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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re BRETT CHRISTOPHER HOOPER
AND WENDY SUE HOOPER,

Debtor.

Chapter 7

Case No. 09-bk-26224-SSC

MEMORANDUM DECISION RE:
TRUSTEE'S MOTION TO COMPEL
TURNOVER OF ESTATE PROPERTY

I. PRELIMINARY STATEMENT

Brett and Wendy Hooper (“Debtors”) filed a voluntary Chapter 7 bankruptcy petition on October 16, 2009. On October 22, 2009, Brian J. Mullen (“Trustee”) was appointed the Chapter 7 Trustee of the bankruptcy estate. At the time of the commencement of the case, the bankruptcy estate was mostly comprised of the Debtors’ tax refunds for taxable years 2008 and 2009 in the amount of roughly \$2,000.

On November 6, 2009, however, Congress passed the Worker, Homeownership and Business Assistance Act (“WHBAA”), which allows taxpayers to apply 2008 and 2009 net operating losses (“NOLs”) to the previous three, four, or five taxable years to reduce the tax liability that may be due and owing by a taxpayer. 26 U.S.C. § 172 (West 2010). Depending on the amount of the NOLs, the taxpayer may be able to reduce the tax liability in a subject year to zero, producing a refund. See id. Prior to the passage of WHBAA, the standard carryback period for any NOL was only two years. Id. As a result of the passage of WHBAA, the Trustee

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III. DISCUSSION

As previously noted, the Trustee retained an accounting firm to determine whether the Debtors' tax returns should be amended, in light of WHBAA, to generate tax refunds as property of the bankruptcy estate. It appears that the Debtors independently retained their own certified public accountant to assist them, and that their accountant may already have amended their returns and filed them with the Internal Revenue Service ("IRS").³ Although the Court has not received a copy of these amended returns, the Debtors have apparently relied on WHBAA and have applied the substantial NOLs incurred from the operation of their various business entities during the 2008 and 2009 taxable years to offset portions of their 2004 and 2005 taxable income, producing *additional* refunds beyond what they disclosed upon filing their bankruptcy petition.

The Trustee contends that the NOLs and any refunds they may generate are property of the bankruptcy estate under 11 U.S.C. § 541, and are subject to the Trustee's powers of turnover under 11 U.S.C. § 542. The Debtors argue that the money generated through application of WHBAA is not bankruptcy estate property at all, but is rather a forward-looking stimulus payment based upon a postpetition change in the law.

Under § 541(a), the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." The term "property" as used in § 541 should be construed broadly. In re Feiler, 218 F.3d 948, 955 (9th Cir. 2000). An interest should not be disqualified as property simply because it is "novel or contingent" or

3. There has been an ongoing dispute between the Trustee and the Debtors as to whether the Debtors alerted the Trustee as to what they intended to do, whether the Debtors provided all of the tax information necessary for the Trustee's accountant to make an informed decision as to how to amend any of the Debtors' returns, and whether the Debtors willfully violated the automatic stay by amending their returns. The Debtors counter that the Trustee received all of the necessary information, including the amended returns, that no information was withheld, and that since the refunds were not property of the estate, the Debtors never willfully violated the stay. The facts underlying these disputes, including the Debtors' willful violation of the stay, have not been fully developed. Therefore, the Court will set these matters for further hearing.

1 subject to postponed enjoyment. Id. (quoting Segal v. Rochelle, 382 U.S. 375, 379 (1966)).

2 Although the current facts are somewhat unique, the federal courts have
3 addressed similar issues over the years. In Segal v. Rochelle, 382 U.S. 375, 379, 86 S. Ct. 511,
4 515 (1966), the United States Supreme Court considered to what extent a refund received
5 postpetition by bankrupts, but generated by the application of a net operating loss carry-back to
6 prepetition taxes paid by the bankrupts, was property of the bankruptcy estate. The bankrupts
7 had generated “loss-carryback tax refunds” during 1961, prior to filing their bankruptcy petition
8 on September 27, 1961.⁴ Id. at 376. They elected postpetition to carry back their losses to offset
9 their net income from 1959 and 1960, which generated a postpetition refund. The bankrupts
10 argued the refund should not be property vested in their bankruptcy trustee, since it had not been
11 acquired by the petition date. Id. at 377.

12 The Supreme Court disagreed. It found that the refund was vested in the
13 bankruptcy trustee for distribution to creditors, and noted that “postponed enjoyment [did] not
14 disqualify an interest as ‘property.’” Id. at 379-80. The Supreme Court stated that after-acquired
15 property would be considered property vested in the bankruptcy trustee, if it were “sufficiently
16 rooted in the prebankruptcy past and so little entangled in the bankrupts’ ability to make an
17 unencumbered fresh start that it should be regarded as ‘property’ [of the bankruptcy estate].”⁵

18
19 **4.** The loss-carryback tax refunds, described in the Segal decision, are the equivalent of
20 the net operating loss tax refunds that are now being considered.

21 **5.** In determining what property was vested in the trustee for distribution to creditors, the
22 Supreme Court analyzed Bankruptcy Act § 70(a)(5), the precursor to § 541. The statute
provided, in pertinent part,

23 (a) The trustee of the estate of a bankrupt . . . shall . . . be vested by operation of law
24 with the title of the bankrupt as of the date of the filing of the petition initiating a
proceeding under this title, except insofar as its is to property which is held to be
exempt, to all of the following kinds of property wherever located . . .

25 (5) property, including rights of action, which prior to the filing of the petition he
26 could by any means have transferred or which might have been levied upon and
sold under judicial process against him, or otherwise seized, impounded, or
27 sequestered

1 Id. at 380. The Supreme Court relied on two key elements in concluding that the refund
2 temporally existed at the time the bankruptcy petition was filed. First, the bankrupts had already
3 paid taxes on the net income generated within the past three years. Id. Second, at the time of
4 filing of the petition, it appeared that the bankrupts would have a net operating loss for the year.
5 Id. Although the refund claim was contingent insofar as it might increase or decrease based on
6 earnings received after the filing of the petition and before the end of the tax year, the contingent
7 nature of the claim did not change the fact that the refund was property of the bankruptcy estate
8 at the time the bankrupts filed their petition.⁶ Id.

9 _____
10 Bankruptcy Act § 70(a)(5), 30 Stat. 565 (1964) (repealed 1978).

11 The First and Third Circuits had previously determined that prior to the end of the tax
12 year, any attempt to classify a loss-carryback refund claim as property of a bankruptcy estate was
13 “too tenuous.” They also reasoned that the refund claims were “inchoate” because of the federal
14 anti-assignment statute, 31 U.S.C. § 203 (1964) (repealed 1982), which precluded the property
15 from being transferred as required under Bankruptcy Act Section 70(a)(5). The relevant portion
16 of the federal anti-assignment statute provided, at the time, that

17 [a]ll transfers and assignments made of any claim upon the United States, or any part or
18 share thereof, or interest therein, whether absolute or conditional and whatever may be
19 the consideration therefor. . . . shall be absolutely null and void, unless they are freely
20 made and executed in the presence of at least two attesting witnesses, after the allowance
21 of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the
22 payment thereof.

23 The Fifth Circuit had created a circuit split by concluding that the refund claims were both
24 “property” and “transferable” at the time of the filing of the bankruptcy petition, and therefore
25 passed to the trustee. Segal, 382 U.S. at 377-78.

26 **6.** The bankrupts argued that such a ruling would apply to “loss carryovers”—that is, to
27 the application of pre-bankruptcy losses to earnings in future years—which would force the
28 trustee to leave the estate open for five, seven, or even ten years in an attempt to recover further
assets, and would be an “inconvenience” or “hindrance” to the bankrupts. While the Supreme
Court did not rule on the matter, it noted that the bankrupts had net income and a net loss when
they filed their petitions and “would have deserved an immediate refund had their tax year
terminated on that date,” while the “supposed loss-carryover would still need to be matched in
some future year by earnings, earnings that might never eventuate at all.” Segal, 382 U.S. at
381.

A second issue addressed by the Supreme Court, concerning whether the bankrupt had an
interest in property which could be transferred prior to the filing of the petition, is no longer
relevant. Compare Bankruptcy Act § 70(a)(5), with Bankruptcy 11 U.S.C. § 541, and S. Rep.
No. 95-989, at 82 (1978).

1 As in Segal, the Debtors in this case seek to offset prepetition NOLs against
2 prepetition income upon which they have already paid taxes. The fact that they will *receive* the
3 refund postpetition does not change the essential character of the asset. Specifically, the Debtors
4 will be applying NOLs from 2008 and 2009 to offset 2004 and 2005 income upon which they
5 have paid taxes. By carrying back the NOLs, the Debtors in this case essentially hope to
6 generate an overpayment of 2004 and 2005 taxes that will lead to an additional tax refund now.
7 As was true in Segal, the refund, although it will be received postpetition, is “rooted in the
8 prebankruptcy past” and is, therefore, property of the estate.⁷ Id.

9 The Debtors claim that their case is distinguishable because a postpetition change
10 in the law has given them an interest in property that did not exist at the time of petition,⁸ and the
11 NOLs had no value at the time of the filing of their petition because of that change.⁹ See In re
12 Lambert, 273 B.R. 887 (Bankr. D. Or. 2001) (finding that a postpetition change in tax law could
13 potentially disqualify a tax refund as estate property if further factual inquiry in that case showed
14 the refund was forward-looking).

15
16 **7.** The Trustee has met the two critical elements set forth in the Segal decision to support
17 a turnover of the refund to be generated postpetition: to wit, the Debtors have already paid taxes
18 on the net income that will generate the refund, and as of the time of the filing of their
19 bankruptcy petition, the Debtors have generated a loss from their business operations for the
20 2009 tax year.

21 **8.** The Debtors seek to characterize the refund as a “stimulus relief payment” that is
22 “2010 income.” However, the Court finds no evidence of any such label in the WHBAA other
23 than a reference to a refund that is based on the extended application of prior years’ NOLs to
24 prior years’ taxable income. Even with such a label, the Court concludes that the refund to be
25 paid is rooted in the past and, hence, unrelated to earnings that are actually generated by the
26 Debtors *postpetition*.

27 **9.** The Debtors argue that this Court should adopt the Third Circuit’s reasoning in In re
28 Sussman, 289 F.2d 76 (3d Cir. 1961). In Sussman, the court held that a refund was not property
of the bankruptcy estate because the bankrupts had no vested right to the refund when they filed
their bankruptcy petition. The Supreme Court, however, has essentially overturned Sussman on
that point. See Segal, 382 U.S. at 375. The Court specifically disapproved of the Sussman
holding and followed another Circuit’s rationale in determining that an interest in property still
existed even if it vested postpetition. Segal, 382 U.S. at 378-79.

1 The Debtors assert that Segal is not relevant to the issue at hand, and that In re
2 Lambert, 273 B.R. 887 (Bankr. D. Or. 2001), somehow creates a bright-line rule that legislation
3 which becomes effective after a debtor files a bankruptcy petition creates a new legal or
4 equitable interest of the debtor in any property generated after the commencement of the case.
5 Since the legal or equitable interest is created after the commencement of the case, the Debtors
6 argue that it cannot be property of the estate under § 541(a)(1). The Debtors have misconstrued
7 the reasoning and conclusion of Lambert.

8 First, the Lambert court specifically acknowledged that Segal was still binding
9 precedent. See Lambert, 273 B.R. at 890. Further, the Lambert court stated that the key to
10 determining whether a refund was property of the bankruptcy estate was not whether the tax
11 attribute relied on prepetition conduct, but whether the application of the attribute would result in
12 a return of moneys placed in the hands of the IRS prior to the filing of the petition. Id. at 891
13 (citing In re Christie, 233 B.R. 110 (B.A.P. 10th Cir. 1999)). Finally, the Lambert court
14 differentiated between its facts and those in which benefits created postpetition might relate to
15 prepetition conduct, but were nevertheless *new funds*. Id. (citing In re Schmitz, 270 F.3d 1254
16 (9th Cir. 2001) (postpetition commercial fishing rights); In re Vote, 261 B.R. 439 (8th Cir. 2001)
17 (postpetition crop disaster assistance programs)). The court stated that such new benefits were
18 not tied to funds previously paid by the debtor and could not be considered property of the estate.
19 Id.

20 Ultimately, however, the Lambert court concluded that it had insufficient facts to
21 rule on the matter, because the debtors had not yet filed their returns for 2001, the year that they
22 filed their bankruptcy petition, when the court heard the matter. Id. at 892. The court did state
23 that if the postpetition check received by the debtors was equal to or less than the their total tax
24 liability, then the check was a refund, with the portion attributable to the period from January 1,
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1 the estate (except with certain personal defenses against the debtor to which the estate is not
2 subject). From this legislative intent, the Debtors have derived a non sequitur: since the Debtors
3 could not apply for the refund at the commencement of the case, the bankruptcy estate should not
4 have a right to the refund now. This reasoning creates an ethereal refund belonging to no one.
5 Returning to the nature of the refund, not its timing, WHBAA relates to prepetition taxes paid by
6 the Debtors to the IRS. At least on this record, any return of those funds—even if generated and
7 received postpetition—has roots in the prebankruptcy past. Except to the extent of a possible
8 proration, the refund is property of the bankruptcy estate.

10 IV. CONCLUSION

11 Based upon the foregoing, the Court concludes that the postpetition refund
12 generated by the enactment of postpetition legislation is property of the bankruptcy estate to the
13 extent that the refund is predicated on prepetition taxes having been previously paid by the
14 Debtors to the Internal Revenue Service. The nature, not the timing, of the refund determines
15 whether the refund is property of the bankruptcy estate. The Debtors' 2008 and 2009 NOL's and
16 the refund in question generated by those NOL's are property of the estate subject to the
17 Trustee's turnover power under 11 U.S.C. § 542. The Trustee's motion to compel turnover is
18 hereby granted, in part, and the Debtors are hereby ordered to turn over to the Trustee any
19 refunds they have received, or will receive, under the WHBAA from the application of the 2008
20 and 2009 NOL's.

21 The Court has insufficient information to determine if any of the losses for the
22 limited period of time between the filing of the Debtors' bankruptcy petition in October 2009
23 and the end of the 2009 tax year generated any net operating losses that may lead to some type of
24 proration of the refund to permit any payment to the Debtors. The Court is also unable to
25 resolve the Trustee's additional claims concerning a violation of the automatic stay or a lack of
26 cooperation by the Debtors with the Trustee at this time. The Court will set a status hearing on
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1 the remaining issues through a separate notice of the Court. The Trustee shall lodge an order, on
2 notice to the Debtors, that is consistent with this Memorandum Decision.

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4 DATED this 14th day of December, 2010.

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8 Honorable Sarah Sharer Curley
9 United States Bankruptcy Judge
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