir. 2004). The IRS's sovereign immunity claim challenges the debtors' jurisdictional claim on its face. All factual allegations in the complaint

[8] As noted, the complaint asserts that the IRS had not released the debtors' tax year 2000 refunds and asks for a refund with interest. The IRS does not request dismissal of this claim for failure to state a claim, but instead states that the refunds with interest have been issued. *See* IRS brief at 2, docket 126. Due to the crowded appellate docket, a considerable amount of time has passed since the debtors filed their motion to amend, with the proposed third amended complaint appended. If the refunds have been issued in the interim, the court assumes that the parties will resolve that through stipulation.

must, therefore, be taken as true.[9]

A. Sovereign Immunity

The United States enjoys sovereign immunity and may not be sued unless it waives the immunity. *United States v. Mitchell*, 445 U.S. 535, 538 (1980). The IRS, as an agency of the United States, is immune from private actions absent waiver. *Whittle v. United States*, 7 F.3d 1259, 1262 (6th Cir. 1993). Congress defines the terms and conditions of a waiver of sovereign immunity. *McGinness v. United States*, 90 F.3d 143, 145 (6th Cir. 1996). Any waiver must be

[9] The IRS submitted evidence with its motion to dismiss which the court will not consider. Although the IRS describes its evidence as an effort to "flesh out" the debtors' allegations in their complaint, *see* the IRS brief at page 2, it does not cite any law to support the proposition that a court should or must look outside the complaint when considering a motion to dismiss for lack of subject matter jurisdiction where the complaint is challenged on its face. (Docket 126). Similarly, the IRS request that the court take judicial notice of conversations that allegedly took place during case management conferences in chambers is denied. *See* IRS brief at footnote 6. (Docket 126). The IRS has not cited any authority for the proposition that unrecorded conversations in chambers are an appropriate subject for judicial notice. *See* FED. R. EVID. 201(b). The court finds that any such conversations are also irrelevant to the motion to dismiss under either 12(b)(1) or 12(b)(6). The court finds further that the IRS's complaints about the chapter 13 trustee are irrelevant to the motion to dismiss and they are not considered in this opinion. *See* IRS brief at footnote 12. (Docket 126). Additionally, the court has not considered the IRS argument that the court should take judicial notice of the "fact" that the court "tacitly approved" the IRS's practice by signing orders in other cases, which the IRS argues shows that "the court plainly understood that the IRS had held the refunds in the meantime while . . . motions [to modify] were prosecuted." *See* IRS brief at 24 and footnote 21. (Docket 126). This is, again, not an appropriate subject of judicial notice and is irrelevant to the legal issues presented here. Along the same lines, the court does not give any weight to the IRS's argument that the court should consider comments made by another bankruptcy judge during a status conference in a different circuit, in a different case, involving different facts and different issues, regardless of the esteem in which this court holds the commenting judge. *See* IRS brief at 25. (Docket 126). And finally, the court declines the IRS's invitation to read into the actions of one of the debtor's attorneys in another case a "tacit admission" that the IRS should prevail in this case. *See* IRS brief at footnote 5. (Docket 126). As a corresponding matter, the court has not considered the debtors' argument that IRS offices in the Second Circuit handle refunds in a particular fashion. *See* debtors' brief at 4. (Docket 139). In other words, the court will adhere to the legal standard that a motion to dismiss which attacks subject matter jurisdiction on its face is determined by reference to the factual allegations in the complaint and that a motion to dismiss for failure to state a claim is similarly analyzed.

unequivocally expressed and must be strictly construed in favor of the sovereign. *United States v. Nordic Village, Inc.*, 503 U.S. 30, 33-34 (1992). If an entity has sovereign immunity and if it has not been waived, a court does not have subject matter jurisdiction over claims against that entity. *United States v. Mitchell*, 463 U.S. 206, 212 (1983).

1. 11 U.S.C. § 106(a)

As noted above, the debtors claim that the IRS violated bankruptcy code §§ 362, 525, and 1327. They argue that the IRS waived its sovereign immunity with respect to these claims under 11 U.S.C. § 106(a).

Bankruptcy code § 106(a) is a specific waiver of sovereign immunity. The section states that:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:
>
> > (1) Sections 105, 106, 107, 108, 303, 346, **362**, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, **525**, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and **1327** of this title.
> >
> > (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
> >
> > (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(a)(A) of title 28.
> >
> > (4) The enforcement of any such order, process, or judgment against governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in

> the case of a money judgment against the United States shall be paid as if it is a judgment rendered by a district court of the United States.
>
> (5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.

11 U.S.C. § 106(a) (emphasis added). Because the United States and the IRS are governmental units within the meaning of this provision, they have waived immunity as set forth in this section. *See* 11 U.S.C. § 101(27).

The IRS does not dispute that § 106(a) is an unequivocal waiver of sovereign immunity. Instead, it disputes the extent of the waiver, an issue that is discussed below. For the purpose of determining whether this court has jurisdiction over the bankruptcy code claims, however, it is clear that § 106(a) by its terms waives the IRS's immunity from suit based on those claims. *See* 11 U.S.C. § 106(a)(1). By virtue of the waiver, this court "may hear and determine any issue arising with respect to the application" of those sections to the IRS. 11 U.S.C. § 106(a)(2). Additionally, this court may issue an order or judgment against the IRS, 11 U.S.C. § 106(a)(3), and may enforce that order or judgment, 11 U.S.C. § 106(a)(4). Accordingly, this court has jurisdiction to address the debtors' bankruptcy code claims.

2. 11 U.S.C. § 106(b)

The next issue is whether the court has jurisdiction over the debtors' claim that the IRS violated their constitutional rights to procedural due process by the manner in which it dealt with the postpetition tax refunds. Specifically, the debtors allege that the IRS violated their rights when it imposed the freeze without notice and an opportunity to be heard and committed further violations by failing to have a procedure in place through which the debtors could challenge the freeze. They argue that the IRS waived sovereign immunity as to this claim under § 106(b).

That section states that:

> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

11 U.S.C. § 106(b). "Accordingly, when the government files a proof of claim against the debtor, the debtor may bring a counterclaim against the government if (1) the property that the debtor claims is the property of the estate and (2) the debtor's claim arises out of the same transaction or occurrence as the government's claim." *Gordon Sel-Way, Inc. v. United States (In re Gordon Sel-Way, Inc.)*, 270 F.3d 280, 285 (6th Cir. 2001).

The IRS filed a claim in the chapter 13 case for the 1993, 1994, 1995, and 1997 tax years. The IRS denies that its claim falls within the § 106(b) waiver of immunity.

The analysis used to determine whether the IRS's claim and the debtors' due process claim arise out of the same transaction or occurrence is the same one that is used to determine whether a claim is a compulsory counterclaim under federal civil rule 13. *Id.* at 287. That determination is made by asking these questions:

> (1) Is there a logical relationship between the two claims?
>
> (2) Are the issues of fact and law raised by the claim and counterclaim largely the same?
>
> (3) Would res judicata bar a subsequent suit on the counterclaim if the court were not to take jurisdiction?
>
> (4) Would substantially the same evidence support both the claim and the counterclaim?

Brown v. United States (In re Rebel Coal Co.), 944 F.2d 320, 321-22 (6th Cir. 1991).

Answering these questions leads to the conclusion that the debtors' due process claim does not arise out of the same transaction or occurrence as the IRS claim for income tax liability.

The IRS proof of claim seeks payment of income taxes for tax years before the debtors filed their bankruptcy case. This must be compared to the debtors' claim that the IRS violated their due process rights under the United States Constitution when it dealt with their postpetition tax returns. These claims are not connected in time, with one being prepetition and the other arising postpetition. They require consideration of different law and evidence, with the IRS claim focusing on the amount of tax debt owed by the debtors to the government and the debtors' claim addressing the government's actions in its alleged efforts to collect that debt. If the IRS proof of claim is adjudicated in this proceeding and the debtors' due process claim is not, the doctrine of res judicata will not bar the debtors from asserting their claim in a separate, subsequent lawsuit. The debtors did not, then, show that their due process claim arises out of the same transaction or occurrence as the IRS's tax claim. As a result, the government did not waive sovereign immunity under § 106(b) and the court lacks jurisdiction with respect to it.

3. Remaining Jurisdictional Issues

The IRS's sovereign immunity argument includes a second prong which is directed at the type and extent of relief available to the debtors in this proceeding. The IRS argues that under the terms of the § 106(a) waiver, the debtors may be awarded damages under § 362(h) but not under any other statute cited by the debtors. The IRS also argues that this court lacks jurisdiction to grant any relief which involves the mechanics of how the IRS carries out its functions.

a. Statutory Bases for Damages

The complaint requests damages under three statutes: bankruptcy code § 362(h), bankruptcy code § 105(a), and 28 U.S.C. § 2412.[10]

[10] *See* third amended complaint at 13. (Docket 122).

1. Bankruptcy code § 362(h)

The IRS concedes that the government waiver of sovereign immunity in § 106(a) permits the court to award damages under § 362(h). *See* 11 U.S.C. § 362(h).

2. 28 U.S.C. § 2412

Section 2412 of title 28 provides that costs and fees may be awarded against the government in certain circumstances, but it does not provide for an award of damages. *See* 28 U.S.C. § 2412. That section cannot, therefore, support an award of damages to the debtors.

3. Bankruptcy code § 105

The remaining statute is bankruptcy code § 105. *See* 11 U.S.C. 105. The debtors argue that the IRS can be held in contempt under this statute for violating §§ 525(a) and 1327 and that damages may be awarded as part of the contempt finding. None of the three sections at issue provides an express action for damages.[11]

Section 105 states in pertinent part that the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). The government waived sovereign immunity to permit the court to determine whether or not the debtors are entitled to relief under § 105. *See* 11 U.S.C. § 106(a)(1). In appropriate circumstances, a court may award damages as part of a contempt sanction. *See Chambers v. Greenpoint Credit (In re Chambers)*, 324 B.R. 326, 329 (Bankr. N.D. Ohio 2005). Section 106(a)(3) provides that the court may issue a judgment against the government "including . . . awarding a money recovery, but not including an award of punitive damages." Courts have

[11] The debtors do not argue that there is an implied right of action for damages under §§ 105, 525 or 1327. In any event, they may be foreclosed from making that argument based on Sixth Circuit precedent. *See Pertuso v. Ford Motor Credit Corp.,* 233 F.3d 417, 423 at n.1 (6th Cir. 2000) (noting that § 105(a) does not authorize bankruptcy courts to create substantive rights that are otherwise not available under the applicable law).

determined that compensatory damages may be awarded against the government under § 105(a) as a sanction for contempt. *See, for example, Jove Eng'g, Inc. v. Internal Revenue Serv.,* 92 F.3d 1539, 1555 (11th Cir. 1996). *But see United States v. Rivera Torres (In re Rivera Torres)*, 432 F.3d 20 (1st Cir. 2005) (determining that the IRS was immune from an award of emotional distress damages as a contempt sanction). It is not, however, necessary to decide whether damages are available here as a contempt sanction against the IRS for violating either § 525(a) or § 1327 because, as discussed below, the debtors have not stated a claim for violation of either statute.

b. Declaratory and Injunctive Relief

The complaint also includes broad requests for declaratory and injunctive relief on behalf of the debtors and all bankruptcy debtors on several issues, including that the IRS's actions violated the rights of all bankruptcy debtors to due process as well as their rights under § 525(a). The IRS argues that these requests run afoul of its sovereign immunity. While the IRS acknowledges that this court may determine whether the bankruptcy code has been violated in this case and may also grant injunctive relief to remedy the particular violation,[12] it argues that the broader relief requested by the debtors is not available based on 26 U.S.C. § 7421 (the anti-injunction provision of the Internal Revenue Code) and 28 U.S.C. § 2201 (the Declaratory Judgment Act).

1. Declaratory Relief

In general, a request for declaratory relief asks the court to determine the parties' rights. Such a request is governed by 28 U.S.C. § 2201, which provides:

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[12] *See* IRS brief at 8, 10. (Docket 126).

> (a) In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1986, a proceeding under section 505 or 1146 of title 11, or in any civil action involving an antidumping or countervailing duty proceeding regarding a class or kind of merchandise of a free trade area country (as defined in section 516A(f)(10) of the Tariff Act of 1930), as determined by the administering authority, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

28 U.S.C. § 2201(a) (emphasis added). *See also* 28 U.S.C. § 2202 (providing that further relief may be granted on a declaratory judgment as is necessary or proper). By its terms, this statute bars a federal court from granting declaratory relief with respect to federal taxes except in prescribed circumstances. One such exception is a proceeding brought under either § 505 or § 1146 of the bankruptcy code. Section 505 deals with requests for determination of tax liability and § 1146 sets out special tax provisions for chapter 11 cases. *See* 11 U.S.C. §§ 505 and 1146. The debtors' request for declaratory relief with respect to federal taxes is not a proceeding under either of these sections. It does not, therefore, request declaratory relief authorized by § 2201.

The debtors' request for declaratory relief on behalf of other debtors has an additional infirmity. The rules regarding joinder of parties apply to actions for declaratory relief. *See Nat'l Labor Relations Bd. v. Doug Neal Mgmt. Co.*, 620 F.2d 1133, 1138 (6th Cir. 1980). This adversary proceeding is not a class action. The other debtors referred to in the complaint have not been joined as parties and, consequently, their rights cannot be decided here. *See* FED. R. BANKR. P. 7020 (incorporating FED. R. CIV. P. 20 and providing for the permissive joinder of parties).

2. Injunctive Relief

The debtors also request that the court enjoin the IRS from continuing to impose a computer freeze on refunds claimed by debtors in this district. The Internal Revenue Code limits the situations in which a party may bring a lawsuit in federal court relating to tax collection. Internal Revenue Code § 7421(a), also called the Anti-Injunction Act, provides:

> (a) Tax.--Except as provided in sections 6015(e), 6212(a) and ©, 6213(a), 6225(b), 6246(b), 6330 (e)(1), 6331(I), 6672©, 6694©, 7426(a) and (b)(1), 7429(b), and 7436, no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

26 U.S.C. § 7421(a). The purpose of the statute is to protect "the Government's need to assess and collect taxes as expeditiously as possible with a minimum of preenforcement judicial interference[.]" *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974). The provision also protects the IRS from litigation pending a suit for refund. *Id.* This section has been broadly construed to apply not only to the assessment and collection of taxes, but also to activities which are intended to result in tax collection or assessment. *See Dickens v. United States*, 671 F.2d 969, 971 (6th Cir. 1982). An exception is recognized when a plaintiff can show both: (1) irreparable injury, and (2) certainty of success on the merits. *Bob Jones Univ.*, 416 U.S. at 737 (citing *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962)).

The IRS argues that § 7421 bars the requested relief. The debtors counter that this section does not apply and, alternatively, that the IRS's actions come within an exception to the anti-injunction provision because the IRS acted illegally.

The debtors' complaint asks that the IRS be restrained from continuing to use a computer freeze with respect to bankruptcy debtors; this amounts to a suit to restrain the IRS from activities which it undertakes to collect taxes. The request for an injunction, therefore, comes

within the scope of § 7421. The argument that § 7421 does not apply where the IRS engages in illegal conduct fails because the case law does not support an exclusion based solely on that allegation. The debtors' citation to *Jenson v. IRS*, 835 F.2d 196 (9th Cir. 1987) is inapposite as the plaintiff in that case alleged that the IRS had violated 26 U.S.C. § 6213(a); that section–not raised in this proceeding–is an explicit statutory exception to the Anti-Injunction Act.

The remaining question is whether the debtors can bring themselves within the irreparable harm and certainty of success on the merits exception. The debtors cannot show irreparable harm because their chapter 13 case is completed and their alleged injury will be addressed in this proceeding. Consequently, injunctive relief is not available.

II. Federal Civil Rule 12(b)(6)

In addition to its jurisdictional arguments, the IRS moves under federal rule of civil procedure 12(b)(6) to dismiss the claims that the IRS violated § 362(a)(3) and (a)(6), § 525(a), and § 1327. Civil rule 12(b)(6) provides for dismissal "for failure to state a claim upon which relief can be granted[.]" FED. R. CIV. P. 12(b)(6) (made applicable by FED. R. BANKR. P. 7012(b)). In deciding such a motion, the court "must 'construe the complaint in the light most favorable to the plaintiff, accept all the factual allegations as true, and determine whether the plaintiff can prove a set of facts in support of its claims that would entitle it to relief'." *Power & Tel. Supply Co. v. SunTrust Banks, Inc.* 447 F.3d 923, 929-30 (6th Cir. 2006) (quoting *Bovee v. Coopers & Lybrand C.P.A.,* 272 F.3d 356, 360 (6th Cir. 2001)). "A complaint will survive a motion to dismiss if it contains either direct or inferential allegations with respect to all material elements necessary to sustain a recovery under some viable legal theory." *Moon v. Harrison Piping Supply*, ___ F.3d ___, 2006 WL 2772763 at *2 (6th Cir. Sept. 28, 2006) (internal citations

and quotations omitted). The court need not accept legal conclusions or unwarranted factual inferences as true. *Power & Tel. Supply Co.,* 447 F. 3d at 930.

A. 11 U.S.C. § 525(a)

Section 525(a) provides in pertinent part that a:

> governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title[.]

11 U.S.C. § 525(a).

The challenged action does not involve a license, permit, charter, or franchise, so the debtors must show that the IRS's action is a "similar grant" to state a claim under this section. In support of their position, the debtors contend that the section should be read broadly to prohibit the IRS from imposing a computer freeze on the debtors' postpetition refunds when it does not impose a similar freeze on non-debtors.

The debtors' argument for an expansive reading of § 525(a) is contrary to Sixth Circuit authority. *See Toth v. Michigan State Housing Dev. Auth*., 136 F.3d 477 (6th Cir. 1998). In *Toth,* a discharged debtor applied for a low-income home improvement loan. The state housing authority and its officers denied the application based on the debtor's bankruptcy discharge. The debtor sued, arguing that the officials violated § 525(a). The Sixth Circuit construed the section narrowly and noted that:

> The items enumerated in the statute–licenses, permits, charters, and franchises–are benefits conferred by government . . . They reveal that the target of § 525(a) is the government's role as a gatekeeper in determining who may pursue certain livelihoods. It

> is directed at governmental entities that might be inclined to discriminate against former bankruptcy debtors in a manner that frustrates the "fresh start" policy of the Bankruptcy Code, by denying them permission to pursue certain occupations or endeavors. The intent of Congress incorporated into the plain language of § 525(a) should not be transformed by employing an expansive understanding of the "fresh start" policy to insulate a debtor from all adverse consequences of a bankruptcy filing or discharge.

Toth, 136 F.3d at 480. The debtors do not claim in this case that the government denied them permission to pursue an occupation or endeavor or took other action similar to such a denial. As a result, the debtors have failed to state a claim under § 525(a).

B. 11 U.S.C. § 362(a)(3)

The automatic stay provisions found in bankruptcy code § 362 take effect on the filing of a bankruptcy case. As the Sixth Circuit has noted:

> An oft-quoted excerpt from the legislative history of section 362(a) indicates the provision's major purposes: The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.
>
> The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

Fed. Bank of Louisville v. Glenn (In re Glenn), 760 F.2d 1428, 1436-37 (6th Cir. 1985) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1997), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6296-97). Section 362(a)(3) operates as a stay of "any act to obtain possession of

property of the estate or property from the estate or to exercise control over property of the estate[.]" 11 U.S.C. § 362(a)(3).

The phrase "property of the estate" under the bankruptcy code is expansive and includes all of a debtor's legal and equitable interests in property as of the date the petition is filed. *See* 11 U.S.C. § 541(a)(1). This broad definition has been applied to stay actions under § 362(a)(3). *See Amedisys, Inc. v. Nat'l Century Fin. Enters., Inc. (In re Nat'l Century Fin. Enters., Inc.)*, 423 F.3d 567, 574 (6th Cir. 2005).

The IRS argues that the debtors fail to state a claim under § 362(a)(3) because (1) tax refunds are not property; (2) even if tax refunds are property, the IRS did not exercise control over them; and (3) even if tax refunds are property and the IRS did exercise control over them, the tax refunds are not property of the estate.

With respect to the first part of the argument, the IRS contends that its acts in withholding the debtors' refunds are properly characterized as a refusal to pay a debt rather than as a refusal to turnover property; consequently, goes the argument, the tax returns are not property within the meaning of § 362(a)(3). However, regardless of how one characterizes the *act* of refusing to turnover a tax refund, federal tax refunds themselves have long been defined as property for purposes of bankruptcy. *See Segal v. Rochelle,* 382 U.S. 375 (1966) (concluding that a loss-carry back refund claim is property for bankruptcy purposes under § 70(a)(5) of the former Bankruptcy Act). *See also, Johnston v. Hazlett (In re Johnston)*, 209 F.3d 611 (6th Cir. 2000) (determining that an earned income tax credit is an interest in property within the scope of 11 U.S.C. § 541). *See also, Williams v. Johnson (In re Williams Bros. Asphalt Paving Co.)*, 56 F.3d 66 (6th Cir. 1995) (unpublished opinion) (holding that a debtor's anticipated refund owed by the U.S.

Department of Energy for crude oil overcharges was property). The debtors have, therefore, alleged facts sufficient to show that property is at issue.

The IRS then contends that the debtor did not allege facts that would support a claim that the IRS exercised control over the refunds within the meaning of § 362(a)(3). Congress added the "exercise control" language in 1984 without defining the phrase. *Javens v. City of Hazel Park (In re Javens)*, 107 F.3d 359, 368 (6th Cir. 1997). The Sixth Circuit has not provided a test for determining when an actor has exercised control. Instead, the issue seems to be considered on a case by case basis. *See, for example, TranSouth Fin. Corp. v. Sharon (In re Sharon)*, 234 B.R. 676, 682 (B.A.P. 6th Cir. 1999) (discussing *In re Javens* and concluding that "[w]ithholding possession of property from a bankruptcy estate is the essence of 'exercising control' over possession.").

In this case, the debtors' factual allegations include these: the debtors filed a chapter 13 case; they proposed a chapter 13 plan which ultimately was confirmed; the refunds became due postpetition; the IRS did not tell the debtors it had frozen their refunds; the IRS did not have any procedures in place to explain to the debtors why their refunds had been frozen or how to challenge the freeze; the IRS did not respond to the debtors' repeated efforts to find out what had happened to their refunds; the IRS told Andrea Harchar that she did not deserve a refund; the IRS told Andrea Harchar that it would not release her refund because the IRS was going to apply it to her prepetition debt; the IRS did not file a motion for relief from stay to apply the refund in that fashion; and the IRS delayed seven weeks before filing a motion to modify the debtors' plan, which the IRS later withdrew. Accepting these allegations as true, which the court must, the debtors have stated that the IRS affirmatively acted postpetition to prevent the debtors from receiving their postpetition tax refunds and to further prevent them from knowing how to obtain

possession. Additionally, the debtors claim that the IRS affirmatively stated that it would not give the tax refunds to the debtors. This certainly states a claim that the IRS exercised control over the debtors' tax refunds.

In support of a different result, the IRS makes a factual argument and a legal argument. With respect to the facts, the IRS argues that its actions in both years were intended solely to make sure that the debtors were truly entitled to their postpetition refunds and that it was not attempting to collect the prepetition taxes through the postpetition freeze. Along these lines, the IRS argues many additional facts about how it operates its computer system and what its motives were in dealing with the debtors.[13] For example, the IRS argues that it only held the 1999 refund "temporarily." It also contends that the facts are that it refunded Mrs. Harchar's 2000 money with "reasonable dispatch"[14] and that it "would have processed the 1999 refund manually with dispatch, but for [its own decision] to file a motion to modify and turn it over to the trustee to increase the dividend to unsecured creditors."[15] The IRS also attempts to recharacterize the debtors' allegations by saying that "all that is meant by the complaint's allegation that the freeze reflects an IRS motive to 'collect' prepetition taxes is a desire [on the part of the IRS] to preserve the ability to make a future setoff, which might be preceded by a motion to lift the stay, if such an

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[13] The district court's opinion includes a factual and procedural history, which the court states is based on the summaries provided by the parties in their appellate briefs and the allegations in the amended complaint. The IRS states in the current motion that the district court made certain observations, including that the IRS promptly refunded the amounts due to the debtors before learning of this adversary proceeding. (Docket 126 at 6). Based on the district court's statement, this court does not believe that the district court intended to make any factual findings as to intent or related issues that are binding on remand.

[14] Docket 126 at 16.

[15] Docket 140 at 19.

order is necessary at the time . . . ."[16] With respect to tax year 2000, the IRS again argues that it only "temporarily" refused to refund Mr. Harchar's overpayment while it "assured itself" that the refund was owed, based on a "well-founded suspicion" (later found by the IRS to be untrue) that Mr. Harchar might not be entitled to his year 2000 refund because of the status of his children.[17]

The IRS may or may not be able to prove the facts underlying the statements cited above when all of the evidence is presented and the arguments based on those claimed facts may or may not be successful at that time. At the moment, however, in the context of a motion to dismiss, the IRS's argument as to what the evidence will prove and how it should be interpreted is outside the scope of the court's inquiry and is insufficient to support a finding that the debtors have failed to state a claim under § 362(a)(3).[18]

The IRS also makes a legal argument that the debtors' claim brought under § 362(a)(3) is unequivocally foreclosed by the United States Supreme Court decision in *Citizens Bank of Maryland v. Strumpf,* 516 U.S. 16 (1995), a contention that the IRS also applies to the debtors' claims under § 362(a)(6).[19] The IRS overstates the *Strumpf* holding. In *Strumpf,* the Supreme Court focused on interpreting § 362(a)(7), the provision that prohibits a creditor from setting off a debt owing to the debtor that arose prepetition against a claim against the debtor. In that case, a bank placed an administrative hold on a portion of a debtor's bank account to protect a claimed

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[16] Docket 126 at 11.

[17] Docket 126 at 24.

[18] Federal rule 12(b) provides that if a rule 12(b)(6) motion presents matters outside the pleadings *and if the court does not exclude those matters*, the court is to treat the motion as one for summary judgment and give all parties the chance to present material pertinent to a rule 56 motion. FED. R. CIV. P. 12(b)(6). This court has specifically excluded all matters outside the pleadings, so the provision relating to summary judgment is inapplicable.

[19] The IRS challenge to the § 362(a)(6) claim is also discussed below.

right to setoff under bankruptcy code § 553. The precise issue decided was "whether [the bank's] refusal to pay its debt to [debtor] upon the latter's demand constituted an exercise of the setoff right and hence violated the stay . . . All that concerns us here is whether the refusal *was a setoff*." *Id.* at 19 (emphasis in original). In reconciling the debtor's rights under § 362(a)(7), the creditor's rights under § 553, and the general provisions of § 542(b), the Supreme Court held that the bank's acts did not violate § 362(a)(7) because the hold was temporary, the setoff claim was valid, and the bank filed a motion for relief from stay within five days to obtain court review of its action.

The *Strumpf* court went on briefly to address §§ 362(a)(3) and (a)(6), concluding that the bank had not violated either one. The Court characterized the bank's acts as a temporary refusal to perform its promise to pay rather than as an exercise of control over the bank account, before returning to its main point:

> In any event, we will not give § 362(a)(3) or 362(a)(6) an interpretation that would proscribe what § 542(b)'s exception and § 553(a)'s general rule were plainly intended to permit: the temporary refusal of a creditor to pay a debt that is subject to setoff against a debt owed by the bankrupt.

Strumpf, 516 U.S. at 21 (internal quotations, footnote, and alterations omitted).

The facts and legal issues in the present case are different from those considered in *Strumpf*: the debtors do not allege a violation of § 362(a)(7), the IRS admits it had no right to setoff under § 553, and the IRS did not file a motion for relief from stay at all, much less within the five day time frame approved in *Strumpf*. While *Strumpf* does consider §§ 362(a)(3) and (a)(6), the Court emphasized that its decision was based on the interplay between and among those sections, § 542, and § 553. The *Strumpf* decision is not, therefore, dispositive on the question of whether these debtors have stated a claim upon which relief may be granted. Other

courts considering the reach of *Strumpf* have reached a similar conclusion. S*ee, for example, Jiminez v. Wells Fargo Bank, N.A. (In re Jiminez)*, 335 B.R. 450, 457-59 (Bankr. D. N.M. 2005) (discussing the limited nature of the *Strumpf* holding as to § 362(a)(3)).

The IRS also relies on *Mountaineer Coal Co. v. Liberty Mut. Ins. Co. (In re Mountaineer Coal Co.)*, 247 B.R. 633, 644 (Bankr. W.D. Va. 2000), in which the court engaged in extensive factual analysis before determining that "a party does not violate the automatic stay when its conduct is limited to its failure, even without good cause, to pay over to the [debtor] a debt which it owes to the bankruptcy estate [based on an insurance contract]. *Id*. at 644 (emphasis added). In the present case, the allegations are not that the IRS's conduct was limited to failing to pay funds to the debtor, but include numerous other alleged acts as described above. This decision is, therefore, not persuasive at this point in the case. The IRS also cites *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1472 (D.C. Cir. 1991), in which the court concluded that the Department of Justice did not violate § 362(a)(3) when it continued postpetition to use the debtor's intangible trade secrets that had been provided to it by the debtor prepetition. This is, again, a factual scenario not present here.

In contrast to the case law which the IRS cites, other courts have concluded that under various fact patterns, the IRS's imposition of the computer freeze violates § 362(a)(3). *See, for example, United States v. Holden*, 258 B.R. 323 (D. Vt. 2000). Any meaningful analysis of the case law on this issue (both as cited by the IRS and as cited by the debtors) will require consideration of the relevant facts, an exercise outside the scope of a 12(b)(6) motion.

The next part of the IRS argument is that the complaint fails to state a claim upon which relief may be granted because the debtors have not shown that the refunds at issue are property of

the estate, as opposed to their own property. This argument is based on how the tax refunds should be treated under the debtors' confirmed plan.

The bankruptcy code sets out certain tests that a chapter 13 plan must meet to be confirmed. The code does not, however, require a uniform plan or a uniform definition of what constitutes property of the estate after a plan is confirmed. *See* 11 U.S.C. §§ 1322, 1325. As a result, there are many different plans discussed in the case law and those plans may include different provisions which are relevant to a determination of what constitutes property of the estate after plan confirmation. *See, for example, Gordon Sel-Way, Inc. v. United States of America (In re Gordon Sel-Way, Inc.)*, 270 F.3d 280, 286 (6th Cir. 2001) (noting that the terms of a confirmed plan must be considered in determining whether a tax refund was property of a chapter 11 estate). *See generally*, Keith M. Lundin, *Chapter 13 Bankruptcy* § 230.1 (3d ed. 2000 and Supp. 2004). The debtors' chapter 13 plan is outside the scope of the pleadings and the court has specifically declined to convert the motion to one for summary judgment.[20] Consequently, the factual issue of whether the two refunds are estate property cannot be resolved through a motion to dismiss under the circumstances of this case.

In sum, construing the allegations in the light most favorable to the debtors, the debtors have stated a claim that the IRS violated § 362(a)(3) of the automatic stay by the manner in which it handled their refund claims.

11 U.S.C. § 362(a)(6)

Section 362(a)(6) stays "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case . . . [.]" 11 U.S.C. § 362(a)(6). The IRS

[20] *See* n. 1.

contends that the debtors fail to state a claim under this section because neither the use of the computer freeze nor the delay in making the refunds was an act to collect a prepetition debt.

To support its argument, the IRS cites *Strumpf* for the proposition that § 362(a)(6) does not preclude mere acts to preserve a creditor's rights. *See Strumpf*, 516 U.S. at 21. In response to this argument, the reader is referred to the discussion of *Strumpf*, above, and its limited applicability to this case. The IRS also cites *In re Price*, 134 B.R. 313 (Bankr. N.D. Ill. 1991), a case in which the court found on the evidence submitted that the IRS's delay in processing the debtors' tax returns did not violate § 362(a)(6).[21] And it argues against the holding in *United States v. Holden*, where the court held that the IRS violated § 362(a)(6) by the manner in which it implemented an administrative freeze on the debtors' tax refund. The IRS points to factual distinctions between this case and that case. *See United States v. Holden*, 258 B.R. 323 (D. Vt. 2000).

The IRS argument on this point is again based on its own version of the facts, as recounted in large measure above, and its interpretation of that version of the facts. This approach misapprehends the nature of a motion to dismiss for failure to state a claim, under which the court assumes the debtors' factual allegations to be true and considers whether the debtors have stated a claim. The court need not repeat the debtors' factual allegations that have already been set out, but notes in particular the allegation that an IRS employee stated to Mrs. Harchar that the IRS would not release the refunds because it intended to apply them to the prepetition debt. Both this particular allegation and the totality of circumstances stated in the

[21] The IRS also cites case authority that the stay does not apply to motions filed in the chapter 13 case, a statement with which the debtors agree. *See* debtors' response, docket 139 at 18.

complaint clearly state a claim that the IRS acted to collect a claim from the debtors that arose prepetition.

D. 11 U.S.C. § 1327

The debtors request a determination that the IRS's conduct violated the terms of their confirmed plan.[22] The IRS argues that they have failed to state a claim.

Section 1327 sets out the effect of plan confirmation:

> (a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.
>
> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
>
> © Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. § 1327. Although the complaint broadly asserts that the IRS violated the debtors' confirmed plan, it does not identify any provisions of the plan or confirmation order that the IRS allegedly violated. As a result, the complaint fails to state a claim that the IRS violated the confirmed plan.

CONCLUSION

For the reasons stated in this memorandum of opinion, the IRS's motion to dismiss is granted in part and denied in part. The debtors' claims for violation of due process, for declaratory relief, and for injunctive relief are dismissed for lack of subject matter jurisdiction

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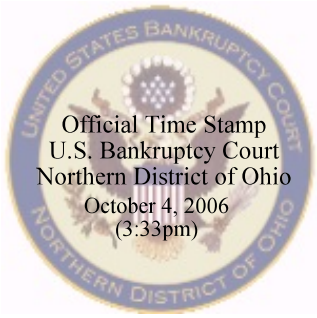
[22] Although the complaint does not reference § 1327, that section controls as to the effect of confirmation and the debtors' brief indicates that it is the basis for their claim.

under civil rule 12(b)(1) and the debtors' claims for violation of bankruptcy code §§ 525(a) and 1327 are dismissed under civil rule 12(b)(6) for failure to state a claim upon which relief can be granted. The remaining claims state a claim and the defendant is now required to answer them. *See* FED. R. BANKR. P. 7012(a).

A separate order reflecting this decision will be entered.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 98-13277
	)	
KENNETH HARCHAR and ANDREA HARCHAR,	)	Chapter 13
	)	
	)	Judge Pat E. Morgenstern-Clarren
Debtors.	)	
_____	)	
	)	
KENNETH HARCHAR and ANDREA HARCHAR,	)	Adversary Proceeding No. 00-1184
	)	
Plaintiffs,	)	
	)	
v.	)	**ORDER**
	)	
UNITED STATES OF AMERICA,	)	
	)	
Defendant.	)	

For the reasons stated in the memorandum of opinion entered this same date, the defendant's motion to dismiss is granted in part and denied in part. (Docket 125). The plaintiff-debtors' claims for violation of due process, for declaratory relief, and for injunctive relief are dismissed for lack of subject matter jurisdiction under federal civil rule 12(b)(1) and the plaintiff-debtors' claims for violation of bankruptcy code §§ 525(a) and 1327 are dismissed under federal civil rule 12(b)(6) for failure to state a claim upon which relief can be granted.

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge