

In the United States Bankruptcy Court

for the Northern District of Iowa

Dennis Weymiller
Debtor(s).

Bankruptcy No. 94-20350-D
Chapter 7

RULING ON TRUSTEE'S FINAL REPORT

A telephonic hearing was held on January 23, 1998, pursuant to assignment. Present, by phone, were John Waters, Attorney for the Iowa Department of Revenue, and Trustee Eric Lam. The matter before the Court is Trustee's Final Report and objection thereto. After presentation of arguments, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) & (O).

FACTS AND PROCEDURAL HISTORY

Debtor Dennis Weymiller filed a voluntary Chapter 7 bankruptcy petition on March 8, 1994. Eric Lam was appointed Trustee. The Notice of Commencement of Case was mailed to all creditors and parties-in-interest on March 9, 1994. The Notice advised creditors not to file a proof of claim as there appeared to be no assets available from which payment could be made to unsecured creditors. The Iowa Department of Revenue (IDOR) received the Notice by mail.

Trustee held the meeting of creditors on April 25, 1994. On May 11, 1994, the clerk issued an Order Fixing Time for Filing Claims and Directing Notice. According to this Notice, claims were to be filed on or before August 9, 1994. The IDOR also received this Notice by mail. No one disputes that this Notice was issued and received.

Eric Lam filed his Trustee's Final Report on November 20, 1997. Trustee showed \$11,105.65 on hand for distribution. He proposed an allowance of \$5,233.51 for administrative claims. The balance of funds in the estate was to be distributed pro rata among ten nonpriority unsecured creditors representing \$188,103.15 in claims but not including any debt to the IDOR. Notice of Trustee's Final Report and accounting was mailed to all creditors and parties-in-interest, including the IDOR. The deadline for objections was set for December 10, 1997.

The IDOR had not filed a proof of claim prior to receiving the Notice of Trustee's Final Report. The IDOR objected to Trustee's Final Report on December 5, 1997. In its objection, the IDOR states that it issued a notice of assessment to Debtor on July 5, 1994 for a 1993 Iowa income tax liability. The IDOR argues that under 11 U.S.C. §726(a)(1), a priority claim is entitled to distribution if it is filed prior to the commencement of distribution to creditors.

Accompanying its objection, the IDOR filed a Proof of Claim in the amount of \$4,680 and an itemized statement to support its claim. The IDOR asserts that it did not file any claim until it received notice of Trustee's Final Report because of an inadvertent error by an accounting clerk. The IDOR requests that Trustee's Final Report be modified to allow its claim and grant it priority over other unsecured claims.

Trustee, however, argues that the IDOR's objection should be overruled because its claim was not timely filed. He seeks approval of the Final Report. Furthermore, Trustee asserts that the IDOR cannot prove its claim because it is unable to locate the Debtor's tax return. In response, the IDOR argues that this issue is not properly before the Court as Trustee has not filed an objection to the validity of the IDOR's claim.

CONCLUSIONS OF LAW

The issue before the Court is whether the Court should sustain the IDOR's objection to Trustee's Final Report or overrule the IDOR's objection and approve Trustee's Final Report. Although 11 U.S.C. §726(a)(1) was amended in 1994 to address tardily filed claims, the amendment did not become effective until October 22, 1994. This Chapter 7 bankruptcy petition was filed on March 8, 1994. Therefore, this case is governed by the unamended version of §726(a)(1), which states:

(a) Except as provided in section 510 of this title, property of the estate shall be distributed--

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title.

11 U.S.C. §726(a)(1) (1993) (amended 1994). Prior to the 1994 amendment, §507(a) provided for eight categories of priority status for claims. The category at issue here is subsection seven, which states in relevant part:

(a) The following expenses and claims have priority in the following order:

...

(7) Seventh, allowed unsecured claims of governmental units only to the extent that such claims are for--

(A) a tax on or measured by income or gross receipts--

(i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition.

11 U.S.C. §507(a)(7)(A)(i) (1993) (amended 1994).

The Code does not prescribe deadlines for the filing of a claim by a creditor, but rather the Rules of Procedure set the appropriate deadlines. See In re McLaughlin, 157 B.R. 873, 875 (Bankr. N.D. Iowa 1993). In Chapter 7 cases, the deadline for filing a creditor's claim is fixed pursuant to Rule 3002. In this case, the IDOR admits that it did not file a proof of claim by August 9, 1994, which was the deadline set by the Court pursuant to Rule 3002(c)(5). However, the IDOR asserts that its claim should still be entitled to priority distribution pursuant to 11 U.S.C. §726(a)(1).

"For cause shown," the court may enlarge certain time periods on a request made within the original time period. See Fed. R. Bankr. P. 9006(b)(1). However, if the request is made after the period has expired, the court must find, in addition to cause, that the failure to act within the required time period was "the result of excusable neglect." Id. The court's authority under Rule 9006(b)(1) to extend the time period to take various actions for excusable neglect does not govern late filings of proofs of claim in Chapter 7 cases. See Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. Partnership, 507 U.S. 380 (1993); see also In re Glenwood Med. Group, Ltd., 211 B.R. 282, 288 (Bankr. N.D. Ill. E.D. 1997); McLaughlin, 157 B.R. at 876. Instead, Rules 9006(b)(3) and 3002(c) set out the limits on the court's discretion regarding the timeliness of a proof of claim in Chapter 7. See McLaughlin, 157 B.R. at 876. These Rules do not include a provision that allows the court to enlarge certain time periods for a creditor's excusable neglect.

In a Chapter 7 case, a creditor's claim may be filed at any time. However, the Rules lead to a determination as to whether the claim is timely or tardily filed. See id. Although a filed claim may be disallowed by courts on various grounds, tardiness is not a ground for disallowance despite the implication of Rule 3002(a) that the claim must be filed in accordance with the Rule to be allowed. See id.; see also Glenwood Med. Group, 211 B.R. at 289 (stating that Rule 3002 "does not act as an absolute bar to exclude late filed claims").

In a Chapter 7 case, the timeliness of a creditor's claim may affect its priority in the distribution of assets. See McLaughlin, 157 B.R. at 876. However, "section 726(a)(1), concerning distribution of priority claims, makes no distinction between priority claims which are filed late and those which are filed in a timely manner." In re Century Boat Co., 986 F.2d 154, 157 (6th Cir. 1993) (citing United States v. Cardinal Mine Supply, Inc., 916 F.2d 1087, 1091 (6th

Cir. 1990)); see also McLaughlin, 157 B.R. at 876-78 (stressing that "§726(a)(1) makes no distinction in the order for payment [between] timely filed and tardily filed priority claims").

Section 726(a)(1) can be contrasted with §§726(a)(2) and (a)(3), which specifically address tardily filed claims. Section 726(a)(2) provides second tier distribution to tardily filed claims if the unsecured creditor did not have proper notice or actual knowledge of the case but was able to file in time to permit payment. See 11 U.S.C. §726(a)(2) (1993); see also In re

Vecchio, 20 F.3d 555, 557 (2d Cir. 1994) (contrasting §726(a)'s subsections). Section 726(a)(3) provides third tier distribution to tardily filed claims in which the unsecured creditor did or did not have proper notice but was unable to file in time to permit payment. See 11 U.S.C. §726(a)(3) (1993); see also Vecchio, 20 F.3d at 557. "The contrast in [these] three subsections' treatment of late and timely claims indicates Congress intended priority claims to receive first [tier] distribution regardless of whether proof of the claim was filed timely or late." In re Pacific Atlantic Trading Co., 33 F.3d 1064, 1067 (9th Cir. 1994); see also Vecchio, 20 F.3d at 557 ("The absence of a timeliness distinction in §726(a) (1) strongly suggests that this subsection encompasses all priority claims whenever filed.").

The Eighth Circuit has not squarely addressed the issue of tardily filed claims in a Chapter 7 case. Several other Circuit Courts, however, have addressed the issue of whether tardily filed claims should be paid as priority claims under §726(a)(1). See generally In re Davis, 81 F.3d 134 (11th Cir. 1996); Pacific Atlantic Trading Co., 33 F.3d at 1064; Vecchio, 20 F.3d at 555; Cardinal Mine, 916 F.2d at 1087. All of these courts have upheld priority status for claims specified in §507 without regard to the timeliness of filing. See Davis, 81 F.3d at 135; Pacific Atlantic Trading Co., 33 F.3d at 1067; Vecchio, 20 F.3d at 557; Cardinal Mine, 916 F.2d at 1091.

In Century Boat, the Sixth Circuit limited the Cardinal Mine holding to a case dealing with priority creditors who did not receive proper notice of the bankruptcy. See Century Boat Co., 986 F.2d at 158. However, other courts have held that "the force of [the Sixth Circuit's] interpretation of §726(a) applies to priority creditors with notice as well." Vecchio, 20 F.3d at 559-60; see also In re MacLochlan, 134 B.R. 2, 3-4 (Bankr. N.D. Ohio 1991).

Courts have examined the following four elements to determine whether the priority status of a tardily filed claim takes precedence over its untimeliness: (1) whether the creditor filed its proof of claim before the trustee made any distribution; (2) whether the bankruptcy court had closed the estate; (3) whether the creditor had exhibited any indicia of bad faith; and (4) whether there would be any undue prejudice to the creditors. See Century Boat Co., 986 F.2d at 158; In re Miller, 171 B.R. 163, 164-65 (Bankr. S.D. Fla. 1994); In re Brenner, 160 B.R. 302, 306 (Bankr. E.D. Mich. S.D. 1993). In this case, the IDOR filed its proof of claim before Trustee made any distribution; the Court has not yet closed the estate; and the IDOR did not exhibit any indicia of bad faith. Although the unsecured creditors might be prejudiced in the amount of dividend they receive from the bankruptcy estate if the IDOR's priority claim is accounted for in Trustee's Final Report, this is not the type of undue prejudice that would satisfy the fourth element. See, e.g., Miller, 171 B.R. at 165-66 (according priority status to a tardily filed claim did not unduly prejudice other creditors because no distributions were made to creditors during the case and the trustee's Final Report reflected that any distribution made to unsecured creditors would be de minimus). As this Court noted in McLaughlin, 157 B.R. at 877, "[a]t least until distribution is made, an unsecured priority creditor can tardily file its claim and still receive its priority distribution."

Furthermore, there are valid policy reasons to find that the statutory scheme stresses priority status over timeliness of filing.

Congress has chosen to place certain taxes in the privileged category. Congress has expressed itself that these claims are to be paid first. Since their priority is set in the statute, it is reasonable that that priority is more important than whether they were tardily filed....

Cardinal Mine, 916 F.2d at 1091. This Court finds that the Circuit Courts' analysis coupled with the elements considered in Century Boat, Miller, and Brenner furthers the distribution policy of the Code. This conclusion is strengthened by the 1994 amendment to §726(a)(1), which codifies the vast amount of caselaw on this issue by dictating that both timely filed and tardily filed claims of priority unsecured creditors receive first tier distribution. See 11 U.S.C. §726(a)(1) (1997). Accordingly, the IDOR's claim is entitled to priority distribution under §726(a)(1).

Trustee points out that this Court has cautioned creditors regarding the risks inherent in treating a Chapter 7 Final Report as a reminder to take action to establish their unsecured claims. See In re Ratka, 144 B.R. 94, 96 (Bankr. N.D. Iowa 1992). This cautionary language, however, does not apply to the case at issue. In Ratka, a creditor filed a motion to enlarge the time to object to the Final Report on the very same day this Court approved the report and authorized the trustee to disburse the funds. See id. at 95. The creditor argued that its attorney did not receive notice of the Report. See id. The record, however, was insufficient to rebut the presumption of receipt established by the clerk's certificate of service. See id. The creditor requested to be included in the distribution as a nonpriority unsecured creditor, asserting that its security interest was worthless.

Trustee's reliance on Ratka is misplaced. In this case, the IDOR was not seeking to enlarge the time to object to Trustee's Final Report, there had been no final distribution when the IDOR objected to Trustee's Final Report, and Trustee was not yet authorized to disburse the funds in accordance with the proposed distribution set forth in his Final Report. Furthermore, the IDOR has a priority unsecured claim and not a general unsecured claim like the creditor in Ratka had. Thus, Ratka's cautionary language regarding the inherent risk to a creditor who delays the establishment of its claim is inapplicable to this case.

Validity of the IDOR's Proof of Claim

Trustee asserts, in the alternative, that the IDOR cannot find the Debtor's tax return and, therefore, cannot prove the amount of its claim. Under 11 U.S.C. §502(a), a proof of claim filed in a bankruptcy proceeding is deemed allowed unless a party in interest objects. Rule 3007 requires that an objection to the allowance of a claim be in writing and filed with the Court. See Fed. R. Bankr. P. 3007. If such an objection is made, "the court, after notice and a hearing, shall determine the amount of such claim." 11 U.S.C. §502(b) (1993) (amended 1994).

According to Rule 3001(f), a proof of claim correctly filed "shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). An objecting party must produce evidence rebutting the claim or the claimant will prevail. See In re Gran, 964 F.2d 822, 827 (8th Cir. 1992); see also In re White, 168 B.R. 825, 829 (Bankr. D. Conn. 1994) (stating that the objecting party must produce evidence with probative force at least equal to that of the proof of claim itself). Legal memoranda and oral argument are insufficient to overcome the presumption of validity. See White, 168 B.R. at 830; see also In re All Am. of Ashburn, Inc., 156 B.R. 696, 703 (Bankr. N.D. Ga. 1993) (holding that a statement in a brief denying liability that is not supported by any evidence is insufficient to rebut the presumption of validity); In re Unimet Corp., 74 B.R. 156, 167 (Bankr. N.D. Ohio 1987) (stating that the bare allegation of a corporate officer is insufficient to rebut a prima facie valid proof of claim).

Because the IDOR's proof of claim was filed more than three years past the claims bar date, Trustee had no reason to object to the IDOR's claim until the Court resolved the issue of whether to allow the IDOR's tardily-filed priority unsecured claim. The Trustee's duties include examining proofs of claims and objecting to the allowance of any claim that is improper "if a purpose would be served." 11 U.S.C. §704(5)(1997). Obviously, no purpose was served by the Trustee objecting to this claim which was filed on December 5, 1997, until the Court resolved this issue.

Bankruptcy Rule 3007 contains no specific time period within which the Trustee must object to the allowance of a claim. Therefore, fundamental fairness requires that Trustee be given an opportunity to object to the IDOR's claim. To expedite the objection process, the Trustee shall have 14 days from the date of this Order within which to file an objection to the IDOR's claim. If Trustee chooses to file an objection to this proof of claim, the procedure shall be controlled by Bankruptcy Rule 3007. If no objection is filed within the 14 day period, the claim shall be considered final and the Trustee shall thereafter file an amended final report reflecting the IDOR's priority unsecured claim in the amount of \$4,680.

SUMMARY

In summary, in light of the caselaw and the 1994 statutory amendment to §726(a)(1), the proof of claim filed by the IDOR in this case shall be treated as a priority claim under 11 U.S.C.

§§ 507 and 726(a)(1). Trustee has 14 days to decide whether to object to the IDOR's Proof of Claim. If Trustee decides

to object to the IDOR's Proof of Claim, he must proceed in compliance with Bankruptcy Rule 3007. Trustee shall make no distribution to general unsecured creditors at this time.

WHEREFORE, the IDOR's objection to Trustee's Final Report is sustained.

FURTHER, Trustee has 14 days from the date of this Order to file an objection to the IDOR's Proof of Claim.

FURTHER, Trustee shall make no distribution to general unsecured creditors at this time.

SO ORDERED this 6th day of March, 1998.

Paul J. Kilburg
U.S. Bankruptcy Judge