

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA  
Augusta Division

|                               |   |                        |
|-------------------------------|---|------------------------|
| IN RE:                        | ) | Chapter 11 Case        |
|                               | ) | Number <u>91-10468</u> |
| BURKE MANUFACTURING CO., INC. | ) |                        |
|                               | ) |                        |
| Debtor                        | ) |                        |
| _____                         | ) |                        |

**ORDER**

Before me is debtor Burke Manufacturing Company, Inc.'s Amended Application For Disbursement of \$36,376.67 from the sale of assets of debtor in accordance with a modified confirmed chapter 11 plan of liquidation. According to debtor's application, sufficient funds exist for priority payment of \$8,414.51 in garnished funds, debtor's approved but unpaid attorney fees of \$10,374.23 plus expenses of \$458.97, approved consultant fees of \$2,644.68, approved but unpaid accountant fees of \$1,500.00, and any amounts owed to the Bankruptcy Court Clerk or the United States Trustee. Debtor's amended application seeks to have the balance of any remaining funds distributed equally between the debts due the Internal Revenue Service ("IRS") for post-petition withholding taxes (at least \$20,000.00) and the Georgia Department of Revenue for withholding taxes (at least \$13,076.75) under 11 U.S.C. § 507 seventh priority.<sup>1</sup>

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<sup>1</sup>Debtor's original application was amended only in so far as to provide that the division of the remaining funds between the IRS

The United States Trustee (the "Trustee") objects to this proposed treatment contending that the tax claims are administrative expenses entitled to be paid pro rata with other administrative claims. Having heard and considered the evidence presented and arguments of counsel and having consulted applicable authorities, I enter the following order overruling the Trustee's objection.

At the time of its chapter 11 filing on March 12, 1991, debtor operated a sewing and cutting operation employing approximately 175 persons. In resolution of an objection to claim, the IRS filed an amended proof of claim on December 16, 1991 for prepetition withholding taxes, interest and penalties of \$254,052.37 representing an unsecured priority claim in the amount of \$230,424.86 and a general unsecured claim in the amount of \$23,627.51. The Georgia Department of Revenue filed a proof of claim on May 20, 1991 for prepetition withholding taxes, interest and penalties of \$70,830.52 representing an unsecured priority claim in the amount of \$57,867.85 and a general unsecured claim in the amount of \$12,962.67. After objection and pursuant to a consent order filed March 24, 1992, the claim of the Georgia Department of Revenue for prepetition taxes was allowed in the amount of \$33,285.72 to be classified and paid under the terms of class 4 of

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and the Georgia Department of Revenue was to be equal (pro rata) and to clarify that the claims were only entitled to seventh priority.

debtor's plan of reorganization<sup>2</sup> and the claim for interest and penalty was allowed in the amount of \$11,729.17 to be classified and paid under class 6 of debtor's plan of reorganization as a general unsecured claim.

On December 20, 1991, prior to confirmation of debtor's plan on March 30, 1992, the IRS filed a motion to dismiss based on debtor's late payments of postpetition withholding taxes. On February 14, 1992 I entered an order denying the motion and requiring debtor to bring current the withholding taxes due as of the date of hearing and to continue making timely payments.

A second motion to dismiss or in the alternative to allow a late administrative claim was filed by the IRS on August 17, 1992. The IRS alleged that subsequent to the February order debtor deposited sufficient funds to bring the withholding tax liability current, but did not pay the following deposit penalties, incurred as a result of late payment, on those taxes.

2nd quarter of 1991 - \$11,715.70  
3rd quarter of 1991 - \$10,338.78  
4th quarter of 1991 - \$10,028.83

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<sup>2</sup>Debtor's original confirmed plan of reorganization provided for two classes of administrative claims: Class 1 consisting of post-petition costs and expenses of administration as defined in the Code; Class 2 consisting of post-petition administrative expense claims incurred by the debtor-in-possession in the normal course of business. Class 3 consisted of all allowed § 507(a) priority claims except class 2 claims and Tax claims. Class 4 consisted of all allowed pre-petition tax claims. Class 4 claims were to be paid in full on the effective date of the plan or later, with a reservation of right to pay the claim pursuant to § 507(a)(7) and § 1129(a)(9)(c) over a period of six years after assessment with interest.

The IRS further alleged that debtor continued to make postconfirmation withholding payments late resulting in additional withholding deposit penalties for the first and second quarters of 1992 in the respective amounts of \$12,033.95 and approximately \$11,000.00. The IRS contended that all of those liabilities were administrative expenses except for the 1992 penalties.<sup>3</sup> Subsequently, at hearing on October 29, 1992 the motion to dismiss was withdrawn and, by order dated November 5, 1992, the IRS was granted leave to file an administrative expense claim to be classified under 11 U.S.C. § 507(a)(1) for taxes, penalties and interest arising postpetition and preconfirmation.<sup>4</sup> As of this date, the IRS has not filed any such claim.

On February 12, 1993 debtor moved to modify the plan to provide for a sale and liquidation of the corporation with distribution to be made as if the case were in chapter 7 and with debtor's attorney acting as distributing agent. Debtor's modified plan was confirmed March 31, 1993.

The Trustee objects to debtor's proposed disbursement claiming that postpetition withholding taxes are to be treated as administrative expenses. The Trustee's argument is based on Bankruptcy Code § 346(f), which provides:

The trustee shall withhold from any payment

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<sup>3</sup>The IRS also listed debtor as owing \$10,907.73 for 1991 Form 940 unemployment tax as an administrative expense.

<sup>4</sup>The November 5, 1992 order does not reference any claim for postconfirmation taxes, penalties or interest.

of claims for wages, salaries, commissions, dividends, interest, or other payments, or collect, any amount required to be withheld or collected under applicable State or local tax law, and shall pay such withheld or collected amount to the appropriate governmental unit at the time and in the manner required by such tax law, and with the same priority as the claims from which such amount withheld was paid.

The Trustee contends that this provision automatically grants administrative expense status to Federal and State postpetition withholding taxes and that 11 U.S.C. § 1129(a)(9) requires payment of such administrative expenses, including postpetition taxes, on the effective date of the plan.<sup>5</sup> The trustee further contends that if a liquidating plan is approved, any distribution must comply with the priority distribution set forth in § 726.<sup>6</sup>

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<sup>5</sup>The Trustee is incorrect in his contention that § 346(f) applies to Federal taxes. Although there are no published decisions interpreting this provision, the plain language of the statute references only the trustee's duty with regard to State or local taxes required to be collected or withheld. See 2 Collier on Bankruptcy ¶ 346.01 (L. King, 15th ed. 1994).

<sup>6</sup>11 U.S.C. § 726 provides in pertinent part:

(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 the order specified in, section 507 of this title[.]

11 U.S.C. § 507 provides in pertinent part:

(a) The following expenses and claims have priority in the following order:  
    (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28 [28 USC § 1911 et seq.].

The debtor relies on the case of United States v. Redmond, 36 B.R. 932 (D. Kan. 1984). In Redmond, the debtor was unable to successfully complete a confirmed chapter 11 plan and the case was converted to a chapter 7. The IRS filed administrative expense claims for unpaid employment and unemployment taxes required to be withheld for which the debtor became liable postconfirmation and preconversion. The chapter 7 trustee objected contending the claims were only entitled to sixth priority status under § 507(a).<sup>7</sup> In following the reasoning of the bankruptcy court, see In re Westholt Manufacturing, Inc., 20 B.R. 368 (Bankr. D. Kan. 1982), the district court concluded, based on legislative history, that § 503(b)(1)(b)<sup>8</sup>

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- . . .  
(7) Seventh allowed unsecured claims of governmental units, only to the extent that such claims are for-
- . . .  
(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity[.]

<sup>7</sup>Under the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-533, the sixth priority given to certain taxes was redesignated as seventh priority.

<sup>8</sup>11 U.S.C. § 503(b)(1) provides in pertinent part:

- (b) After notice and a hearing, there shall be allowed administrative expenses, . . . including-
  - (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case;
  - (B) any tax-
    - (i) incurred by the estate, except a tax of a kind specified in section 507(a)(7) of this title[.] (emphasis

did not per se preclude postpetition taxes, which were otherwise § 507(a)(6) [now (7)] taxes, incurred as an actual, necessary cost of preserving the estate from being given administrative expense priority. Redmond, at 934. Whether postpetition taxes were entitled to be promoted to administrative expense status, however, depends on whether they are incurred preconfirmation or postconfirmation. Id. The effect of confirmation on the priority given to such postpetition tax claims in a subsequent conversion of the case was explained as follows:

Unless a reorganization plan provides otherwise, confirmation vests all of the property of the estate in the debtor and releases it from all claims and interests of creditors. See 11 U.S.C. § 1141(b) & (c). The IRS, as well as other post-confirmation creditors of the reorganized debtor, are no longer restrained by the automatic stay in bankruptcy which terminates when the property of the estate vests in the reorganized debtor upon confirmation. See 11 U.S.C. § 362. Since the estate is no longer being administered by the trustee or debtor in possession, taxes which accrue post-confirmation are not incurred as actual, necessary costs and expenses of preserving the estate pursuant to section 503(b)(1)(B). Upon conversion of a Chapter 11 reorganization to a Chapter 7 liquidation, unpaid employment and unemployment taxes are treated the same as prepetition claims. See 11 U.S.C. § 348(d). Accordingly, they are entitled to a sixth priority under section 507(a)(6).

Id. Thus, under Redmond, only taxes incurred postpetition and preconfirmation may be entitled to administrative expense status; taxes incurred postconfirmation and preconversion are only entitled

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added).

to seventh priority status. Other courts considering this issue have followed the Redmond analysis with regard to postconfirmation taxes. See In re Hirsch-Franklin, Enterprises, Inc., 63 B.R. 864, 871-72 (Bankr. M.D. Ga. 1986); In re Patch Press, Inc., 71 B.R. 345, 347 (Bankr. W.D. Wis. 1987); see also In re Frank Meador Buick, Inc., 59 B.R. 787, 790-92 (Bankr. W.D. Va.) aff'd 65 B.R. 200 (W.D. Va. 1986) (rental payments); In re Roy Gooden Plumbing & Sewer Co., 156 B.R. 635, 637-38 (Bankr. E.D. Mo. 1993) (construction supplies).

I find the Redmond rationale persuasive and applicable in this case. Although this is a liquidating chapter 11 case, the postconfirmation modification of the plan effectively renders it equivalent to the postconfirmation converted case situation found in Redmond, especially as the plan calls for distribution to be made as if the case were in chapter 7. Finally, § 346(f) does not conflict with this decision. Section 346 places a burden on a trustee to pay withholding taxes as they become due. After confirmation in a chapter 11 case, however, as recognized by Redmond, the status of a trustee or debtor in possession no longer exists. Any obligation for payment of taxes at that point becomes that of the reorganized debtor. In accord with Redmond § 346 only requires a trustee to pay preconfirmation, not postconfirmation withholding taxes.

In this case, neither the IRS nor the Georgia Department of Revenue have filed a claim for withholding tax liability accruing postpetition and preconfirmation which would be entitled to

administrative expense status. The only filed claims by those parties relate to prepetition withholding tax claims not entitled to administrative expense status.

Therefore, it is hereby ORDERED that the objection of the United States Trustee to debtor's amended application for disbursement of funds is overruled. Distributions are ORDERED in accordance with the application of the debtor.

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JOHN S. DALIS  
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia  
this \_\_\_\_\_ day of May, 1994.