

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF SOUTH DAKOTA  
Southern Division

In re:	)	Bankr. No. 87-40209
	)	Chapter 11
DAKOTA INDUSTRIES, INC.,	)	
	)	MEMORANDUM OF DECISION
Tax I.D. No. 46-0306951,	)	RE: PLAN TREATMENT OF
	)	THE IRS'S CLAIM
Debtor.	)	

The matter before the Court is an interpretation of the Court's prior orders and related documents<sup>1</sup> regarding the plan treatment of the Internal Revenue Service's claim. The matter was raised by the Debtor's motion to reopen the case, which was granted by Order entered November 8, 1996. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision and subsequent Order shall constitute the Court's findings and conclusions. As set forth below, the Court concludes that Debtor is obligated to pay \$255,004.92 in withholding taxes plus pre-petition and post-confirmation interest. The Court also concludes that no pre-petition, post-petition, or post-confirmation interest is owed on Debtor's pre-petition unemployment taxes of \$22,000.00.

I.

Dakota Industries, Inc., filed a Chapter 11 petition on July 22, 1980. A plan was confirmed on April 3, 1984. The confirmed plan set forth treatment for the claims of the Internal Revenue Service (IRS). The case was dismissed December 2, 1986 but the confirmed plan was never revoked.

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<sup>1</sup> The Hon. Peder K. Ecker, presiding.

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Dakota Industries (Debtor) filed a second Chapter 11 petition on April 3, 1987, just a few months after the first case was dismissed. On August 21, 1987, the IRS filed proofs of claims totaling \$546,279.36, which covered taxes from 1978 through 1986. The proof of claim did not recognize the earlier confirmed Chapter 11 plan as binding for the amount of taxes due for the years preceding the first petition.

Debtor filed a plan on August 6, 1987. The plan provided:

Class 2. Tax Priority Claims. This Class includes the unsecured claims of the governmental units to the extent that these claims are entitled to priority under Bankruptcy Code § 507(a)(7). There are three, (with the second claims being disputed as far as having priority), namely:

1. UNITED STATES OF AMERICA, INTERNAL REVENUE SERVICE for pre-petition withholding taxes to include penalties and interest in the total amount of \$192,170.80.

2. UNITED STATES OF AMERICA, UNEMPLOYMENT in the amount of \$19,489.78. This claim is disputed by Debtor as not being of priority status. Claimant has agreed to treatment of this claim as being in the unsecured/non-priority category. This portion of creditor's claim shall be considered a Class 4 claim.

Section III of the plan set forth the treatment for the IRS's claim for withholding taxes:

This claimant shall receive monthly payments of \$2,000.00 from the sixth month of the plan through the 24th month. \$4,000.00 per month from the 25th to the 36th month. \$6,000.00 per month from the 37th month to the 55th month. Any post-petition interest and penalties from date of petition to the date of confirmation of the plan is waived. Upon receipt of the 55th payment this claimant will release all liens of record against Debtor and its current and former officers. Payments shall be applied first to most delinquent taxes to comply with 11 U.S.C. § 1129(a)(9)(c).

Section III repeated the earlier provision for the treatment of Debtor's unemployment taxes: "This claim is disputed . . . [and] shall be considered a Class 4 claim." Class 4 contained three

separate payment categories: one for unsecured claims of less than \$1,000.00, another for unsecured claims of more than \$1,000.00, and a third for undersecured claims. Although the plan did not clearly designate into which of the three categories the IRS's unemployment tax claim fell, the paragraph's introductory sentence indicates that it was considered an unsecured claim over \$1,000.00. Treatment for that category was 10% of their claim without interest through annual payments for several years.

The IRS objected to Debtor's proposed plan on December 17, 1987 on the grounds that Debtor had undervalued its claims and had not correctly set forth the portions that were entitled to priority treatment. The IRS also objected that the plan did not appropriately provide for interest on its priority unsecured claim. Further, the IRS contested the plan's feasibility.

On December 29, 1987, Debtor filed an objection to the IRS's proof of claim. A hearing on the objection was noticed for March 1, 1988.

A confirmation hearing was held December 30, 1987 and resulted in a "conditional" confirmation of Debtor's plan. The confirmation order, entered February 23, 1988, stated:

11. That confirmation of the debtor's plan is subject to the following:

A) The proof of claim objection filed by the debtor against . . . the proof of claim filed by the U.S. Government by the IRS . . . which objections are to be heard March 1, 1988.

On February 25, 1988, the IRS responded to Debtor's objection to its proof of claim. The March 1, 1988 hearing was not held. On March 21, 1988, an order was entered continuing the hearing to May 12, 1988. The May 12, 1988 hearing also was not held. The United States Trustee's attempt in the fall of 1990 to get the matter resolved was thwarted by an order continuing the hearing on ten days' notice. On January 28, 1991, the IRS filed a motion to dismiss, which lead to the tax matter being put back on the calendar for May 23, 1991. The May 23, 1991 hearing was continued to June 7, 1991. Another hearing was set for July 16, 1991. That hearing was held! The Order following the hearing, which was entered July 18, 1991, provided:

After extensive discussions between the parties, it was agreed that there are no factual issues in dispute, agreed that the base tax amounts were \$22,000 for the 940's and \$220,000 for the 941's, and that there are three prime legal issues which will be briefed concerning: 1) trust funds allegedly offset by the Alcester State Bank; 2) the legal effect of a combined annual wage report discrepancy; and 3) interest.

The Order set up a briefing deadline and the parties were directed to file stipulated facts "concerning the tax matters[.]" The parties complied. On September 4, 1991, the Court entered a Memorandum Decision. The issues addressed therein varied a bit from the issues set forth in the July 18, 1991 Order.

In its Memorandum of Decision, the Court concluded that: (1) all of Debtor's delinquent taxes from 1978 to 1986 were still collectible because the applicable statute of limitation had been

effectively tolled by Debtor's two Chapter 11 cases; (2) the IRS's lack of activity in resolving Debtor's tax matters did not justify negating any interest and tax assessments; (3) all of the IRS's pre-petition claims were priority claims, that the post-petition claims were administrative expenses, and that the statutory interest rates applied; (4) the IRS did not carry its ultimate burden of persuasion under § 502(a) that it was entitled to a Combined Annual Wage Report (CAWR) tax adjustment; and (5) no decision on whether a bank had misappropriated Debtor's trust fund taxes would be entered because the bank was an indispensable party who had not been joined in the action.

The third issue in the Court's prior decision is at the heart of the matter now before the Court. In its September 4, 1991 Memorandum Decision, the Court specifically stated:

Dakota's 941 tax debt, a tax by which an employer must withhold income taxes from employees and tender such funds held in trust by the employer to the IRS, constitutes a priority tax under 11 U.S.C. § 507(a)(7)(C). Dakota's 940 tax liability, a tax measured by the gross income of employees, is a priority expense pursuant to 11 U.S.C. § 507(a)(7)(A). The IRS's entire tax claim falls within Section 507's priority scheme and includes pre- and post-petition taxes. Pre-petition priority expenses accrue interest up to the filing date. [Case cite omitted.] Post-petition administrative priority taxes normally accrue interest during the pendency of the bankruptcy. Post-petition tax claims and interest thereon are administrative expenses of the estate. 11 U.S.C. § 503(b)(1); [case cites omitted]. Interest unquestionably accrues on Dakota's tax debt. Dakota need tender to the IRS the amount required by law as interpreted and contracted to in Dakota's confirmed plan.

An Order following the Memorandum Decision was entered October 28, 1991. Therein, the Court ordered:

1. That the undisputed tax owed by the debtor for employee withholding is \$220,000.00 and \$22,000.00 for unemployment benefits;

2. That the debtor's objection to the Internal Revenue Services (IRS) proof of claim including the \$41,721.72 assessed by the Combined Annual Wages Report (CAWR) is upheld in that the debtor reputed the IRS' proof of claim prime facie validity; that the IRS did not tender any credible proof to support its CAWR tax assessment;

3. That the debtor's objection to the IRS' proof of claim including the \$35,004.92 removed from the IRS withholding tax trust account in the State Bank of Alcester by the bank's officers cannot be heard due to the fact that under Fed. R. Civ. P. 19(a) an indispensable party, the State Bank of Alcester, was not joined in the action, thus the IRS need not credit the amount to the debtor's account;

4. That the statute of limitations had not run on the taxes listed in the IRS' proof of claim;

5. That Section III, Class 2, Paragraph 2 of the confirmed Chapter 11 plan entitled United States unemployment shall be amended to state a tax amount of \$22,000.00 per the stipulated agreement;

6. That the debtor's payments to the IRS for withholding taxes listed in Section III, Class 2, Paragraph 2 of the debtor's Chapter 11 plan shall commence in January 1992;

7. That the interest owed on the \$220,000.00 plus the \$35,004.92 withholding tax must be recalculated based on the court's decision. That the interest so determined shall be paid under the plan provisions.

No appeal was taken from the Order. The IRS's motion to dismiss was denied. Debtor never proposed a formal modification of its confirmed plan to reflect the Court's October 28, 1991 Order and neither party recalculated the interest Debtor was to pay.

During early 1992 Debtor faced a motion to dismiss by the Small Business Administration. The IRS supported the motion in a response filed March 2, 1992. Therein, the IRS briefly stated that the Court's September 4, 1991 Memorandum Decision had

decided the issues raised by the debtor's objections to the claim of the United States for federal taxes. By Order dated October 28, 1991, the debtor was required to commence payments to the United States in accordance with the Court's decision by January 1992.

The IRS further stated that Debtor had not made any plan payments

on its pre-petition tax claim "even for the lesser amounts originally provided for in the . . . confirmed plan." The Small Business Administration's motion was later resolved by a stipulation between Debtor and the Small Business Administration. The IRS was not a party to the stipulation. An order approving the withdrawal of the SBA's motion to dismiss was entered March 11, 1992. A final decree was entered August 31, 1993 and was served only on Debtor, Debtor's counsel, and the United States Trustee.

On September 5, 1996, Debtor filed a motion asking that its 1987 case be reopened "in order for the Court to review the Plan and Orders to determine if interest can be charged by the IRS and if so, when the interest commenced." The IRS joined in the motion because it wanted the case reopened so that it could seek dismissal. By Memorandum of Decision entered November 8, 1996, the Court granted Debtor's motion but limited the purpose of the reopening to an interpretation of what the plan, confirmation order, and the October 28, 1991 Order and related Memorandum Decision provided regarding how interest on the IRS's claim was to be calculated and paid. The parties filed a stipulated record and issues and briefs. The parties' stipulated issues were:

Whether the Chapter 11 Plan confirmed April 3, 1984 precluded the IRS from assessing interest on taxes owed by the debtor prior to the July 22, 1980 filing date for Bankr. No. 480-00224 [Debtor's first case].

Whether confirmation of the Chapter 11 Plan in Bankr. No. 87-40209 [Debtor's present case] precluded the IRS from assessing interest on taxes owing prior to the April 3, 1987 filing date and

also after the February 23, 1988 order of confirmation.

How much does the debtor owe the IRS for taxes and interest involved in the 1980 and 1987 Chapter 11 bankruptcies.

## II.

As previously discussed in the Court's November 8, 1996 Memorandum of Decision regarding Debtor's motion to reopen, the window of opportunity to modify Debtor's plan has passed because the plan has been substantially consummated. 11 U.S.C. § 1127(b); *Metropolitan Life Insurance Co. v. Olsen (In re Olsen)*, 861 F.2d 188, 190 (8th Cir. 1988); and *United States v. Novak*, 86 B.R. 625 (D.S.D. 1988). Further, the time for revoking the confirmation order, as modified by the October 28, 1991 order regarding the IRS's claim and plan treatment, has expired. 11 U.S.C. § 1144. The bankruptcy estate has been dissolved or at least is without assets. *Harstad v. First American Bank*, 39 F.3d 898, 904 (8th Cir. 1994); *In re Pauling Auto Supply, Inc.*, 158 B.R. 789, 793 (Bankr. N.D. Iowa 1993); and *In re Winom Tool and Die, Inc.*, 173 B.R. 613, 625 (Bankr. E.D. Mich. 1994). Debtor and the IRS are back in the "real world." The Court can only interpret its prior orders. It is without jurisdiction at this stage to do more. Consequently, there is no need to consider the parties' first stipulated issue regarding the effect of the first confirmation order. Whatever IRS claim treatment the plan and confirmation order in the first case provided was novated by the plan confirmed in the second case and



the related post-confirmation order on October 28, 1991.

The next issue presented by the parties is whether confirmation of the Chapter 11 plan in Debtor's present case precluded the IRS from assessing interest on taxes owed before the April 3, 1987 filing date and also after the February 23, 1988 order of confirmation. We must look to the Court's final order on October 28, 1991 to resolve this question since the February 23, 1988 confirmation order was modified to the extent of any interest allowed under the Court's October 28, 1991 Order.

In addition to establishing the amount of base taxes owed, the October 28, 1991 Order also established that interest was to be paid on these pre-petition taxes, as further discussed below. As to taxes that accrued post-petition, however, the plan, the confirmation order, and the October 28, 1991 Order are silent. Therefore, any post-petition taxes were not discharged unless they fell under 11 U.S.C. § 1141(d)(1)(A), 502(i), and 507(a)(7)<sup>2</sup>. Under these Code sections, certain pre-petition taxes that become payable post-petition are treated as pre-petition taxes that are deemed discharged upon confirmation of a plan. However, all the taxes set forth on the IRS's proof of claim were payable pre-petition. None fell within the confines of § 1141(d)(1)(A). Moreover, Debtor's post-confirmation taxes are not within this

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<sup>2</sup> Section 507(a)(7) at the time this case was confirmed (1988) is now § 507(a)(8).

Court's jurisdiction to determine. *Holywell Corp. v. Smith*, 112 S.Ct. 1021, 1027-28 (1992). Therefore, the amount of any taxes, interest, or penalties that Debtor owes for quarters after the April 3, 1987 petition date will have to be determined elsewhere.

The Court acknowledges that Debtor and the IRS stipulated to the amount of base taxes due at a hearing on July 16, 1991, which was well after the April 3, 1987 petition date and also after the February 23, 1988 confirmation hearing date. However, the stipulation was in response to Debtor's objection to the IRS's proof of claim and the proof of claim was limited to pre-petition taxes. The Court can find no basis for attributing some of the stipulated base tax amounts to post-petition quarters.

The parties' third issue is how much does Debtor owe the IRS for taxes and interest involved in the 1980 and 1987 Chapter 11 bankruptcies. As discussed above, any tax payment provisions in the confirmed plan in the 1980 case were novated by the confirmation order in the second order. And the confirmed plan and confirmation order in the second case were subsequently modified by the 1991 Memorandum Decision and Order. Therefore, the final question is what taxes and interest does Debtor owe under the confirmed plan in the second case, as modified by the confirmation order on February 23, 1988, and as further modified by the Court's September 4, 1991 Memorandum Decision and October 28, 1991 Order. As the parties have acknowledged, that question is difficult to

answer.

*Withholding taxes.* Initially, Debtor proposed in the plan to pay pre-petition withholding taxes of \$192,170.80, which included penalties and interest, in monthly payments of \$2,000.00 from the sixth month of the plan through the 24th month; \$4,000.00 per month from the 25th to the 36th month, and \$6,000.00 per month from the 37th to the 55th month. Post-petition interest and penalties from the petition date to the confirmation date were waived. The IRS was to release its tax lien upon the 55th monthly payment. Payments were to be applied to the most delinquent taxes first to preserve the claims priority status under 11 U.S.C. § 1129(a)(9)(C).

The confirmation order left resolution of the IRS's claim to another day. When the "another day" came in 1991, the Court's Memorandum Decision entered September 4, 1991 stated the withholding taxes were a priority claim and that interest accrued on them until the date of filing. The Court further stated, "[Debtor] need tender to the IRS the amount required by law as interpreted and contracted to in Dakota's confirmed plan."

Initially, the Memorandum appears to have an internal conflict because it states interest is to be paid but that the amount to be paid is already set forth in Debtor's confirmed plan. Consistency can be found, however, in light of the earlier stipulation by the parties. At a preliminary hearing on July 17, 1991, counsel for

Debtor and counsel for the IRS agreed that the *base* withholding tax due was \$220,000.00 and that the base employment tax was \$22,000.00. The hearing transcript further indicates that the parties used the term "base tax" to mean the tax only, not any penalties or interest. At the July 17, 1991 hearing, Debtor also agreed to commence making monthly payment of \$2,000.00 as contemplated in the plan but agreed that the length of the repayment term would be adjusted to accommodate any interest to be paid on the \$220,000.00. Therefore, it appears that the Court concluded in the Memorandum that interest on the \$220,000.00 was owed and that the interest was to be paid by extending the payment terms already in the plan.

Most important, the Court's October 28, 1991 Order reflects this interpretation and, regardless, the language of the Order takes precedence over the language of the Memorandum Decision. *See, e.g., Eakin v. Continental Illinois National Bank and Trust Co. of Chicago*, 875 F.2d 114, 118 (7th Cir. 1989). The Order clearly provides that the withholding taxes are \$220,000.00 plus an additional \$35,004.92, that interest on this total must be recalculated based on the Court's decision, and that the base tax and recalculated interest must then be paid according to the plan provisions beginning January 1992.

The trouble, of course, is that the interest to be paid was never recalculated. Moreover, the \$255,004.92 base tax was not

allocated to any particular quarter of a year to aid in the calculation of interest.

The IRS's proposed method of calculating the interest due by allocating the taxes to a particular quarter based on the IRS's proof of claim is sound and will be adopted by the Court. However, some modifications are needed. First, the allocation should be based on withholding taxes of \$255,004.92, rather than \$220,000.00 used by the IRS. Second, the only proof of claim that the IRS timely filed was the one filed August 21, 1987, which is different than the AMENDMENT NO. 1 TO PROOF OF CLAIM that the IRS used in its initial calculation. The AMENDMENT was never formally filed as an amendment during the pendency on the case and cannot be accepted now under this limited reopening. Finally, the appropriate post-confirmation interest rate is not necessarily the statutory interest rate that the IRS would apply outside of bankruptcy. The post-confirmation interest applied to the IRS's claim must be the rate that on February 23, 1988, the confirmation date, would give the IRS the present value of its claim over the plan payment term, as provided by § 1129(a)(9)(C).

The Court will entertain a final interest calculation by the IRS on Debtor's pre-petition withholding taxes. The IRS should calculate the pre-petition interest by setting forth the statutory interest rate for each quarter, by using \$255,004.92 as the base withholding tax due, and by using the IRS's original proof of claim

to allocate the \$255,004.92 among the pre-petition quarters set forth on the proof of claim. The IRS should calculate post-confirmation interest by using an interest rate that meets the present value requirements of § 1129(a)(9)(C). The IRS must insure that no interest is charged between the petition date of April 3, 1987 and the confirmation date of February 23, 1988. There was no allowance for interest for that period in Debtor's plan or in the October 28, 1991 Order.

Debtor argues that because a formal modification of the confirmed plan was not made, only the original plan and confirmation order control the treatment of the IRS's claim. The Court disagrees. The Court's September 4, 1991 Memorandum Decision and October 28, 1991 Order clearly modified the plan and fulfilled the confirmation order's directive that the IRS's claim treatment would be determined later. Moreover, there is nothing in the 1991 Memorandum or Order that indicates the Court required a formal modification order. The Court only directed the parties to recalculate the interest.

*Unemployment taxes.* Debtor's plan stated Debtor owed \$19,489.78 in unemployment taxes. Debtor proposed to pay these taxes with the class of unsecured claim holders. The unsecured claim holders with claims over \$1,000.00 were slated to receive 10% of their claim without interest through about five annual, pro rated payments. The confirmation order stated the treatment of

this claim would be decided post-confirmation.

As discussed above, in the Court's September 4, 1991 Memorandum Decision, the Court stated the IRS's claim included both pre and post-petition claims, that pre-petition taxes accrue interest up to the filing date, and that post-petition taxes are an administrative expense that accrue interest "during the pendency of the bankruptcy." However, all the taxes listed on the IRS's proof of claim were assessed pre-petition. Nothing more is said in the Memorandum about interest on the unemployment taxes other than general statements that interest accrues and Debtor is to pay the IRS "the amount required by law as interpreted and contracted to in [Debtor's] confirmed plan." Therefore, the Court again must look to the controlling October 28, 1991 Order.

The Order, which the IRS drafted and from which neither party appealed, did not provide for any interest -- pre-petition, post-petition, or post-confirmation -- on Debtor's pre-petition unemployment taxes. The Order only states that the stipulated amount of \$22,000.00 is to be inserted into Section III, Class 2, Paragraph 2 of the confirmed plan. When that insertion is made, only the amount of the tax due is modified. According to the unmodified plan treatment provisions on page 3 of the plan, this claim is still treated as an unsecured claim on which Debtor has agreed to pay 10% without interest. Therefore, Debtor's obligation for pre-petition unemployment taxes of \$22,000.00 is satisfied when

Debtor pays 10% of the \$22,000.00. While this may not have been the Court's original intention, that is what the Order provides. The September 4, 1991 Memorandum Decision provides no help in arriving at a result that is more consistent with the allowance of interest on Debtor's withholding taxes.

The IRS shall recalculate the interest due on Debtor's withholding taxes as discussed above, file it with the Court, and serve a copy on Debtor's counsel. If Debtor is satisfied with the calculation, Debtor shall prepare a proposed order in compliance with this Memorandum of Decision. If Debtor is not satisfied with the calculation, Debtor shall submit an alternative calculation and the Court will enter an appropriate order.

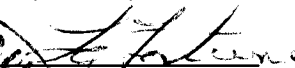
Dated this 28<sup>th</sup> day of April, 1997.

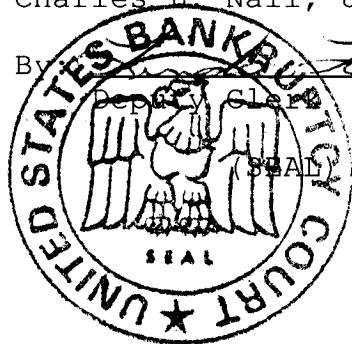
BY THE COURT:




Irvin N. Hoyt  
Chief Bankruptcy Judge

ATTEST:  
Charles L. Nail, Jr., Clerk

By: 



**CERTIFICATE OF SERVICE**  
I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties in interest identified on the attached service list.  
Charles L. Nail, Jr., Clerk  
U.S. Bankruptcy Court  
District of South Dakota

By:   
Date: 4-28-97

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**APR 28 1997**

Charles L. Nail, Jr., Clerk  
U.S. Bankruptcy Court  
District of South Dakota



Case: 87-40209 Form id: 122 Ntc Date: 04/28/97 Off: 4 Page : 1  
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\*\*\* ACTIVITY REPORT \*\*\*  
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