(Cite as: 1992 WL 59029 (Bankr.D.Vt.))

In re C.M.R. ASSOCIATES, INC., Debtor.

No. 90-00590.

United States Bankruptcy Court. D. Vermont.

March 25, 1992.

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MEMORANDUM OF DECISION ON PREPETITION PAYMENTS BY DEBTOR TO IRS

FRANCIS G. CONRAD, Bankruptcy Judge.

***1** Debtor seeks, [FN1] postpetition, to recover one prepetition tax payment to the IRS as a preference, and to have two other prepetition payments reallocated to "trust fund" taxes. We deny Debtor the relief it seeks because (a) both reallocation and preference should have been put in issue by an adversary proceeding, not by motion; and, (b) Debtor has failed to prove facts justifying the relief sought.

Debtor paid $14,000 to IRS on March 16, 1990, to stave off the impending seizure of one of its corporate vehicles. As we understand the record, the money was paid because Debtor was afraid that IRS would take legal enforcement measures which would ultimately be successful. No such measures were actually taken in connection with this payment, which IRS split between Debtor's own unpaid employment taxes--$6,194.38, and accrued and assessed penalties and interest--$7,805.62. Debtor asks us to compel IRS to reallocate the entire $14,000 to payment of so-called "trust-fund" taxes. We sketched out the parameters of this area of federal tax law in In re Vermont Fiberglass, 76 BR 358 (Bkrtcy.D.Vt.1987).

"Trust Fund Taxes" are those taxes withheld by employers from employees' wages that are required to be held in trust for the United States Treasury pursuant to 26USC 57501. When making payments of wages to employees, 26 USC § 3402 requires employers to deduct and withhold income taxes. Liability for payment of the tax required to be deducted and withheld is placed upon the employer under 26 USC § 3403. An employee receives credit for the withheld taxes regardless of whether the employer actually remits the "Trust Fund Taxes" to the government.

If the employer fails to remit the taxes, then the government may look to a "responsible person" for the willful nonpayment for recourse. Congress has provided the IRS with a powerful tool for recourse to prevent a presumed loss to the Treasury, 26 USC § 6672. Section 6672 imposes personal liability upon ... one who has the power, duty, and control over the collection and remittance of "trust fund" taxes.

Id., at 360-61, rev'd on other grounds, 88 BR 41 (D.Vt.1987).

(Citations omitted).

The two other prepetition payments resulted from levies on Debtor's corporate bank accounts. The first levy produced $3,108.34 on July 18, 1990, and the second, on October 9, 1990, garnered $4,822.08. Both payments were applied to accrued and assessed penalties and interest.

Debtor filed its voluntary Chapter 11 Petition on November 11, 1990, just 32 days after the October 9 levy, and well within the § 547(b)(4)(A) preference period. The IRS' Proof of Claim, filed February 25, 1991, claims a total due of $54,852.98. About $24,000 is attributed to unpaid taxes, and the balance is for penalties and interest. To date, Debtor has not filed a Plan of Reorganization.

Debtor's request for relief is procedurally defective, as to both preference and reallocation, because it raises by motion issues which Fed.R.Bkrtcy.P. 7001 requires be determined in an adversary proceeding commenced by filing of a complaint. Fed.R.Bkrtcy.P. 7003. The preference issue involves an attempt # e to recover money or property," and thus falls within Fed.R.Bkrtcy.P. 7001(1). Reallocation fits under Rule 7001(2), because it requires that we "determine the validity, priority, or extent of [Debtor's] interest in property" in the possession of IRS. In addition, it is a request for equitable relief, which falls under Fed.R.Bkrtcy.P. 7001 (7).

***2** Adjudication of an issue brought on by motion which should have been raised by adversary proceeding can, in some circumstances, be grounds for reversal, entangling the parties in prolonged procedural skirmishing. See, e.g., In re Commercial Western Finance Corp., 761 F.2d 1329, 1336-38 (9th Cir.1985) (powerful tools given to trustee to recover certain forms of property for benefit of estate must be exercised in adversary proceeding, not upon motion to confirm Plan); In re McClain Airlines, Inc., 80 BR 175, 180 (Bkrtcy.D. Ariz.1987) ("(F)ailure to proceed by complaint when one is required is reversible error," but where adversary matter was raised as a defense to proceedings properly brought by motion, court had discretion to mandate adversary rules as necessary).

Our concern that the rules be followed, however, has more to do with results than with

concern for procedural niceties. [FN2] An adversary proceeding provides the mechanism for bringing before us the facts relevant to determining the issues raised. A consequence of Debtor's failure to follow proper procedure is a complete lack of any factual basis upon which to grant the relief requested.

(T)he traditional understanding [is] that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships. U.S. v. Energy Resources Co., 495 US 545, ---, 109 L.Ed.2d 580, 586, 110 S.Ct 2139, 2142 (1990). (Citations omitted.) That traditional understanding is reflected in and reinforced by specific provisions of the Bankruptcy Code. Section 1123(b)(5), for example,

grants the bankruptcy courts residual authority to approve reorganization plans including "any ... appropriate provision not inconsistent with the applicable provisions of this title." 11 USC § 1123(b)(5); see also § 1129. The Code also states that bankruptcy courts may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. § 105.

Energy Resources, supra, 495 U.S. at ---, 109 L.Ed.2d at 586, 110 S.Ct at 2142. Our broad, equitable authority includes the power to control how payments to the IRS are allocated.

(W)hether or not the payments are rightfully considered to be involuntary, the bankruptcy court has the authority to order the IRS to apply the payments to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan.

Id., 495 U.S. at 1 109 L.Ed.2d 585-86, 110 S.Ct at 2142-43.

Debtor asks us to stretch our authority past the point explicitly approved by the Supreme Court in Energy Resources. The tax payments at issue there were postpetition payments under a confirmed plan of reorganization. Whether our traditional and statutory equitable powers reach the reallocation of the prepetition payments here is an issue we decline to reach at this time in this proceeding, because Debtor has failed to make any preliminary showing justifying an equitable remedy. We have not been provided with any information about why reallocation "is necessary to the success of [its] reorganization plan, " id., or to some other appropriate bankruptcy purpose. Debtor's failure to provide us with any factual foundation makes it impossible for us to detemine where the equities lie. We refuse to exercise our broad equitable powers in the dark, because of the risk that we would be denying justice instead of doing justice. Moreover, we will require a solid factual footing before we attempt to apply traditional equitable concepts to new situations.

***3** Lack of a factual foundation also precludes relief on Debtor's preference claim. The applicable statute, 11 USC § 547(b), provides:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property-

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made-

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if-

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(c) such creditor received payment of such debt to the extent provided by the provisions of this title.

Each of these defining elements of a preference involves questions of fact which must be decided based upon evidence. Debtor bears the burden of proving that a transfer is avoidable, § 547(g), by a preponderance of the evidence. In re Kelton Motors, Inc., 130 BR 170, 176 (Bkrtcy.D.Vt.1991). Because Debtor has failed to prove its case, we will deny its motion.

Our decision to deny Debtor the relief sought is without prejudice, either as to the preference or the reallocation issue. Counsel for IRS is to submit an order.

> FN1. Our subject matter jurisdiction over this controversy arises under 28 USC § 1334 (b) and the "Standing Order of Referral of Cases to Bankruptcy Judges" of the United States District Court for the District of Vermont. This is a core matter under 28 USC § 157(b)(2)(A), (F), (K), and (O). This Memorandum of Decision constitutes findings of fact and conclusions of law under F.R.Civ.P. 52, as made applicable to this proceeding by Fed.R.Bkrtcy.P. 7052.

FN2. See, for example, In re Summit Ventures, 135 BR 483 (Bkrtcy.D.Vt.1991), which we decided on the undisputed facts, despite the parties' failure to properly raise the issues by commencing an adversary proceeding.

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