UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 13-17204
	)	
MINNIE M. BOWERS SMITH and JAMES SMITH,	)	Chapter 11
	)	
Debtors.	)	Chief Judge Pat E. Morgenstern-Clarren
	)	
MINNIE M. BOWERS SMITH, *et al.*,	)	Adversary Proceeding No. 13-1248
	)	
Plaintiffs,	)	
	)	
v.	)	
	)	
UNITED STATES OF AMERICA, *et al.*,	)	**MEMORANDUM OF OPINION**[1]
	)	
Defendants.	)	

In their second amended complaint, plaintiff-debtors Minnie Bowers Smith and James Smith raise six causes of action against the United States based on tax liabilities.[2] The United States moves to dismiss, for judgment on the pleadings, or for summary judgment as to each cause of action. The debtors oppose the motion.[3] For the reasons stated below, the motion is granted in part and denied in part.[4]

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[1] This opinion is not intended for publication, either in print or electronically.

[2] The second amended complaint also requests relief against the Ohio Tax Commissioner as to the debtors' Ohio income tax liabilities.

[3] The debtors filed an untimely response to the motion and included within it their own motion for summary judgment. The court accepted the late-filed response, but denied the untimely summary judgment request. Docket 37. The debtors then re-filed their response at the court's direction. Docket 43.

[4] Docket 34, 40, 43.

I. JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 2012-7 entered by the United States District Court for the Northern District of Ohio on April 4, 2012. This is a core proceeding under 28 U.S.C. § 157(b)(2)(E), (F), (I) and (K), and it is within the court's constitutional authority as analyzed by the United States Supreme Court in *Stern v. Marshall*, 131 S.Ct. 2594 (2011).

The court's jurisdiction is discussed further in connection with the motion to dismiss.

II. UNDISPUTED BACKGROUND FACTS[5]

Prepetition, the United States, through its agency the Internal Revenue Service (IRS), assessed these income taxes:

Tax Period	Dates of Assessment
2001	8/26/2002 and 3/1/2004
2006	12/10/2007
2007	10/19/2009

On October 3, 2008, the IRS filed a Notice of Federal Tax Lien with Cuyahoga County as to unpaid tax debts arising from the 2001 and 2006 income tax periods. Additionally, the IRS served a Notice of Levy on Dr. Minnie Bowers Smith's employer, The Cleveland Clinic Foundation, and received five payments, with the payments beginning on July 30, 2013.

The debtors soon filed their chapter 11 petition. The IRS filed an amended proof of claim asserting:

[5] *See* the pleadings and the joint pretrial statement. Docket 28.

(1) a secured claim in the amount of $16,100.00 for unpaid tax debt and penalties for the 2001 income tax period;

(2) an unsecured priority claim in the amount of $9,899.60 arising from unpaid tax debt and interest for the 2011 and 2012 income tax periods; and

(3) a general unsecured claim in the amount of $119,822.48 for unpaid tax debt, interest and penalties for the 2001, 2006 and 2007 income tax periods.

The debtors have not objected to this claim.

After this motion was briefed, the debtors filed a plan providing that:[6]

(1) Class 2 is the IRS's secured claim valued at approximately $16,100.00;

(2) Class 3 is the IRS's unsecured priority claim in the approximate amount of $8,389.00; and

(3) Class 5 is the IRS's general unsecured claims in the approximate amount of $119,822.48.

The debtors propose to pay each of the three classes in full over five years.

III. THE SECOND AMENDED COMPLAINT

The debtors assert these causes of action:

> First Cause of Action–requests a determination that the collection statute of limitations has expired with respect to the debtors' delinquent federal income taxes for tax year 2001, which were assessed on August 26, 2002, and that the defendant is prohibited from collecting those taxes.

[6] Docket 56, Case No. 13-17204.

> Second Cause of Action–requests a determination that the federal income taxes assessed for tax years 2001, 2006 and 2007, plus all subsequent amounts added or accrued, are dischargeable under 11 U.S.C. § 523(a)(1).[7]
>
> Third Cause of Action–requests a determination that the penalties assessed for tax years 2001, 2006 and 2007 are dischargeable under 11 U.S.C. § 523(a)(7)(B).
>
> Fourth Cause of Action–requests a determination that the property securing the defendant's tax liens has no value.
>
> Fifth Cause of Action–requests avoidance of the transfer of $28,485.00 by Dr. Bowers Smith's employer to the defendant pursuant to a Notice of Levy as a preference under 11 U.S.C. § 547.
>
> Sixth Cause of Action– requests turnover of exempt funds which Dr. Bowers Smith's employer transferred to the defendant.

IV. DISCUSSION

The IRS moves to dismiss for lack of jurisdiction, for judgment on the pleadings, and for summary judgment.

A. Dismissal for Lack of Subject Matter Jurisdiction

The motion to dismiss for lack of subject matter jurisdiction is directed to the first, second, third, and sixth causes of action. Subject matter jurisdiction cannot be waived. *See* FED. R. CIV. P. 12(h)(1) (excepting lack of subject matter jurisdiction from list of defenses that may be waived); FED. R. CIV. P. 12(h)(3) ("If the court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action."); *Mich. Emp't Sec. Comm'n v. Wolverine Radio Co. (In re Wolverine Radio Co.)*, 930 F.2d 1132, 1137-38 (6th Cir. 1991)

[7] These are the tax years referred to in paragraph 19 of the amended complaint, the joint pretrial statement, and the briefs. While amended complaint paragraph 14 refers to tax years 2001, 2007, and 2008, there is no indication of a 2008 tax liability.

(parties can neither waive the lack of federal court subject matter jurisdiction nor confer it by consent). Although the debtors did not respond to the jurisdictional arguments, the court must still determine if it has jurisdiction. *See Campanella v. Commerce Exch. Bank*, 137 F.3d 885, 890-91 (6th Cir. 1998).

1. <u>The legal standard</u>

The court may dismiss a cause of action for lack of subject matter jurisdiction under Federal Civil Rule 12(b)(1). FED. R. CIV. P. 12(b)(1) (made applicable by FED. R. BANKR. P. 7012(b)); *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). This kind of a motion can "challenge the sufficiency of the pleading itself (facial attack) or the factual existence of subject matter jurisdiction (factual attack)." *Cartwright v. Garner*, 751 F.3d 752, 759 (6th Cir. 2014). In a facial attack, the allegations in the complaint are taken as true and the issue is whether the plaintiff has alleged a basis for jurisdiction. *Id.* (citing *United States v. Ritchie*, 15 F.3d 592, 598 (6th Cir. 1994)). A factual attack addresses the factual existence of subject matter jurisdiction. *Id.* The court has broad discretion as to what evidence should be considered, with the plaintiff bearing the burden of proof. *Id.* at 759-760.

The IRS's motion presents factual challenges to this court's jurisdiction.

2. <u>The case or controversy requirement</u>

The IRS argues that the counts do not meet the requirement of "Article III of the Constitution [which] limits the jurisdiction of federal courts to 'Cases' and 'Controversies.'" *Susan B. Anthony List v. Driehaus*, – U.S. – ,134 S.Ct. 2334, 2341 (2014) (citing U.S. Const., Art. III, § 2). This limitation is "a cradle-to-grave" requirement that must be satisfied at the time a plaintiff brings suit and must remain satisfied throughout the life of the case. *Fialka-Feldman*

v. Oakland Univ. Bd. of Tr., 639 F.3d 711, 713 (6th Cir. 2011). The requirement applies to federal bankruptcy courts. *Cassim v. Educ. Credit Mgmt. Corp. (In re Cassim)*, 594 F.3d 432, 437 (6th Cir. 2010).

Article III "requires a party who invokes the jurisdiction of the federal courts to 'demonstrate that he possesses a legally cognizable interest, or personal stake, in the outcome' of the case." *Hrivnak v. NCO Portfolio Mgmt., Inc.*, 719 F.3d 564, 567 (6th Cir. 2013) (quoting *Genesis Healthcare Corp. v. Symczyk*, 133 S.Ct. 1523, 1528 (2013) (internal quotation marks omitted)). "The basic inquiry is whether the 'conflicting contentions of the parties . . . present a real, substantial controversy between parties having adverse legal interests, a dispute definite and concrete, not hypothetical or abstract.'" *Babbitt v. United Farm Workers Nat. Union* 442 U.S. 289, 298 (1979) (quoting *Railway Mail Assn. v. Corsi*, 326 U.S. 88, 93 (1945)). A number of doctrines have been developed to enforce the requirement, including standing, ripeness, and mootness. *Warshak v. United States*, 532 F.3d 521, 525 (6th Cir. 2008).

The motion at issue is based on the ripeness doctrine. "The 'basic rationale' of ripeness doctrine 'is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements . . . and also to protect . . . from judicial interference until a[] . . . decision has been formalized and its effects felt in a concrete way by the challenging parties.'" *Kiser v. Reitz*, 765 F.3d 601, 606 (6th Cir. 2014) (quoting *Abbott Labs. v. Gardner*, 387 U.S. 136, 148-49 (1967)). A claim is not ripe for adjudication if it depends on "contingent future events that may occur as anticipated, or indeed may not occur at all.'" *Id.* (quoting *Texas v. United States*, 523 U.S. 296, 300 (1998)).

There are two aspects to the ripeness doctrine: constitutional ripeness and prudential ripeness. *Id.* However, a court only lacks subject matter jurisdiction when a claim is not constitutionally ripe within the meaning of Article III. *Cassim*, 594 F.3d at 438. The prudential aspect of ripeness, on the other hand, allows a court to exercise its discretion to determine whether resolution of the issue should be addressed at the time, given all the circumstances. *Id.* at 437. The Supreme Court recently suggested that prudential ripeness is in tension with a court's obligation to decide cases and has "cast into some doubt . . . the . . . prudential aspects of the ripeness doctrine, specifically the aspects that concern hardship to the parties and fitness of the dispute for resolution." *Kiser*, 765 F.3d 606-7 (citing *Susan B. Anthony List v. Driehaus*, – U.S. –, 134 S.Ct. 2334, 2347 (2014) and *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, – U.S. –, 134 S.Ct. 1377, 1386 (2014)).

Although the motion does not reference the mootness doctrine, it merits discussion. "If after filing a complaint the claimant loses a personal stake in the action, making it 'impossible for the court to grant any effectual relief whatever,' the case must be dismissed as moot." *Hrivnak*, 719 F.3d at 567 (quoting *Church of Scientology v. United States*, 506 U.S. 9, 12 (1992)); *see also Harmon v. Holder*, 758 F.3d 728, 732-33 (6th Cir. 2014) (stating that a case is moot when it no longer presents live issues or the parties lack a legally cognizable interest in the outcome). "Generally speaking, '[s]ettlement of a plaintiff's claims moots an action.'" *Pettrey v. Enter. Title Agency, Inc.*, 584 F.3d 701, 703 (6th Cir. 2009) (quoting *Brunet v. City of Columbus*, 1 F.3d 390, 399 (6th Cir. 1993)). The party seeking dismissal based on mootness bears the burden of demonstrating that the doctrine applies. *Harmon,* 758 F.3d at 732-33.

a. <u>The first cause of action</u>

The complaint requests a determination that the collection statute of limitations has expired as to the delinquent taxes for tax year 2001 assessed on August 26, 2002. *See* 26 U.S.C. § 6502 (limiting the period of time in which a tax may be collected by levy or court proceeding). The IRS argues that it never disputed this count and that the court lacks subject matter jurisdiction as a result. In the joint pretrial statement, however, the IRS did dispute this count by identifying this issue: "[w]hether the statute of limitations on the collection of the first assessment for year 2001 was tolled or suspended such that the tax (with accruals) arising from the August 26, 2002 assessment remains due and owing."[8] In any event, the IRS now concedes that the statute has expired, as a result of which there is no case or controversy. The debtors' response focuses on whether the statute of limitations has expired as to the second assessment made on March 1, 2004, which the IRS accurately notes is not an issue raised in the complaint.

Because the IRS concedes that the statute has run as to count one, there is no case or controversy as to that count. As a result, the court does not have jurisdiction and the motion to dismiss is granted. *See Sheehan v. United States (In re Sheehan)*, Adv. No. 09-1351, 2010 WL 4499326 at *5 (Bankr. N.D. Ohio Oct. 29, 2010).

b. <u>The second cause of action</u>

The debtors request a determination that their taxes for 2001, 2006, and 2007, and all subsequent additions and accruals, are dischargeable under 11 U.S.C. § 523(a)(1). That section

[8] Docket 28 at 2.

states that a chapter 11 discharge does not discharge an individual debtor from liability for any debt–

> (1) for a tax or a customs duty–
>
> (A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
> (B) with respect to which a return, or equivalent report or notice, if required–
>
> (i) was not filed or given; or
>
> (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax[.]

11 U.S.C. § 523(a)(1).

The IRS argues that:

(1) This claim is not constitutionally ripe because the debtors will only receive a discharge if they confirm and complete a plan. The argument continues that the debtors have sufficient disposable income to fund a 100% plan and, if they propose and complete such a plan, the tax claims will be paid in full and there will have no need to contest dischargeability; and

(2) Alternatively, if the debtors propose a plan that commits an insufficient amount to plan funding, there will be no need for a dischargeability determination because the government will object to the plan and move to dismiss the case based on bad faith.

The Sixth Circuit's *Cassim* decision is instructive on the issue of ripeness.[9] There, the Circuit addressed whether a chapter 13 debtor's post-confirmation complaint to discharge her student loans under § 523(a)(8) was constitutionally ripe before the debtor completed her plan and received her discharge. The Circuit concluded that notions of constitutional ripeness did not preclude jurisdiction:

> By filing for bankruptcy, Cassim sought to discharge her student loan obligations under § 523(a)(8), and Educational Credit, for its part, sought to prevent her from obtaining such relief. If Cassim prevailed, Educational Credit stood to lose some or all of its claim. The dispute thus involved a specifically-defined debt and a statutorily-based claim for relief that, Cassim, as a Chapter 13 petitioner, was entitled to pursue. The collision of these opposing interests produced a definite and substantive controversy between the parties, not an abstract disagreement . . . . Resolution of Cassim's entitlement to relief from this obligation is material to her 'fresh start,' because her student loan debt constitutes a substantial component of her overall debt. Without question, Cassim's interest in adjudicating the discharge cannot be viewed as hypothetical, nor has Defendant suggested why its incentive to address the issue is insubstantial.

594 F.3d at 440. The Circuit noted, however, that certain facts could have rendered the claim too speculative to meet the ripeness requirement:

> Finally, it is significant that the bankruptcy court's confirmation of Cassim's plan was necessarily premised on a finding that she would complete the plan. . . While it is true that factual developments may occur rendering it too speculative that Cassim

[9] While this case involves individual chapter 11 debtors and § 523(a)(1), the discussion in *Cassim* is instructive because: (1) the opinion discounts the difference between a § 523(a)(8) request and other dischargeability requests under § 523(a); and (2) relief for individual debtors under chapter 11 is comparable to chapter 13 relief insofar as a debtor's discharge generally depends on completing plan payments under 11 U.S.C. § 1141(d)(5).

> would receive a discharge under § 1328, such that the existence of an actual, substantial controversy then ceased to exist, Educational Credit has not advanced any facts to suggest that Cassim is particularly unlikely to receive a discharge.

Id. at 440.

Under *Cassim*, the debtors must prove that there is a presently existing dispute and that the facts establish that the issue is not hypothetical. The facts in this case have shifted since the debtors filed their adversary complaint and the parties briefed the issues. The debtors have now filed a plan in which they propose to pay the IRS's secured, priority, and general unsecured tax claims in full.[10] The plan proposes monthly payments of $5,252.00–an amount which the IRS has stated is sufficient to fund full payment of its claims.[11] Although the IRS objects to certain plan provisions, it appears likely that the debtors are in a position both to confirm and complete a plan providing for full payment of the claims, leaving nothing to discharge.[12] As a result, the debtors' interest in obtaining a dischargeability determination is best described as speculative.

The motion to dismiss this count is granted.

c. <u>The third cause of action</u>

The debtors request a determination that the penalties assessed for tax years 2001, 2006, and 2007 are dischargeable under Bankruptcy Code § 523(a)(7). That section states that a chapter 11 discharge does not discharge an individual debtor from liability for any debt:

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[10] Docket 56, Case No. 13-17204.

[11] *See* Motion at 3, docket 34.

[12] Based on this conclusion, there is no need to consider the issue of prudential ripeness discussed in *Mlincek v. United States (In re Mlincek)*, 350 B.R. 764 (Bankr. N.D. Ohio 2006) to the extent such consideration remains appropriate under current case authority. *See Kiser*, 765 F.3d 606-7.

> (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty–
>
> > (A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or
> >
> > (B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition[.]

11 U.S.C. § 523(a)(7). The IRS concedes in its motion that the penalties at issue are dischargeable because they accrued more than three years before the petition date and argues that the count should be dismissed for lack of a case or controversy. As stated above, jurisdiction must exist at all times during the life of the dispute. With the IRS's recent concession, the count is moot and the court now lacks jurisdiction. *Sheehan*, 2010 WL 4499326 at *5. The motion to dismiss this count is granted.

3. <u>Sovereign immunity</u>

The IRS challenges jurisdiction as to the sixth cause of action based on sovereign immunity, which limits jurisdiction by providing "that 'the United States, as sovereign, is immune from suit, save as it consents to be sued . . . and [that] the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit.'" *Harchar v. United States (In re Harchar)*, 694 F.3d 639, 648 (6th Cir. 2012) (quoting *United States v. Dalm*, 494 U.S. 596, 608 (1990)). Bankruptcy Code § 106 specifies the terms under which the United States waives sovereign immunity against suit in bankruptcy court. 11 U.S.C. § 106; *Gordon Sel-Way, Inc., v. United States (In re Gordon Sel-Way, Inc.)*, 270 F.3d 280, 284 (6th Cir. 2001).

a. <u>The sixth cause of action</u>

The debtors seek turnover of $6,545.00 in wages which Dr. Bowers Smith's employer transferred to the IRS in response to its Notice of Levy. The debtors contend that the employer improperly turned over the debtor's entire net wages, including exempt wages. *See* 26 U.S.C. § 6334(a)(9) and (d) (providing that certain wages shall be exempt from levy). The debtors base this count on Bankruptcy Code § 542. *See* 11 U.S.C. § 542 (providing for turnover of property to the estate).

By enacting Bankruptcy Code § 106(a), Congress specifically waived sovereign immunity as to various Bankruptcy Code sections, including § 542. The IRS argues that the § 106(a) waiver does not apply because the debtors do not have a property interest in the funds and, therefore, cannot use § 542 to accomplish their goal of having the improperly paid-over funds returned to them. Instead, according to the IRS, the debtors can only obtain an interest by avoiding the transfers as a preference and recovering the property transferred or its value. *See* 11 U.S.C. § 547 and 11 U.S.C. § 550.

Based on the facts presented, the § 106(a) waiver does not apply. After the IRS levied on the wages, the employer turned the money over to the IRS and the IRS applied the funds to reduce the debtors' tax liabilities. All of this took place before the debtors filed their bankruptcy case. *See* 26 U.S.C. § 6342 (providing for the application of the proceeds of a levy). At that point, the debtors' interest in the funds terminated. *United States v. Coghlan (In re Coghlan)*, 227 B.R. 304, 307-308 (D. Ariz. 1998). What they had instead was the right to request a refund. *See* 26 U.S.C. § 6343(b) (providing for a written request for the return of an amount equal to an amount of money that was wrongfully levied) and 26 U.S.C. § 7422(a) (providing that "[n]o 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 sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund has been duly filed").

The right to request a refund is in the nature of a debt, rather than a tangible interest in property, making § 542(b) the relevant turnover provision. *See Harchar v. United States (In re Harchar)*, 694 F.3d 639, 646 (6th Cir. 2012). However, recovery by turnover under § 542(b) is limited to debts that are "matured, payable on demand, or payable on order[.]" 11 U.S.C. § 542(b). Any claim the debtors have for a refund of the exempt funds is not a matured debt or one that is payable by demand or order. Under these facts, the claim is not properly characterized as a § 542 turnover action and the § 106(a) waiver does not apply.[13]

This does not necessarily end the discussion because § 106(b) also waives sovereign immunity:

> 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). In practice, § 106(b) means "that '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 property of the estate, and (2) the debtor's claim arises out of

[13] Section 106(a) also waives immunity with respect to § 505 determinations of tax liability. 11 U.S.C. § 505. The debtors do not rely on § 505 for this count and the court declines to address it for that reason.

the same transaction or occurrence as the government's claim.'" *Harchar,* 694 F.3d at 649 (quoting *Gordon Sel-Way, Inc.*, 270 F.3d at 285).

The first requirement for waiver is met because the debtors' claim for a refund of the exempt funds is property of their chapter 11 estate. *See* 11 U.S.C. § 541(a)(1) (providing that the estate includes "all legal and equitable interests of the debtor in property as of the commencement of the case"). The second requirement meets with less success because the refund claim does not arise out of the same transaction as the IRS's claim in the chapter 11 case. Federal Civil Rule 13 jurisprudence applies in making that determination, with the relevant considerations including: (1) whether there is a logical relationship between the two claims; (2) whether the issues of law and fact are largely the same; (3) whether res judicata would bar a subsequent suit on the counterclaim; and (4) whether substantially the same evidence would support both the claim and the counterclaim. *Harchar,* 694 F.3d at 649. The IRS proof of claim is for 2001, 2006, 2007, 2011, and 2012 tax liabilities. While there is a logical relationship between the IRS claim and the debtors' claim for a refund of exempt amounts improperly levied, the factual issues as to the claims are not the same, each claim will require different evidence, and any determination on the IRS's claim would not apply to bar the debtors' pursuit of their claim for a refund of exempt funds.

For these reasons, the court lacks jurisdiction and the motion to dismiss the sixth cause of action is granted.

B. Judgment on the Pleadings

The IRS moves for judgment on the pleadings as to the fourth cause of action.[14]

1. The legal standard

A party may move for judgment on the pleadings "[a]fter the pleadings are closed–but early enough not to delay trial[.]" FED. R. CIV. P. 12(c) (made applicable by FED. R. BANKR. P. 7012(b)). Such a motion is properly granted "when no material issue of fact exists and the party making the motion is entitled to judgment as a matter of law." *Paskvan v. City of Cleveland Civil Serv. Comm'n*, 946 F.2d 1233, 1235 (6th Cir. 1991). The material, well-pleaded allegations of the complaint are taken as true, and the motion can only be granted when the movant is nevertheless entitled to judgment as a matter of law. *JPMorgan Chase Bank, N.A. v. Winget*, 510 F.3d 577, 582 (6th Cir. 2007).

Under Federal Rule 12(c), a complaint's factual allegations must be sufficient to give the defendant notice as to what claims are being alleged and must plead sufficient factual matter to render the legal claim plausible. *Fritz v. Charter Twp. of Comstock*, 592 F.3d 718, 722 (6th Cir. 2010) (citing *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)). "And, '[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *Reilly v. Vadlamudi*, 680 F.3d 617, 623 (6th Cir. 2012) (quoting *Hensley Mfg. v. ProPride, Inc.*, 579 F.3d 603, 609 (6th Cir. 2009)).

[14] While the motion also requests dismissal, it fails to state a basis for that relief.

a. The fourth cause of action

As stated, this count seeks to value the defendant's security. In addition to incorporating various background allegations made in other parts of the complaint, this count alleges that:[15]

> 30. Defendant has caused to be filed in the County of Cuyahoga, Notice of Federal Tax Lien in regarding the assessments set forth in Paragraphs 12 and 15 hereinabove.
>
> 31. By reason of said Notice of Federal Tax Liens Defendant claims a security interest in the 403(b) pension plan duly scheduled on Schedule B of Plaintiffs Chapter 11 petition as well as all other assets scheduled by Plaintiffs in the Chapter 11 Petition.
>
> 32. Plaintiff Minnie M. Bowers Smith's pension plan is exempted under Ohio Exempt Statute. Accordingly, defendant's lien has a value of zero (-0-) in the subject real property.
>
> 33. Plaintiffs are informed and believe and thereon allege that Defendant's lien has no value in any other property of Plaintiffs and in particular Plaintiff Minnie M. Bowers Smith's 403(b) pension benefits.

As the IRS acknowledges, the debtors have stated a claim that the pension is excluded from the estate and should be excluded from the valuation of its secured claim.[16] The motion for judgment on the pleadings is, therefore, denied. While it appears that the debtors may have intended to assert a broader claim for why property (other than the pension interests) should be excluded in valuing the defendant's secured position, they failed to do so. Moreover, they failed to address or to attempt to cure that deficiency in their response to the motion.

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[15] Docket 25 at 6.

[16] Docket 35 at 5.

C. Summary Judgment

The IRS moves for summary judgment on the fifth cause of action.

1. The legal standard

Summary judgment is appropriate if the movant "shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a) (made applicable by FED. R. BANKR. P. 7056). The moving party bears the initial burden of production. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). "After the moving party has met its burden, the burden shifts to the nonmoving party, who must present some 'specific facts showing that there is a genuine issue for trial.'" *Jakubowski v. Christ Hosp., Inc.*, 627 F.3d 195, 200 (6th Cir. 2010) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)). "[I]f the nonmoving party fails to make a sufficient showing on an essential element of the case with respect to which the nonmovant has the burden, the moving party is entitled to summary judgment as a matter of law." *Thompson v. Ashe*, 250 F.3d 399, 405 (6th Cir. 2001).

All of the facts and the reasonable inferences drawn from the facts must be considered in the light most favorable to the non-moving party. *City Mgmt. Corp. v. U.S. Chem. Co.*, 43 F.3d 244, 250 (6th Cir. 1994). "[A] 'judge's function' at summary judgment is not 'to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial.'" *Tolan v. Cotton*, 134 S.Ct 1861, 1866 (2014) (per curium) (quoting *Anderson,* 477 U.S. at 249). "However, if 'the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no genuine issue for trial.'" *Vaughn v. Lawrenceburg Power Sys.*, 269 F.3d 703, 710 (6th Cir. 2001) (quoting *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)).

a. <u>The fifth cause of action</u>

The debtors seek to avoid the transfers of Dr. Bowers Smith's wages made by her employer in response to the Notice of Levy. Bankruptcy Code § 547 permits a debtor to avoid certain prepetition transfers of a debtor's interests in property, which results in bringing that property back into the bankruptcy estate. The debtor must prove each of the five elements set out in § 547(b). 11 U.S.C. § 547(g); *Triad Int'l Maintenance Corp. v. Southern Air Transp., Inc. (In re Southern Air Transp., Inc.)*, 511 F.3d 526, 534 (6th Cir. 2007).

The motion focuses exclusively on the § 547(b)(5) requirement that the transfers must have enabled the defendant to receive more that it would have received in a hypothetical chapter 7 case if the transfers had not been made. 11 U.S.C. § 547(b)(5). The IRS reasons that its position as a secured creditor precludes a finding that the transfer allowed it to improve its position relative to other creditors.

The IRS relies on federal tax law which provides that a federal tax lien on all of a delinquent taxpayer's property arises at the time the tax liability is assessed. 26 U.S.C. §§ 6321 and 6322; *United States v. Hunter (In re Walter)*, 45 F.3d 1023, 1027 (6th Cir. 1995). The lien covers "all property and rights to property" of the taxpayer as of the assessment date and continues until the liability is satisfied or becomes unenforceable. 26 U.S.C. §§ 6321 and 6322. And it attaches not only to property belonging to the taxpayer on the assessment date, but also to property acquired after the date the lien attaches. *United States v. Safeco Ins. Co. of Am., Inc.*, 870 F.2d 338, 341 (6th Cir. 1989). The tax lien is valid against third parties following the filing of a notice of the lien. 26 U.S.C. § 6323(a).

As evidence to support its motion, the IRS offers the affidavit of an IRS technical services advisor and documents showing these facts:

A Notice of Tax Lien with respect to the debtors' 2001 and 2006 taxes was filed with Cuyahoga County on October 3, 2008. The lien was for unpaid balances of $88,161.59 for 2001 and $37,374.97 for 2006, for a total amount of $125,536.56.[17] A Notice of Tax Lien with respect to the debtors' 2007 taxes was similarly filed on March 12, 2010 for a total amount of $54,161.24.[18] Additionally, the IRS issued a Notice of Levy on Wages, Salary and Other Income to the Cleveland Clinic on January 17, 2013 for debtor Minnie Bowers Smith for the 2006, 2007, and 2011 income tax periods.[19] The United States began receiving payments through the levy on July 30, 2013 and it received a total of $28,213.41 before the debtors filed their bankruptcy case. The IRS initially applied the second payment towards the 2001 taxes, but changed that application after the debtors filed this adversary proceeding. At this point, all of the payments have been applied to the 2006 taxes.

The IRS filed an amended proof of claim on June 6, 2014 asserting a secured claim in the amount of $16,100.00 for unpaid taxes and penalties for 2001, an unsecured priority claim in the amount of $9,899.00 for unpaid taxes and penalties for 2011 and 2012, and a general unsecured claim in the amount of $119,822.48 for unpaid tax debt, interest and penalties for 2001, 2006 and 2007. The IRS lowered the amount of the secured claim from $30,699.00 to $16,100.00 to

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[17] Def. Exh. B.

[18] *Id.*

[19] *Id.*

reflect the total value of the debtors' scheduled assets.[20] The IRS's brief admits that the secured claim amount should be further reduced to $9,275.00 to reflect that the IRS is not secured by the $6,825.00 value of the pension plan.[21]

As noted, the motion focuses on the § 547(b)(5) requirement which "is designed 'to accomplish proportionate distribution of the debtor's assets among its creditors, and therefore to prevent a transfer to one creditor that would diminish the estate of the debtor that otherwise would be available for distribution to all.'" *Southern Air Transp., Inc.*, 511 F.3d at 530 (quoting *Stevenson v. Leisure Guide of Am., Inc. (In re Shelton Harrison Chevrolet, Inc.)*, 202 F.3d 834, 837 (6th Cir. 2000)). Prepetition payments to a fully secured creditor do not meet this requirement: "Payments to a creditor who is fully secured are not preferential since the creditor would receive payment up to the full value of his collateral in a Chapter 7 liquidation." *Id.* at 533 (citing *Ray v. City Bank & Trust Co. (In re C-L Cartage Co.)*, 899 F.2d 1490, 1493 (6th Cir. 1990)).

Prepetition transfers to creditors holding undersecured claims, on the other hand, may be preferential. As one court explained–

> When a prepetition payment is made to an undersecured creditor, it is assumed that the funds received are first credited to the undersecured portion of the claim . . . As a result, until the unsecured portion of an undersecured claim is fully satisfied, the prepetition payment will neither reduce the secured claim nor

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[20] The debtors' Schedule B lists individual items of property with a total value of $16,100.00; however, the total value is stated as being $30,699.00. *See* Docket 17, Case. No. 13-17204.

[21] *See* Docket 34 at 11.

> increase the debtor's equity in the collateral. Under this circumstance, prepetition payments made to the undersecured creditor, going first to the unsecured portion of the claim, will enable that creditor to receive, to the detriment of the debtor's other creditors, more than it would have received upon the debtor's liquidation in a Chapter 7 bankruptcy.

Yoppolo v. Comerica Bank (In re Norwalk Furniture Corp.), 428 B.R. 419, 426 (Bankr. N.D. Ohio 2009) (internal citations omitted). It is generally accepted, however, that a transfer to an undersecured creditor does not have the same preferential effect when the source of the transfer is the creditor's own collateral. *Krafsur v. Scurlock Permian Corp. (In re El Paso Refinery, LP)*, 171 F.3d 249, 254 (5th Cir. 1999); *Norwalk Furniture Corp.*, 428 B.R. at 426-27; *see also Intercontinental Polymers, Inc. v. Equistar Chemicals, LP (In re Intercontinental Polymers, Inc.)*, 359 B.R. 868, 875-76 (Bankr. E.D. Tenn. 2005). The reason being that "[a] creditor who merely recovers its own collateral receives no more as a result than it would have received anyway had the funds been retained by the debtor subject to the creditor's security interest." *Norwalk Furniture Corp.*, 428 B.R. at 426-27. The IRS met its initial burden of showing that it did not receive more than it would receive in a hypothetical chapter 7 liquidation: the evidence presented showed that it held a lien for the 2006 taxes which was secured by all of the debtors' property and property interests–including Dr. Bowers Smith's wages–and that the funds from the levy constituted its own collateral.

The debtors' main argument in opposition relies on the assertion that the IRS is not a secured creditor because its liens are invalid. They contend that the name Minnie M. Bowers, rather than the debtor's married name as used on her 2001 and 2006 tax returns, appears on the Notice of Federal Tax Lien. The debtors state that they may request lien avoidance in the future

based on this argument. This argument fails to carry the debtors' burden on summary judgment for two reasons.

First, a non-moving party generally may not raise a new legal theory for the first time in response to the opposing party's motion for summary judgment. *Tucker v. Union of Needletrades, Indus. & Textile Employees*, 407 F.3d 784, 788 (6th Cir. 2005). As the debtors acknowledge they did not plead lien avoidance, they are precluded from raising the issue at this late date. The rule is modified in cases where a complaint is ambiguous and the defendant received adequate notice of the claim. *Copeland v. Regent Elec., Inc.*, 499 F. Appx. 425, 435 (6th Cir. 2012) (unpublished opinion). However, there is no basis to modify it here because the debtors' complaint does not provide any notice that the defendant's lien is being challenged. To the contrary, the complaint acknowledges that the Notices of Federal Tax Liens were filed and requests a valuation of the property securing the liens.

Second, the debtors did not provide any evidence to support the theory. Under Sixth Circuit case law, a federal tax lien "need not perfectly identify the taxpayer." *United States v. Crestmark Bank (In re Spearing Tool & Mfg. Co.)*, 412 F.3d 653, 656 (6th Cir. 2005). While the debtors cite case authority for the proposition that a tax lien filed in the wrong name is unperfected and subject to avoidance, they did not provide any evidence to establish that the name used was wrong or even that it was insufficient.

V. CONCLUSION[22]

For the reasons stated, the IRS motion is granted in part and denied in part. The motion to dismiss the first, second, third, and sixth causes of action for lack of subject matter jurisdiction is granted. The motion for judgment on the pleadings as to the fourth cause of action is denied. The motion for summary judgment on the fifth cause of action is granted.

A separate judgment will be entered to reflect this decision.

Pat E. Morgenstern-Clarren
Chief Bankruptcy Judge

[22] Both parties have to some extent raised attenuated and/or irrelevant arguments, which the court in the exercise of its discretion has chosen not to address. However, the court has, before reaching this determination, reviewed all such arguments even though they are not specifically referenced.

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 13-17204
	)	
MINNIE M. BOWERS SMITH and JAMES SMITH,	)	Chapter 11
	)	
	)	Chief Judge Pat E. Morgenstern-Clarren
Debtors.	)	
	)	
	)	
MINNIE M. BOWERS SMITH, M.D., *et al.,*	)	Adversary Proceeding No. 13-1248
	)	
Plaintiffs,	)	
	)	
v.	)	
	)	
UNITED STATES OF AMERICA, DEPARTMENT OF TREASURY, INTERNAL REVENUE SERVICE, *et al.*,	)	**JUDGMENT**
	)	
	)	
Defendants.	)	

For the reasons stated in the memorandum of opinion entered this same date, the United States' motion to dismiss, for judgment on the pleadings, and for summary judgment is granted in part and denied in part. (Docket 34). The motion to dismiss the first, second, third, and sixth causes of action for lack of subject matter jurisdiction is granted; the motion for judgment on the pleadings as to the fourth cause of action is denied; and the motion for summary judgment on the fifth cause of action is granted.

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
Chief Bankruptcy Judge