DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, OMAHA

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Settoff of Postpetition Refunds

This Chief Counsel Advice responds to your memorandum dated May 29, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

You asked us to review your proposed memorandum discussing whether the Internal Revenue Service ("Service") must turn over to the Chapter 7 trustee a refund for a tax period ending after a Chapter 13 bankruptcy petition was filed but before the case was converted to Chapter 7 and whether the Service may setoff a post-petition refund against a pre-petition tax liability.

We agree with your conclusion that an asset acquired after the Chapter 13 petition was filed but before the case was converted to Chapter 7 is not property of the Chapter 7 estate. 11 U.S.C § 348(f)(1)(A) (2001); In re Stramm, 222 F.3d 216 (5th Cir. 2000); Farmer v. Taco Bell, 242 B.R. 435 (Bankr. W.D. Tenn 1999). We therefore agree with your conclusion that the refund should not be turned over to the Chapter 7 trustee. We further agree with your conclusion that the language of Bankruptcy Code section 553(a) does not bar the Service from setting off the post-petition refund against the pre-petition tax liability under I.R.C. section 6402(a), because the debts are mutual and the pre-petition claim is not dischargable.

Because several courts have disallowed the setoff of post-petition debts against pre-petition claims due to a lack of mutuality, you may want to incorporate an explicit statement into paragraph nine of your Motion for Relief that the Service's and the Debtors' claims are mutual. As you correctly concluded, the 2000 tax

refund is owed directly to the Debtors and not to the Chapter 7 estate. Thus, even though the refund is post-petition the Service's and the Debtors' claims are mutual. See, In re Schons, 54 B.R. 665, 666-67 (Bankr. W.D. Wash. 1985) (setoff of creditor's post-petition liability to debtor allowed against debtor's pre-petition liability to creditor since mutuality is present); Contra, In re Apex Int'l Mgt. Serv., 155 B.R. 591, 594 (Bankr. M.D. Fla. 1993) ("Because the pre-petition debtor acts in a different capacity than does the post-petition debtor, debts that arose at different times, one pre-petition and one post-petition, lack mutuality and set-off may not be had under § 553"); Cf., In re Braniff, 42 B.R. 443 (Bankr. N.D. Tex 1984) (finding mutuality lacking because creditor owed liability to debtor-in-possession rather than debtor itself).

Further, to ensure full candor with the court, you may want to note in the Motion for Relief that In re Firestone, 179 B.R. 148 (Bankr. D. Neb. 1995), persuasive authority in your jurisdiction, states that the Service may only exercise a setoff under section 6402(a) of the Internal Revenue Code when the requirements of section 553 are met. Id. at 149. This language can be distinguished as dicta because the Firestone court was only considering pre-petition debts and did not directly confront a post-petition claim.

Although we agree with your analysis and conclusions, you might consider noting adverse authority in your memo to ensure that the Insolvency Group is aware of potential litigation hazards. See, In re Willardo, 67 B.R. 1014 (Bankr. W.D. Mich. 1986) (striking down local court rules because, among other things, they would allow impermissible setoffs of post-petition claims against pre-petition debts); In re Internal Revenue Tax Liabilities & Refunds in Chapter 13 Proceedings, 30 B.R. 811 (Bankr. M.D. Tenn. 1983) (striking down an agreed upon order between the Chapter 13 trustee and the Service because, among other things, it would allow impermissible setoffs of post-petition claims against pre-petition debts); In re Hammett, 21 B.R. 923 (Bankr. E.D. Penn. 1982) (holding that the Service has no right to setoff post-petition refunds against pre-petition liabilities and thus no right to relief from the stay). In our view, the above cases do not properly consider the issue of mutuality.

We note on page eight of your memo and in paragraph six of the Motion for Relief you state that the Service can hold the refund until Debtors receive their discharge.[1] This is true, however, the Service can only retain the amount eligible for setoff. See CCDM 34.10.2.6(2)c. The Service must refund any amount in excess of the

[1]However, long-term or indefinite freezes may in fact violate the automatic stay. See, Citizens Bank v. Strumpf, 516 U.S. 16 (1995); In re Orr, 234 B.R. 249, 255 (Bankr. N.D. N.Y. 1999); In re Wicks, 215 B.R. 316 (E.D. N.Y. 1997). However, as we discussed, in this jurisdiction discharge in a no asset case usually occurs within three to four months. If the Service is going to hold the refund for longer than that amount of time, we should seek relief from the stay. IRM 5.9.4.3.1.

pre-petition tax liability or risk violating the stay. In re Holden, 217 B.R. 161, 166 (D. Vt. 1997).

We also note that in paragraph twelve of your Motion for Relief you discuss the setoff's benefit for the creditors. You may want add a discussion about the benefit to the debtors. Since post-petition interest continues to accrue on non-dischargeable tax liability in Chapter 7 proceedings, it is in the debtors' best interest to allow the Service to setoff the refund against the pre-petition liabilities as soon as possible to stop the accrual of interest. Bruning v. United States, 376 U.S. 358 (1964); In re Hanna, 872 F.2d 829 (8th Cir. 1989).

To review, we agree with the analysis and conclusions in your memo. We recommend that you make minor changes to your memo and Motion for Relief as discussed above.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any further questions please contact the attorney assigned to this matter at (202) 622-3620.