UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

Honorable Fredrick E. Clement
Fresno Federal Courthouse
2500 Tulare Street, 5th Floor
Courtroom 11, Department A
Fresno, California

PRE-HEARING DISPOSITIONS

DAY: **THURSDAY**
DATE: **JANUARY 26, 2017**
CALENDAR: **10:00 A.M. CHAPTERS 13 AND 12 ADVERSARY PROCEEDINGS**

GENERAL DESIGNATIONS

Each pre-hearing disposition is prefaced by the words "Final Ruling," "Tentative Ruling" or "No Tentative Ruling." Except as indicated below, matters designated "Final Ruling" will not be called and counsel need not appear at the hearing on such matters. Matters designated "Tentative Ruling" or "No Tentative Ruling" will be called.

COURT'S ERRORS IN FINAL RULINGS

If a party believes that a final ruling contains an error that would, if reflected in the order or judgment, warrant a motion under Federal Rule of Civil Procedure 60(a), as incorporated by Federal Rules of Bankruptcy Procedure 9024, then the party affected by such error shall, not later than 4:00 p.m. (PST) on the day before the hearing, inform the following persons by telephone that they wish the matter either to be called or dropped from calendar, as appropriate, notwithstanding the court's ruling: (1) all other parties directly affected by the motion; and (2) Kathy Torres, Judicial Assistant to the Honorable Fredrick E. Clement, at (559) 499-5860. Absent such a timely request, a matter designated "Final Ruling" will not be called.

1. 16-10434-A-13 JOSE ANGULO
16-1067
ANGULO V. ANGULO
SCOTT LYONS/Atty. for pl.
RESPONSIVE PLEADING

CONTINUED STATUS CONFERENCE RE: COMPLAINT
6-17-16 [1]

Final Ruling

The status conference is continued to March 29, 2017, at 10:00 a.m. Not later than 14 days prior to the status conference the parties shall file a status report.

2. 11-14278-A-12 MANUEL/MARY BARCELOS
16-1057
BARCELOS V. THE UNITED STATES OF AMERICA, FOR ACTIONS TAKEN
RILEY WALTER/Atty. for pl.

CONTINUED STATUS CONFERENCE RE: COMPLAINT
5-27-16 [1]

No tentative ruling.

3. 11-14278-A-12 MANUEL/MARY BARCELOS
16-1057 US-1
BARCELOS V. THE UNITED STATES OF AMERICA, FOR ACTIONS TAKEN
BORIS KUKSO/Atty. for mv.
RESPONSIVE PLEADING

MOTION TO DISMISS ADVERSARY PROCEEDING/NOTICE OF REMOVAL
12-19-16 [31]

Tentative Ruling

Motion: Dismiss Complaint under Rule 12(b)(1) and Rule 12(b)(6)
Notice: LBR 9014-1(f)(1); written opposition required
Disposition: Denied
Order: Civil minute order

FACTUAL ALLEGATIONS

Underlying Bankruptcy

The complaint alleges that plaintiff Manuel F. Barcelos is an individual residing in Chowchilla, California, who filed a voluntary petition in April 2011 under chapter 12 of the Bankruptcy Code along with his deceased wife. The complaint states that Defendant United States (through its agency the I.R.S.) was included in the mailing matrix for Barcelos's bankruptcy case, and that it was mailed notice of the bankruptcy.

The complaint further alleges that the IRS filed a proof of claim on April 14, 2011 in the amount of $231,395, and amended this claim later in 2014 in the amount of $232,538.80. Barcelos's chapter 12 plan was confirmed on June 2, 2011. The plan provided that "[t]ax obligations otherwise entitled to priority . . . shall be paid in Class V pursuant to [11 U.S.C. §] 1222(a)(2)."

Stay Violations

Barcelos pleads that the IRS seized his 2013 tax refund in the amount of $11,917, in violation of the automatic stay. The time of this violation is asserted as 2014. In December 2014, Barcelos's counsel sent a letter to the IRS requesting return of this refund. This refund was received on April 14, 2015.

The complaint alleges a similar violation as to the 2014 tax refund. Barcelos claims he filed his 2014 tax return on October 7, 2015, which showed entitlement to a refund in the amount of $6,482. He contends that the IRS withheld his refund a second time. He demanded release of the refund on May 6, 2016, without success.

The complaint at paragraph 15 alleges that the 2013 tax refund was received by the debtor on April 14, 2015. In the opposition, the debtor further admits that the 2014 refund has been received by the debtor around June 2016.

The complaint brings a claim under § 362(k) for the Defendant's intentional violation of the automatic stay by seizing Barcelos's 2013 and 2014 tax refunds during his bankruptcy case.

Damages

Plaintiff claims he has incurred—and continues to incur—damages as a result of Defendant's actions. Actual damages, attorneys' fees and costs, and punitive damages are requested in the complaint.

However, in its opposition to the motion, Barcelos has waived and withdrawn his punitive damage claim.

Opposition

In his opposition to the motion, Barcelos adds additional factual detail. Generally, only facts alleged in the complaint are considered on a motion to dismiss under Rule 12(b)(6). But in addition to looking at the facts alleged in the complaint, the court may also consider some limited materials such as (1) documents attached to the complaint as exhibits, (2) documents incorporated by reference in the complaint, and (3) matters properly subject to judicial notice. *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003); *accord Swartz v. KPMG LLP*, 476 F.3d 756, 763 (9th Cir. 2007) (per curium).

The opposition's additional facts are not alleged in the complaint, attached to the complaint, or properly subject to judicial notice. These facts include an exhibit entitled "Administrative Claim." This exhibit includes a number of unauthenticated letters, emails, and billing invoices. The court notes that some of the opposition's additional facts, however, merely provide greater detail regarding the communications between debtor's counsel and the I.R.S. and its attorneys and officials regarding this matter, and greater detail as to whether both refunds have been returned to the debtor.

In short, however, the court will not consider these additional facts and convert the motion to a motion for summary judgment.

LEGAL STANDARDS

Under Federal Rule of Civil Procedure 12(b)(6), a party may move to dismiss a complaint for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6), *incorporated by* Fed. R. Bankr. P. 7012(b). "A Rule 12(b)(6) dismissal may be based on either a lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Johnson v. Riverside Healthcare Sys., LP*, 534 F.3d 1116, 1121–22 (9th Cir. 2008); *accord Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001).

The Supreme Court has established the minimum requirements for pleading sufficient facts. "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556, 570 (2007)). "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." *Id.* (citing *Twombly*, 550 U.S. at 556).

In ruling on a Rule 12(b)(6) motion to dismiss, the court accepts all factual allegations as true and construes them, along with all reasonable inferences drawn from them, in the light most favorable to the non-moving party. *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001); *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337–38 (9th Cir. 1996). The court need not, however, accept legal conclusions as true. *Iqbal*, 556 U.S. at 678. "A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.'" *Id.* (quoting *Twombly*, 550 U.S. at 555).

In addition to looking at the facts alleged in the complaint, the court may also consider some limited materials without converting the motion to dismiss into a motion for summary judgment under Rule 56. Such materials include (1) documents attached to the complaint as exhibits, (2) documents incorporated by reference in the complaint, and (3) matters properly subject to judicial notice. *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003); *accord Swartz v. KPMG LLP*, 476 F.3d 756, 763 (9th Cir. 2007) (per curium) (citing *Jacobson v. Schwarzenegger*, 357 F. Supp. 2d 1198, 1204 (C.D. Cal. 2004)). A document may be incorporated by reference, moreover, if the complaint makes extensive reference to the document or relies on the document as the basis of a claim. *Ritchie*, 342 F.3d at 908 (citation omitted).

DISCUSSION

Operative Plan Provisions

The court takes judicial notice of all filings on its docket in this adversary proceeding and on its docket in the underlying bankruptcy case. This includes Barcelos's chapter 12 plan and its contents. Fed. R. Evid. 201(b)(2), (c)(1). The court further takes judicial notice of the order confirming the plan and order modifying the plan. Order Confirming Plan, June 2, 2011, ECF No. 28. Order Modifying Plan, Oct. 5, 2015, ECF No. 62. Further, the plan and order's legally operative provisions in this case are non-hearsay. "[O]ut of court statements that are offered as evidence of legally operative verbal

conduct are not hearsay." *U.S. v. Pang*, 362 F.3d 1187, 1192 (9th Cir. 2004)); *Stuart v. UNUM Life Ins. Co. of Am.*, 217 F.3d 1145, 1154 (9th Cir. 2000) (holding that insurance policy is verbal act); *Smith v. Town of Clarkton*, 682 F.2d 1055, 1064 (4th Cir. 1982) (substance of governmental agency order non-hearsay).

The plan provides at Section IX that the automatic stay shall be lifted upon the discharge of the debtors unless otherwise provided by court order. *See* 11 U.S.C. §§ 362(c)(2). This section further provides that all property of the estate shall vest in the Debtors upon entry of the debtors' discharge. *See id.* §§ 362(c)(1), 1227(b) (confirmation vests all property of the estate in the debtor unless the plan provides otherwise).

Claim for Stay Violations

The court has considered the following Code provisions in considering this motion: 11 U.S.C. §§ 106(b)-(c), 362(a)(3), (a)(6), (a)(7), (b)(9), (b)(26), (k), 541(a), 1207(a)-(b), 1227(b). Sections 362(a), 541(a), 1207(a)-(b) and 1227(b) are both applicable and material to the present dispute. Section 362(b)(9) is also relevant though not applicable.

At the outset, § 362(b)(26) is not applicable to this dispute because it applies only to a governmental unit's setoff of a *pre-petition* tax refunds against prepetition income tax liability. The refunds at issue in this matter are postpetition refunds, and therefore, are outside the scope of § 362(b)(26) based on its plain language. Furthermore, the complaint does not allege facts that constitute actions by the Defendant that would come within the scope of § 362(b)(9), a provision that excepts from the automatic stay certain tax-related actions by a governmental unit.

Read together, §§ 541(a)(1) and 1207(a)-(b) (and the plan provision vesting property of the estate in the debtor discharge) reveal the basic principle that property of the estate in a chapter 12 case includes all § 541(a) property that the debtor acquires postpetition and before the case is closed, dismissed or converted.

No party disputes that the refunds are property of the estate at this point in time, now that they have been received by Barcelos, the debtor. The question relates to whether the refunds were property of the estate before they were paid during the time that the Defendant allegedly withheld the refunds. As one court explained recently, the issue is "whether the mandatory offset procedures of the Tax Code either usurp the Bankruptcy Code provisions or change the character of the property interest to affect an exclusion from the Bankruptcy Code's protections." *In re Sexton*, 508 B.R. 646, 659 (Bankr. W.D. Va. 2014).

Citing cases and Tax Code provisions, the Defendant argues that a distinction exists between the refund itself (or overpayment) and the debtor's right to such refund or "refund claim." The Defendant posits that the refund does not become property of the estate until the refund check was issued by the I.R.S. The Defendant concludes, then, that a withholding of a refund and a refusal to pay it to a debtor can never constitute a violation of § 362(a)(3) because such an action is not an exercise of control over property of the estate.

A split of authority exists as to the nature of the estate's interest in a tax overpayment or refund. (And the decisions have distinguished between an overpayment and a refund.) Some courts hold that a debtor has no interest, or merely a contingent interest, in an overpayment until a refund is actually paid after the secretary sets off the refund under 26 U.S.C. § 6402 against any tax or other non-tax liabilities owed by that debtor. *See, e.g., In re Sissine*, 432 B.R. 870, 881-84 (Bankr. N.D. Ga. 2010) (citing other cases for this same proposition); *In re Gould*, 401 B.R. 415, 423-26 (B.A.P. 9th Cir. 2009) (discussing the issue of debtor's entitlement to a refund in the context of the I.R.S.'s motion for stay relief to exercise its setoff rights under 26 U.S.C. § 6402, and noting that the automatic stay prevented the I.R.S. from exercising its setoff rights under §362(a)(7).).

In the *Sissine* case, the court held, "The funds at issue [prepetition refunds] do not constitute property of the estate. Debtor's claim to a tax refund does not equate to the claimed funds being property of the estate. Here, Debtor's right to a refund is included in the bankruptcy estate, but Debtor's interest in those funds are limited by IRS review, . . . and the application of 26 U.S.C. § 6402." *In re Sissine*, 432 B.R. at 883.

Other courts have held that the estate has an interest in a tax overpayment or refund, and that the government cannot take collection action against a refund under 26 U.S.C. § 6402 (e.g., by setting off the refund against tax liability) without first obtaining relief from the stay. *In re Sexton*, 508 B.R. 646, 657-64 (Bankr. W.D. Va. 2014) (citing cases on both sides of the split of authority). In the *Sexton* case, the court set forth the position contrary to its own view as follows: "[S]ome courts conclude that the Secretary's statutory claim to apply TOP [Treasury Offset Program under 26 U.S.C. § 6402] eliminates a debtor's property interest in the tax refund, thus removing it from 'property of the estate.'" *Id.* at 664. The *Sexton* court rejected this view, and reasoned:

Although the Court generally agrees with the aforementioned analysis outside of the context of a bankruptcy proceeding, after a taxpayer files a petition for relief, the government's right to collection must comply with the requirements of the Bankruptcy Code. Under bankruptcy law, any property interest not expressly excluded becomes property of the bankruptcy estate—including a debtor's tax overpayment. As with any other right to collect outside of bankruptcy, once the debtor files her petition, the creditor's right to collect becomes subject to the automatic stay.

Id. In *Sexton*, the court ultimately found "that the government's post-petition withholding of the tax overpayment and postpetition offset of [the debtor's] debt to the DOA against her overpayment violated the automatic stay." *Id.* at 662.

The holding and reasoning of *In re Sexton* on this issue are persuasive. In particular, the *Sexton* court reasoned that if the overpayment or refund were not property of the estate until after such time as the government applied any review, reduction, setoff, or intercept under section 6402, then section 362(b)(26) would be surplusage and without effect. *Id.* at 662-64.

But at this stage of the proceeding, the court need not adopt a position as to whether the tax overpayments were property of the estate while they were withheld or seized by the Defendant as alleged. "A Rule 12(b)(6) dismissal may be based on either a lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Johnson v. Riverside Healthcare Sys., LP*, 534 F.3d 1116, 1121–22 (9th Cir. 2008). As discussed, some decisions support the theory that the debtor's tax overpayment is property of the estate subject to the automatic stay while held by the I.R.S. and before the procedures and offsets specified by 26 U.S.C. § 6402 have been applied. As a result, the court need not dismiss the complaint because its facts are plausibly supported by a cognizable theory even though other decisional law takes a contrary view.

Furthermore, § 362(a)(3) is not the only applicable provision regarding the automatic stay in this bankruptcy case. Section 362(a)(6), as Barcelos argues, also applies. Section 362(a)(6) provides that the bankruptcy petition operates as a stay of "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." Even if the 2013 and 2014 tax overpayments were contingent bankruptcy estate interests or were not property of the estate, as the Defendant contends, the Defendant was still subject to the automatic stay as to any collection or recovery actions it could take on account of its prepetition claim.

Withholding an overpayment and retaining it, if such an action was done for collection or recovery of a claim, could be an act within the scope and meaning of section 362(a)(6). In ruling on this motion to dismiss, the court accepts all factual allegations as true and construes them, *along with all reasonable inferences drawn from them, in the light most favorable to the non-movant* Barcelos. A reasonable inference from the use of the words "withholding" and "seizure," as they relate to Barcelos's overpayments, is that they were actions taken by the Defendant to collect or recover on its prepetition claim. This inference is further permitted because the complaint alleges specifically that the stay prohibited any act to collect, assess, or recover a claim, and that the stay was violated by these acts. The complaint sufficiently pleads facts that state a plausible claim to relief for violating this stay provision.

Actual Damages

Defendant argues that Barcelos is not entitled to an award of fees or damages. First, the Defendant asserts that the complaint contains no allegations of actual damages other than attorney's fees, and that Barcelos has received his refunds with interest under 26 U.S.C. § 6611(e).

Section 362(k)(1) provides: "Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C.A. § 362(k)(1).

Attorneys' fees incurred both in ending the stay violation and in prosecuting an action under § 362(k) are recoverable under that provision. *See In re Schwartz-Tallard*, 803 F.3d 1095, 1099 (9th Cir. 2015). The Ninth Circuit held:

"Did Congress intend to authorize recovery of attorney's fees incurred in litigation for one purpose (ending the stay violation) but not for another (recovering damages)? We see nothing in the statute that suggests Congress intended to cleave litigation-related fees into two categories, one recoverable by the debtor, the other not. The statute says 'including costs and attorneys' fees,' with no limitation on the remedy for which the fees were incurred."

The complaint plainly alleges that Barcelos has incurred damages as a result of the Defendant's actions. Compl. for Violation of Stay ¶ 24, Prayer for Relief ¶ 2, ECF No. 1. If Barcelos were to prevail at trial, these actual damages would include attorneys' fees and costs and other fees incurred to end the violation and to prosecute this action. *Id.*

No Waiver of Damages

The court does not find that the status report filed on July 15, 2016, waived any rights as to damages. It confirms that the tax refund was paid to Barcelos on June 29, 2016. By stating that "the issues of attorney's fees and punitive damages" remain to be resolved, Barcelos's statements waived no aspect of damages. His statement is not interpreted as stating that other types of damages are waived and unresolved. The status report only mentions summarily that two types of damages remain to be resolved. The statement is not necessarily meant to be an exhaustive listing of damages that remain in play. Accountant's fees, attorney's fees, and any other damages flowing from the alleged violation are not waived.

Administrative Claim

The Defendant's reply brief raises the issue that Barcelos must exhaust his administrative remedies before proceeding with this adversary to recover attorney's fees. U.S. Reply to Pl.'s Opp'n 4-5, ECF No. 42. These arguments do not appear in the motion. Arguments raised for the first time in a reply brief need not be considered by the trial court. *Zamani v. Carnes*, 491 F.3d 990, 997 (9th Cir. 2007) (citing *Koerner v. Grigas*, 328 F.3d 1039, 1048 (9th Cir. 2003)). Accordingly, the court will not address this issue in ruling on the motion.

CONCLUSION

Assuming the factual allegations of the complaint to be true, the Defendant's "seizure" or wrongful withholding of the tax overpayments or refunds could constitute a collection or recovery action if Barcelos can prove that the these funds were actually withheld and that such withholding and delay was in fact an act to collect or recover on the Defendant's prepetition claim. These actions also could constitute impermissible control over property of the estate under some of the decisions within a split of authority on the issue of whether an overpayment is property of the estate before the government has paid a refund and applied the procedures of 26 U.S.C. § 6402.

The complaint's allegations further allege actual damages caused by the violation. It also alleges that the violation was willful and intentional. The allegations state a plausible claim to relief based on facts that could present a basis for recovery for violation of the automatic stay.

In short, the court will deny the Rule 12(b)(6) motion to dismiss for failure to state a claim. The motion under Rule 12(b)(1) is denied as moot given that Barcelos has withdrawn the claim for punitive damages.

CIVIL MINUTE ORDER

The court shall issue a civil minute order that conforms substantially to the following form:

The Defendant United States' motion to dismiss under Rule 12(b)(6) and Rule 12(b)(1) of the Federal Rules of Civil Procedure has been presented to the court. Having reviewed the motion and papers filed in support and opposition to it, and having heard the arguments of counsel, if any, and good cause appearing,

IT IS ORDERED that the motion to dismiss under Rule 12(b)(6) is denied, and the motion to dismiss under Rule 12(b)(1) is denied as moot. The Defendant's answer shall be served within 21 days after entry of the order on this motion.

IT IS FURTHER ORDERED that the parties shall not enlarge time without order of this court and, if the Defendant fails to respond within the time specified herein, the plaintiff shall forthwith and without delay seek to enter the default of such non-responsive defendant.