

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:)
)
THOMAS CARROLL TRACY) Bankr. Case No. 94-10099
Social Security No. [REDACTED]-9325) Bankr. Case No. 94-10100
Employer's Tax ID No.46-0415628) (Jointly Administered)
)
) Chapter 11
and)
)
THOMAS C. TRACY, INC.) MEMORANDUM OF DECISION RE:
Employer's Tax ID No.46-0415628) DEBTORS' MOTION FOR
) TURNOVER OF PROPERTY BY
) A CUSTODIAN
) Debtors.)

The matter before the Court is the Motion for Turnover of Property by Custodian filed by Debtor Thomas C. Tracy, Inc., and the response thereto by the Internal Revenue Service. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum and subsequent Order shall constitute findings and conclusions under F.R.Bankr.P. 7052. As stated more fully below, the Court concludes that Debtor's bank accounts on which the IRS filed a notice of levy are estate property subject to turnover.

I.

On January 26, 1994, the Internal Revenue Service (IRS) caused to be filed certain tax liens regarding the unpaid taxes of Thomas C. Tracy, Inc., with the Secretary of State for South Dakota, and the Register of Deeds in Roberts, Grant, and Marshall Counties of South Dakota. On or about June 13, 1994, the IRS prepared and served a Notice of Levy on First Federal Savings & Loan of Sisseton. The Notice stated taxpayer Thomas C. Tracy, Inc., owed taxes, interest, and penalties through June 13, 1994 of \$20,357.49 and it instructed First Federal to pay over to IRS certain funds that First Federal maintained in an account of Thomas C. Tracy,

Inc. A copy of the Notice was served on Thomas C. Tracy, Inc. Pursuant to 26 U.S.C. § 6332(c), the Notice stated the Bank must hold the money in Thomas C. Tracy, Inc.'s account for twenty-one calendar days before surrendering it to the IRS.

On June 29, 1994 Thomas C. Tracy, Inc., (Debtor) filed a Chapter 11 petition.¹ On August 8, 1994, Debtor filed a Motion for Turnover of Property by Custodian. Therein, Debtor argued that the account funds held by First Federal were estate property and it sought an order requiring First Federal to turnover those funds to Debtor under 11 U.S.C. § 543.

IRS objected to the Motion on the grounds that the funds held by First Federal effectively were levied by IRS pre-petition and thus were no longer property of the estate. The IRS premised its arguments on *In re Brown*, 126 B.R. 767 (Bankr. N.D. Ill. 1991), wherein the court held that a levy on cash or cash equivalent, where the funds are less than the amount of a debtor's unpaid tax liabilities, extinguishes the debtor's interest in the property and renders the funds immune from turnover.

A hearing on Debtor's Motion and the IRS objection was held September 20, 1994. The parties submitted the matter based on the facts set forth in their pleadings.

II.

Turnover. A custodian of estate property shall deliver it to the trustee or debtor in possession upon commencement of a

¹ The case was ordered to be jointly administered with the personal Chapter 11 case of Thomas Carroll Tracy on September 28, 1994.

bankruptcy case. 11 U.S.C. §§ 543(b)(1), 704(1), 1106(a)(1), and 1107(a). After notice and hearing, the Court may "protect all entities to which a custodian has become obligated with respect to such property[.]" 11 U.S.C. § 543(c)(1).

Tax Levy on Bank Deposits. Under 26 U.S.C. § 6332(c), a bank that receives a notice of levy shall not surrender any deposits to the IRS until twenty-one days after service. According to the legislative history, the subsection (c) was added to § 6332 to "provide taxpayers an opportunity to notify the IRS of errors with respect to garnshished accounts." H.R. IRS gets the interest that accumulates during the 21-day period, 26 U.S.C. § 6332(c), but is taxable income to the account holder. 26 C.F.R. § 301.6332-3(c)(2). Case law is split on whether a pre-petition IRS levy on cash or cash equivalent removes the cash from a bankruptcy estate. See *Metro Press, Inc. v. United States (In re Metro Press, Inc.)*, 139 B.R. 763, 764 (Bankr. D. Mass. 1992)(survey of cases cited therein).

III.

Upon consideration of the statutes and case law cited above, this Court concludes that the bank accounts on which the IRS filed a pre-petition levy are property of the estate subject to turnover. The Court is most persuaded by the reasoning in *Flynn's Speedy Printing, Inc. v. Southtrust Bank of Pinellas County (In re Flynn's Speedy Printing, Inc.)*, 136 B.R. 299, 301 (Bankr. M.D. Fla. 1992). In *Flynn's*, the court concluded that if the IRS is going to tax as income the interest earned during the twenty-one days that the bank

must hold the funds before surrendering them to the IRS, then the funds must still be owned by the debtor during that twenty-one day period. Here, Debtor filed his petition within the twenty-one day holding period. Therefore, Debtors were not divested of ownership and the funds constitute estate property. See also *Metro Press*, 139 B.R. at 764 (relying on *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983)); contra *In re Eisenbarger*, 160 B.R. 542 (Bankr. E.D. Va. 1993).

Although the bank funds are subject to turnover, the IRS is entitled to adequate protection for Debtors' use of them. 11 U.S.C. § 363(e); *West Aire, Inc. v. United States (In re West Aire, Inc.)*, 131 B.R. 871, 872 (Bankr. D. Nev. 1991); *In re Dunne Trucking Co.*, 32 B.R. 182 (Bankr. N.D. Iowa 1983). If the parties can reach an accord on adequate protection, they should submit an agreed order that complies with this Memorandum and that sets forth the adequate protection terms. If the parties cannot agree on adequate protection, they should so inform the Court by letter within fifteen days and a hearing will be set on that issue.

So ordered this ____ day of January, 1995.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy
(SEAL)