

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

REJ FARM ENTERPRISES INC.

Debtor(s).

Bankruptcy No. 93-51776XS

Chapter 11

Contested No. 7231

Internal Revenue Service

Plaintiff(s)

Adversary No.

vs.

R. Eugene Janssen and Eunice Janssen, REJ Farm
Enterprises, Inc.

Defendant(s)

MOTIONS FOR RELIEF FROM STAY

The United States of America, on behalf of the Internal Revenue Service (IRS), seeks relief from the automatic stay to continue prepetition litigation against these debtors in the United States District Court for the Northern District of Iowa. The parties agree there are no disputed facts and that the motions may be decided on the motion papers and briefs. Oral argument on the motions was held March 20, 1998 in Sioux City. Joan Stentiford Ulmer appeared for the IRS. Steven R. Jensen appeared for Janssens and REJ Farm Enterprises, Inc. (REJ).

Eugene and Eunice Janssen filed their joint chapter 11 petition on October 28, 1993. REJ filed its chapter 11 petition the same day. Together Janssens own 97 per cent of the stock of REJ which they formed in 1983 as an Iowa corporation. Janssens transferred real estate and personalty to the corporation. The bankruptcy cases were precipitated by a dispute between the debtors and the IRS over taxes.

In December 1992, the IRS filed a civil action against Janssens and REJ in district court. Also named as defendants were creditors of Janssens holding interests in real property titled in the name of REJ. They are Metropolitan Life Insurance Co., Ronald Riser, and William and Elaine Creasey.

In its action, the IRS alleged that in February 1986, federal income taxes for 1980 and 1981 were assessed against Janssens in the sum of \$277,359.38. The IRS alleges it acquired tax liens against all of Janssens' property. The IRS contends that REJ is the "alter ego" of the Janssens "used by them to conceal their interests in the real and personal property...." (IRS brief, docket no. 99, attached Complaint). The IRS also contends that the transfers to the corporation were fraudulent (*Id.*).

In the civil action, the IRS asked the district court for seven remedies:

- (1) establishment of the amount of taxes for which the Janssens are liable;
- (2) a determination that the IRS tax liens are valid against Janssens' property, including the property

transferred to REJ;

(3) a determination that REJ is the alter ego of Janssens;

(4) a determination that the transfers of property by Janssens to REJ was fraudulent and the avoidance of the transfers;

(5) that its liens be foreclosed;

(6) that if the liens are insufficient to pay the taxes, the IRS have judgment against the Janssens; and

(7) costs and fees.

The Complaint named the third parties whom IRS believed claimed interests in the real estate transferred to REJ. The IRS now agrees that the interests of these third parties are prior to its claims and liens.

The dispute between Janssens and the IRS has been the primary occupation of these parties for the more than four years that these bankruptcy cases have been pending. Substantial energies have been devoted to a determination whether the Janssens could avoid the IRS lien against their stock in REJ. I said they could; the Bankruptcy Appellate Panel said they could not. The matter is now before the Circuit Court.

The IRS has filed a proof of claim in the Janssen case but not in the REJ case. The claims deadline in each case was March 3, 1994. In each case, debtors have filed a plan. Janssens treat IRS as having a secured claim against their stock in REJ and an unsecured claim. The corporation does not treat the IRS as a creditor. The parties agree that it is relevant to confirmation of Janssens' plan whether the assets of REJ are liable for the tax debt of the Janssens either under an alter ego theory or as a result of avoiding the transfers of property to REJ.

The IRS requests that it be permitted to continue with its litigation against REJ and Janssens in district court. The debtors resist the request saying that the IRS has failed to show cause for relief. There is no dispute that the IRS's action in the district court is stayed under 11 U.S.C. § 362(a).

The IRS contends that cause exists to modify the stay when there is pending litigation in another court that does not involve bankruptcy issues but which must be decided prior to the determination of other issues in bankruptcy court. As these issues must be tried, the IRS argues that concern for judicial economy favors granting relief. Debtors argue that the IRS has failed to show cause for relief. They say the IRS has failed to show that the harm to the IRS from the maintenance of the stay outweighs the harm to the debtors of the stay if modified. Also, they say that the IRS has failed to show probability of success in the district court.

Relief from the stay may be granted for cause. 11 U.S.C.

§ 362(d)(1). Cause is not defined. I find there is cause for granting relief to permit the IRS to proceed in the district court with the fraudulent conveyance claim, but that is all.

The Fraudulent Conveyance Claim

Under § 544(b) of the Code "[t]he trustee may avoid any transfer of an interest of the debtor in property ... that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502...." Section 544(b) permits the trustee to proceed under state law. In a chapter 11 case, the debtor has this avoidance power. 11 U.S.C. § 1107(a). The trustee or debtor must assert the rights of an unsecured creditor in existence at the time of filing the bankruptcy petition. Bumgardner v. Simms (In re Simco Mechanical, Inc.),

151 B.R. 978, 983 (Bankr. S.D. Fla. 1993). The IRS is an unsecured creditor in the Janssen case. But only the trustee may use the power. Once the transferor files bankruptcy, the creditor loses its standing to file the fraudulent conveyance action. Saline State Bank v. Mahloch, 834 F.2d 690, 694-95 (8th Cir. 1987); Emerson v. Maples (In re Mark Benskin & Co., Inc.), 161 B.R. 644, 655 (Bankr. W.D. Tenn. 1993).

The Janssens, as debtors, have not filed an adversary proceeding against REJ to avoid the 1983 transfer of their property to the corporation. The IRS has not sought to force the debtors to file such a suit, nor has it sought the appointment of a trustee to bring the action. These are possible solutions where the debtor fails to act. Saline State Bank v. Mahloch, 834 F.2d at 695. It seeks now to pursue the action itself by continuing its pending action in district court. Asking court permission to bring a § 544 action is also a remedy where the debtor fails to act. Id. The appropriate venue for filing such a suit is the bankruptcy court. However, it is now too late to file such a suit here. The trustee's or debtors' right to bring an avoidance action under § 544(b) expired two years after the filing of the case. 11 U.S.C. § 546(a)(1)(A). It expired in October 1995.

The only possibility for the pursuit of a fraudulent conveyance suit under § 544(b) is if the IRS, on behalf of the Janssen estate, may continue with the action it previously filed in the district court. It may be that the assertion in the civil action of the debtors' avoidance power by the IRS would relate back to the 1992 date of the filing of the complaint under Fed.R.Civ.P. 15(c). Allied Int'l, Inc. v. International Longshoremen's Ass'n., 814 F.2d 32, 35-36 (1st Cir. 1987), *cert. denied*, 108 S.Ct. 79 (1987).

Because this appears to be the only possibility for pursuit of the avoidance action, the estate would be prejudiced if the IRS could not proceed with the fraudulent conveyance claim in district court. I will, therefore, modify the stay to permit continuance of the action in district court.

Alter Ego Theory

The IRS asks also to continue pursuing its alter ego theory in district court. The IRS raised this theory as a defense in Janssens' adversary proceeding to avoid the IRS tax lien on their stock in REJ. What the IRS seeks is the ability to satisfy its claim against Janssens out of REJ assets. I struck it as a defense because REJ was not a party to the proceeding, and I considered it to be in the nature of a claim against REJ. My decision in this regard was affirmed by the Bankruptcy Appellate Panel. Janssen v. United States (In re Janssen), 213 B.R. 558, 565-67 (8th Cir. BAP 1997) (reversing on other grounds).

The IRS's claim under the alter ego theory is a claim against REJ. Its use of the alter ego theory satisfies the Code definition of a claim against REJ. 11 U.S.C. § 102(2) ("claim against the debtor" includes claim against property of the debtor.")

The doctrine of alter ego is an equitable remedy. Individuals may not hide behind the corporate form when that would "sanction a fraud or promote injustice." Benson v. Richardson, 537 N.W.2d 748, 761 (Iowa 1995); *see also*, In re Janssen, 213 B.R. at 565 n.10 (court may reject separate corporate entity "used as a subterfuge to defeat public convenience, to justify wrong, or to perpetrate a fraud") (quoting In re B.J. McAdams, Inc., 66 F.3d 931 (8th Cir. 1995)).

The IRS has not filed a claim in the REJ case. It is there that the alter ego claim would be determined. The IRS asks to proceed in district court to litigate a claim it could have filed in bankruptcy court but did not. As a result, the IRS has failed to show cause for relief from the stay to pursue the alter ego claim against REJ.

That is not to say that the IRS could not seek permission to file a timely claim against REJ in its bankruptcy case. Also, it might file a tardy claim. But it has done none of these. It is not in a position to try such a claim in district court.

If it were in a position to try the alter ego claim against REJ, it would promote judicial economy to have the issue heard with the fraudulent conveyance claim. But a common hearing is not in the total control of the bankruptcy court. If the IRS had a disputed claim in bankruptcy against REJ and, on behalf of the Janssen estate, a pending fraudulent conveyance claim against REJ in district court, it could seek to have them tried in the same venue by an appropriate motion in the district court to withdraw the alter ego claim from bankruptcy court, or it could seek removal of the fraudulent conveyance claim to bankruptcy so that it could be heard with the alter ego claim. What the IRS attempts to do and can do will depend on the law and what the IRS perceives as in its own best interests.

Remaining Remedies in the Civil Action

The IRS has failed to show cause for relief so that it can foreclose its liens and obtain judgment against the debtors in district court. Relief will not be granted to permit such actions.

IT IS ORDERED that the United States' motion for modification of the automatic stay is granted to permit the United States on behalf of the Internal Revenue Service to seek to proceed with the fraudulent conveyance claim pending against REJ and Janssens on behalf of the Janssen estate.

IT IS FURTHER ORDERED that relief from the stay for any other purpose is denied.

SO ORDERED THIS DAY OF MARCH 1998.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order by U.S. mail to Steven Jensen, Joan Ulmer, U.S. Attorney and U.S. Trustee.