

DEBTOR/CREDITOR

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IRS Setoff Trumps Bankruptcy Exemption

A federal appeals court in Richmond was recently asked to resolve a conflict between federal statutes regarding a tax refund. Debtors in a Chapter 13 case had overwithheld and were entitled to a tax refund. The debtors also owed the IRS for unpaid taxes from prior years in an amount which exceeded the amount of the refund. The debtors claimed the refund as exempt in their bankruptcy case. The IRS sought to set off the refund against the taxes owed from prior years.

The debtor relied on the provision of the bankruptcy statute which states: “property exempted under this section is not liable during or after the case for any debt....” The IRS relied on provisions of the tax law which permit the set off of refunds against pre-existing tax obligations. The court ruled that the IRS prevailed, because the bankruptcy statute itself elsewhere protects the setoff rights of a creditor.

Copley v. United States, 959 F.3d 118 (4th Cir. 2020)

Paved with Good Intentions

Both the bankruptcy statute and Maryland state law permit a bankruptcy trustee to reverse and recover prebankruptcy transfers made by a debtor with intent to hinder or delay creditors. These transfers may be undone even where the nondebtor transferee gave equivalent value in exchange for the transfer.

A Maryland bankruptcy judge has ruled that in the case of a transfer by a corporation, the intent of an officer acting within the scope of his duties will be imputed to the Corporation. Additionally, “intent is established if the [corporate officer] believes, appreciates, or knows with substantial certainty that creditors will be hindered, delayed, or defrauded as a natural consequence of the transfer, even if the actor’s actual motive is not to hinder, delay, or defraud

such creditors.” For example, an honest belief by the debtor’s officer that the transfers will save the corporate debtor and thereby benefit creditors is not sufficient to prevent a trustee from recovering the transfers.

Sher v. JPMorgan Chase Funding (In re Thornburg Mortgage, Inc.), 610 B.R. 807 (Bankr. D. Md. 2019).

Petitioning Creditors Sanctioned

Three creditors may file a petition requesting that a bankruptcy court put a debtor in bankruptcy involuntarily. However, the petitioning creditors are subject to sanctions if they filed the involuntary petition in bad faith.

Last year, a Maryland bankruptcy judge ruled that failure of the petitioning creditors to make any reasonable inquiry into the debtor’s financial condition or solvency prior to filing the involuntary petition constituted bad faith. The petitioning creditors’ claim that they believed the debtor was disposing of assets could not protect them from sanctions where they made no effort to investigate whether there was a reasonable basis for this belief.

In re Young Electrical Contractors, Inc., 67 Bankr. Ct. Dec. 55 (2019).

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This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation. Congress has required bankruptcy attorneys to state: “I am a debt relief agency. I help people file for bankruptcy relief under the Bankruptcy Code.” 11 U.S.C. § 528. If you wish to receive “Notes on Debtor/Creditor Relations”, go to www.jamesolsonattorney.com/newsletter.html and click on the link at the word “here”.

Prepared by James C. Olson, Attorney and Counselor at Law