

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

RAE ORENE BAUER)	
CYRIL J. BAUER)	
)	Case No. 2-30738
Debtors)	Chapter 7
_____)	
MICHAEL J. IANNAcone,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 04-3099
)	
INTERNAL REVENUE SERVICE,)	
an agency of the UNITED STATES OF)	
AMERICA)	
Defendant.)	
_____)	

UNITED STATES' NOTICE AND MOTION FOR SUMMARY JUDGMENT

The United States moves that summary judgment be granted in its favor. A hearing on the government's motion is set for October 20, 2004 at 11:00 a.m. at the United States Bankruptcy Court, St. Paul, Minnesota, the Honorable Dennis D. O'Brien presiding.

This motion for summary judgment is based upon the pleadings, the records and files in this civil action, the Declaration of Gary E. Swenson and the memorandum of law in support of the United States' motion for summary judgment and the Exhibits attached thereto.

Respectfully submitted,

THOMAS B. HEFFELFINGER
United States Attorney

/s/Stephanie Page

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UNITED STATES BANKRUPTCY COURT
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RAE ORENE BAUER)	
CYRIL J. BAUER)	
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Debtors)	Chapter 7
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an agency of the UNITED STATES OF)	
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**UNITED STATES' MEMORANDUM OF LAW IN SUPPORT OF
MOTION FOR SUMMARY JUDGMENT**

The Chapter 7 Trustee filed this suit seeking to require the IRS to turn over funds transferred post-petition to it on behalf of debtor Cyril Bauer. Mr. Bauer withdrew \$176,232.28 post-petition from his Kemper IRA account and directed that \$33,440 be withheld and paid to the IRS for taxes related to the withdrawal. The IRS received and credited the \$33,440 towards Mr. Bauer's 2003 income tax liability. Because the IRS took the funds for value towards the tax liability of Mr. Bauer in good faith and was unaware of the voidability of the transfer to Mr. Bauer, it is not obligated to turn over the funds to the Trustee. Accordingly, the United States is entitled to summary judgment pursuant to Fed. R. Bankr. P. 7056 in the above entitled case.

ISSUE

Is the Chapter 7 Trustee entitled to recover \$33,440 from the IRS under 11 U.S.C. § 550?

STATEMENT OF UNDISPUTED FACTS

1. On February 20, 2002, debtors, Cyril J. Bauer and Rae Orene Bauer filed their Chapter 7 petition.¹
2. On the Chapter 7 filing date Mr. Bauer was the owner of an IRA account established with Kemper Insurance Company identified as account number KI11036745 (“IRA account”).
3. Although under Minnesota law an IRA can usually be claimed as an exempt asset,² in this particular case, the IRA account was found not to be an exempt asset,³ due to Mr. Bauer’s having fraudulently concealed the IRA account from the bankruptcy court. The Court issued an order dated October 3, 2003, finding that the IRA account was property of the estate and not exempt, and that Mr. Bauer had no interest in the IRA.⁴
4. Mr. Bauer withdrew a total of \$176,232.28 from the IRA account between November 8, 2002 and June 19, 2003.⁵
5. Additionally, Bauer directed Kemper to withhold and pay \$33,400 to the IRS for taxes

¹Adversary Complaint ¶ 3.

²*Clark v. Lindquist*, 683 N.W.2d 784 (Minn. 2004).

³Adversary Complaint ¶ 4 & 5. *See also* the Order dated October 3, 2003 which was attached to the Complaint as Exhibit A.

⁴*Id.*

⁵Adversary Complaint ¶ 6 & 7.

on the distribution.⁶ Kemper issued a 2003 Form 1099-R to Bauer which reflects a gross distribution of \$189,801.68 and federal taxes withheld of \$33,440.⁷ Additionally, Box 7 of the Form 1099-R reflects an early distribution.⁸

6. A third-party payor, such as Kemper Investors Life Insurance Co., throughout the calendar year deposits withheld taxes from clients' accounts with the IRS. The clients' withheld taxes are deposited with the IRS and into the third-party payor's account under its Employer Identification Number (EIN). A third-party payor issues Forms 1099-R to its clients by January 31 of the following year and to the IRS by March 1 of the following year reflecting the amount withheld and turned over to the IRS. The Forms 1099-R identify the taxpayer for whose benefit the taxes are withheld as well as the tax year and amount withheld.⁹

7. Only when the Forms 1099-R are filed are the funds identified to the IRS as withheld taxes of individual taxpayers. Upon receiving the Forms 1099-R the IRS inputs the information into the IRS computer data bank for later matching and verifying with the individual filed returns. At this point the IRS does not do any type of investigation into the taxpayers' accounts, it simply inputs the information from the Forms 1099-R. Further, at the time the information from the Forms 1099-R is loaded, there is no need to, and the IRS employee does not, access the individual accounts.¹⁰

⁶*Id.*

⁷*See* copy of Form 1099-R from Kemper attached hereto as Exhibit 1.

⁸*Id.*

⁹*See* Declaration of Gary E. Swenson at ¶ 4.

¹⁰*Id.* at ¶ 5.

8. The IRS receives millions of Forms 1099 from various institutions in the normal course of business in one tax year. Accordingly, any investigation as to the source of the funds or the status of a taxpayer would be unduly burdensome.¹¹

9. The third-party payor files its Forms 1099-R with the IRS Martinsburg Computing Center (MCC) which is located in Martinsburg, West Virginia.. Kemper timely filed the Forms by magnetic tape by March 1, 2004. There an IRS employee at MCC loaded the information from the Form 1099-R at issue in the IRS computer on June 15, 2004.¹²

10. Mr. Bauer's withheld taxes of \$33,440 were loaded on the IRS data bank on June 15, 2004. Presently the IRS is holding a credit of withheld taxes of \$33,440 in the name of Mr. Bauer relating to the IRA distribution in 2003 of \$189,801.68.¹³

11. Based on the IRS computer records of Mr. Bauer, he has not filed a 2003 income tax return as of this date. Accordingly, his 2003 tax liability cannot be determined at this time and the taxes withheld have not been matched and verified with his yet to be filed return. However, the IRS computer records show that Mr. Bauer requested an extension of time to file his 2003 return until August 2004. Additionally, wages of \$12,127 and withholding of \$800 was reported by Heaven Board Group, Inc. and wages of \$13 was reported by Qwest. Thus, wages of \$12,140, withholding of \$34,240 and a taxable distribution of \$189,901 have been reported for Bauer's 2003 tax year. Based on this information, Bauer's approximate tax liability for 2003 is \$52,141. This is based on the

¹¹*Id.* at ¶ 6.

¹²*Id.* at ¶ 7.

¹³*Id.* at ¶ 8.

reported items, single filing status, standard deductions, etc. Additionally there is a 10% penalty on the early withdrawal from the IRA account which amounts to \$18,980. Thus, Bauer's total 2003 liability is approximately \$71,121.¹⁴

12. Upon receipt of Bauer's 2003 tax return the IRS will match his tax liability and match and verify the withheld funds credited towards the liability and any overpayment will be refunded to taxpayer.¹⁵

13. The insolvency section of the IRS in St. Paul is notified of Minnesota bankruptcies where the IRS is a creditor. However, the IRS does not actively monitor every bankruptcy it gets notice of, only when an adversary is filed or some other unusual circumstance exist. This is partly due to the large number of Chapter 7 bankruptcies filed and an automated system that analyses and determines dischargeability.¹⁶

14. On February 22, 2002, the IRS received electronic notification of this case by the Bankruptcy Noticing Center (BNC). On August 8, 2002 the IRS received amended schedules. The next notice received was in July 2003 regarding a notice to file claims. Since the debtor did not have outstanding pre-petition taxes, a proof of claim was not filed and the case was administratively closed. On January 4, 2004 the IRS received notice that debtors' discharge was revoked.¹⁷

¹⁴*Id.* at ¶ 9. The income tax on the distribution alone based on the same parameters would be approximately \$48,054. Thus, the total tax due on the distribution alone is \$67,034 (\$48,054 plus \$18,980). *Id.*

¹⁵*Id.*

¹⁶*Id.* at ¶ 10.

¹⁷*Id.* at ¶ 11.

15. The IRS was not served with the Objection to the debtor's exemption, the Order denying debtor's exemption of the IRA account or the Trustee's adversary papers against Bauer and Kemper attempting to recover the IRA. It should be noted that the IRS receives numerous random bankruptcy pleadings. Thus, only pleadings relevant to the IRS are reviewed such as those where the IRS is a party. On February 19, 2004, the trustee notified the insolvency section by telephone of the issue related to Bauer's IRA account. However, as of that date, Kemper's Forms 1099-R were not due and there was nothing on the IRS computer reflecting any withholding due to the IRA distribution to Bauer.¹⁸

16. Normally the insolvency section does not monitor and is not concerned with post-petition taxes in Chapter 7 cases. The IRS routinely receives post-petition payments on post-petition tax liabilities and routinely applies them to the post-petition liabilities of debtors. In no circumstances does the IRS return or have a reason or obligation to not accept the post-petition payments. Although the IRS insolvency section did not receive the payment at issue here, if it had, there is nothing that would have alerted it to not accept the payment. Normally pension or retirement funds are either not property of the estate or exempt assets. Thus, the fact that this was a distribution from an IRA account would not have alerted the IRS to treat it differently from any other post-petition tax payment.¹⁹

LEGAL ARGUMENT

Section 549 of the Bankruptcy Code, empowers the trustee to avoid post-petition transfers which are not authorized by the Bankruptcy Code or by the Court. In turn, Section 550 determines

¹⁸*Id.* at ¶ 12

¹⁹*Id.* at ¶ 13.

from whom the avoidable transfer may be recovered. Under Section 550(a)(1) of the Bankruptcy Code, the trustee may seek recovery from Mr. Bauer. As an initial transferee of the funds, his liability is essentially unconditional. The liability of subsequent transferees, however, is not automatic. As Mr. Bauer's "immediate transferee," the IRS enjoys the protection afforded by § 550(b)(2). Section 550(b)(2) does not permit the trustee to recover from "subsequent transferees that take for value, in good faith, and without knowing that the transfer is avoidable, * * *."²⁰

A. The IRS is not an initial transferee under Section 550(a)(1)

The initial transferee under Bankruptcy Code § 550(a)(1) is one who first exercises dominion and control over the debtor's property.²¹ That person is clearly Bauer. Although Bauer had no legal right to make withdrawal from the IRA account, he nevertheless did so, and also directed Kemper to withhold and pay over to the IRS taxes on the distribution.²² Accordingly, Mr. Bauer was the "initial transferee" within the meaning of § 550(a)(1) and the IRS was an "immediate and mediate transferee" within the meaning of § 550(a)(2).

This view is supported by *In re C.F. Foods, LP*.²³ In *C.F. Foods* the trustee brought an action to avoid the tax payments made by the debtor-partnership on behalf of its partners. There David

²⁰*In re Auto-Pak, Inc.*, 73 B.R. at 54.

²¹*In re C. F. Foods, LP*, 265 B.R. 71, 81 (Bankr. E.D. Pa. 2001); *see also In re Reeves*, 65 F.3d 670 (8th Cir. 1995).

²²Although Bauer directed Kemper to withhold and payover the \$33,440 to the IRS from his distributions, in effect it is as if Bauer received the full amount of the distribution and then transferred the funds back to Kemper to transfer to the IRS. *See In re Kenitra, Inc.*, 53 B.R. 150, 151 (Bankr. D. Or. 1985).

²³*In re C. F. Foods, LP*, 265 B.R. 71 (Bankr. E.D. Pa. 2001).

Burry, a partner of debtor, transferred funds from debtor to the IRS for income tax payments on behalf of himself and another partner, Edward Stillman. The income tax payments were based on the debtor's sales figures as reported by David Burry, the vast majority of which were inflated and admittedly fraudulent (thus causing the taxes to be inflated). The trustee sought turnover of the tax paid by debtor through Burry to the IRS. The Court found that Burry was the initial transferee: as the general partner of the debtor, Burry took control of the debtor's funds and used them to satisfy his own tax liabilities (albeit based upon fraudulently reported income) for the benefit of himself and Stillman.²⁴ Further, at the time he made the payments to the IRS, the court found that Burry exercised dominion and control over the debtor's funds in a manner that earned him the status of an initial transferee.²⁵ The court then concluded that as Burry was an initial transferee, then the IRS could not be the initial transferee and was an immediate or mediate transferee.²⁶

Further support for this view is found in *In re Auto-Pak, Inc.*²⁷ In *Auto-Pak*, DeFranco, the owner of both the debtor Auto-Pak and a second company, Stern Chemical, Inc., exchanged a check drawn on Auto-Pak's account and payable to the IRS for a cashier's check payable to the IRS. DeFranco wrote on the cashier's check "Re: Stern Chemical 8309 Period." The IRS cashed the cashier's check and credited the payment to the account of Stern Chemical. Subsequently, Auto-Pak filed a voluntary petition for bankruptcy and the trustee brought an action to set aside the transfer as

²⁴*Id.* at 81.

²⁵*Id.*

²⁶*Id.*

²⁷ 73 B.R. 52 at 54 (D.D.C. 1987).

fraudulent under 11 U.S.C. § 548. The District Court, in holding that the IRS was not an initial transferee as that term is defined by §550(a)(1), stated that DeFranco, by his actions, "essentially took control of the funds underlying the cashier's check and negotiated them on behalf of Stern Chemical and to the benefit of the Internal Revenue Service. He thereby created at least one mediate transferee -- himself or Stern Chemical-- * * *.²⁸

In *In re Kenitra, Inc.*²⁹ the Court found that the IRS was not the initial transferee in facts similar to the case at bar. There debtor gave its employee, Hay, a bonus within one year of filing for bankruptcy. Debtor then withheld and turned over \$14,202 to the IRS which represented withholding tax on the bonus to Hay. The Trustee filed an action to set aside the payment of the bonus and related taxes as fraudulent conveyances under § 548. In finding that the IRS was not the initial transferee, the Court found that the source of the withholding payment was Hay, not the debtor and when viewed from that perspective, the IRS became the mediate or subsequent transferee under 11 U.S.C. § 550(a)(2).³⁰ Likewise, in the instant case the source of the tax payment was Bauer, the initial transferee.

In all these cases, as in the case at bar, the “wrongdoer” who took control of the funds thereby became the initial transferee.

²⁸*Id.*

²⁹53 B.R. 150 (Bankr. D. Or 1985).

³⁰*Id.* at 151.

B. The IRS, as a subsequent transferee, gave value in good faith without knowledge of the voidability of transfer

1. Value

As Bauer's transferee, the IRS gave value to Bauer when it credited his post-petition payment against his 2003 post-petition income tax liability. Kemper distributed \$189,801.68 to Bauer as an early distribution from his IRA account. Although Bauer has not filed his 2003 return as of this date, based on the information reported to the IRS, Bauer has a 2003 tax debt in excess of \$33,400. The early distribution penalty alone is \$18,980 (10% of \$189,801.68).³¹ Additionally, Bauer owes tax in the approximate amount of \$52,141. Value was clearly given to Bauer upon payment to the IRS.

2. Good Faith

In this case the IRS received a Form 1099-R and a corresponding withholding payment from Kemper in the ordinary course of business. The Bankruptcy Code does not define "good faith." However, the Senate and House reports are instructive as to its meaning.³² Both reports state that the purpose of including a good faith requirement for immediate and mediate transferees was "to prevent a transferee from whom the trustee could recover from transferring the recoverable property to an innocent transferee, and receiving a retransfer from him, that is 'washing' the transaction through an innocent third party."³³ Thus, Congress aimed the requirement of "good faith" at arrangements intended

³¹26 U.S.C. § 72(t); *Jones v. Comm.*, T.C. Memo 2000-219.

³²H.R. Rep. No. 95-595, 95th Cong., 1st Sess. at 379 ([1978] 5 U.S. Code Cong. & Ad. News at 5963); S. Rep. No. 95-989, 95th Cong., 1st Sess. at 90 ([1978] 5 U.S. Code Cong. & Ad. News at 5815-5816); *Bonded Financial Services, Inc.*, 838 F. 2d at 897.

³³*Id.*

to interpose intermediaries between the debtor and a "guilty transferee." There is no evidence that the IRS engineered the payment at issue in an attempt to defeat other creditors of the debtor, or that it gave insufficient consideration for the transfer, assisted in secreting property of the estate, or acted in any fashion without good faith in this matter. The IRS received the funds from Mr. Bauer in good faith.

3. Knowledge

The IRS received the withholding tax from Bauer in the ordinary course of business. It was withheld by Kemper and paid over to the IRS throughout 2003. There was nothing unusual in the payment that would have alerted the IRS to investigate the payment.

Knowledge, like good faith, is not defined in the Bankruptcy Code or its legislative history. It has been held, however, to mean more than constructive notice. As the Fourth Circuit explained in *Smith v. Mixon*,³⁴ –

[S]everal courts have noted when analyzing § 544 of the bankruptcy code, "[t]he term 'notice' may include either actual or constructive notice, while the term 'knowledge' includes only actual notice. That Congress selected the term 'knowledge' is significant." (*citations omitted*). We believe that this reasoning applies with equal force to § 550(b)(1) of the Code. (Emphasis added)³⁵

Accordingly, actual notice is necessary to impute knowledge on the IRS. And there is no suggestion in this case that the individual, or even the office in Martinsburg, West Virginia, that received the Form 1099-R and corresponding payment from Kemper would in the normal course be aware that the payment was voidable or even that Bauer was a debtor in bankruptcy. The IRS receives millions of dollars from thousands of third-party payors in the normal course each year. Forms 1099 are received

³⁴788 F. 2d at 232

³⁵*See also Bonded Financial Services*, 838 F.2d at 897-898.

and the information is loaded into the IRS computer. The withheld taxes are credited to the individual taxpayer's account according to the information reported to the IRS on the Forms 1099. The IRS does not investigate and should be under no duty to investigate the source of each payment or the status of each taxpayer. Such a duty would be a huge administrative burden and not realistic. This would require the IRS to investigate the source of funds of hundreds, if not thousands of taxpayers.³⁶ Further, even if a preexisting knowledge of the debtor's bankruptcy might exist, it is unreasonable to impute such knowledge on an institution-wide basis to an organization the size of the IRS.

The IRS insolvency section, the section of the IRS who is tasked with monitoring bankruptcies, did not have actual notice of the voidability of the transfer. The insolvency section routinely receives notices of bankruptcy filings, as it did in this case. However, the IRS does not monitor every bankruptcy and all pleadings filed in the bankruptcies, just those where the IRS is a party or which involves unusual circumstances. Here the IRS was not served with the Objection to the debtor's exemption, the Order denying debtor's exemption or the Trustee's adversary papers against Bauer and Kemper attempting to recover the IRA. The IRS insolvency section was not aware of the denial of the exempt status of the IRA account at issue until February 2004, one month prior to the filing of this adversary complaint.

The tax payment at issue was a post-petition payment towards a post-petition tax period. The IRS routinely receives post-petition payments on post-petition tax liabilities and routinely applies them to the post-petition liabilities of debtors. In no circumstances does the IRS return or have a reason or

³⁶See *In re Nordic Village, Inc.*, 915 F.2d 1049, 1064 (6th Cir. 1990) and citations therein.

obligation to not accept the post-petition payments. Although, the IRS insolvency section did not receive the payment at issue here, if it had, there is nothing that would have alerted the IRS to not accept the payment. Normally pension or retirement funds are either not estate property or are exempt assets in Minnesota. Thus, the fact that this was a tax on a distribution from an IRA would not have alerted the IRS to treat it differently from any other post-petition tax payment.

The payment at issue was simply a post-petition tax payment towards a post-petition liability made in the normal course. Under these circumstances nothing suggested to the IRS that the transfer at issue was voidable.

CONCLUSION

Because the IRS in the normal course of business received the payment from Bauer towards his tax debt in good faith and without notice of the voidable transfer, the IRS is not obligated to turnover the funds to the trustee. Accordingly, summary judgment should be awarded in the United States' favor and the trustee's complaint should be dismissed.

Respectfully submitted,

THOMAS B. HEFFELFINGER
United States Attorney

/s/Stephanie Page

STEPHANIE M. PAGE
Trial Attorney, Tax Division
U.S. Department of Justice
Post Office Box 7238
Ben Franklin Station
Washington, D.C. 20044
Telephone (202) 514-8219
Facsimile (202) 514-6770

DUPLICATE

CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code KEMPER INVESTORS LIFE INS CO 1600 MC CONNOR PARKWAY SCHAUMBURG IL 60196-6801		1 Gross distribution \$ 189801.68	OMB No. 1545-0119 2003	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.		
		2a Taxable amount \$ 189801.68	Form 1099-R			
PAYER'S Federal Identification number 36-3050975		RECIPIENT'S Identification number 394-52-6671	2b Taxable amount not determined <input type="checkbox"/>	Total distribution <input type="checkbox"/>	Copy C For Recipient's Records	
RECIPIENT'S name, street address, city, state, and ZIP code CYRIL J BAUER 1863 IGLEHART AVENUE ST. PAUL MN 55104		3 Capital gain (included in box 2a) \$	4 Federal income tax withheld \$ 33440.00	5 Employee contributions or insurance premiums \$		This information is being furnished to the Internal Revenue Service.
Account number (optional) 0007 K111036745		7 Distribution code(s) 1	IRA/SEP/SIMPLE <input checked="" type="checkbox"/>	6 Net unrealized appreciation in employer's securities \$	8 Other \$ %	
Questions regarding your tax form, please call toll-free (888) 477-9700, Customer Service.		9a Your percentage of total distribution %	9b Total employee contributions \$	10 State tax withheld \$		
		12 State distribution \$	13 Local tax withheld \$	14 Name of locality \$	15 Local distribution \$	

Form 1099-R

(Keep for your records.)

Department of the Treasury - Internal Revenue Service

DUPLICATE

CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code KEMPER INVESTORS LIFE INS CO 1600 MC CONNOR PARKWAY SCHAUMBURG IL 60196-6801		1 Gross distribution \$ 189801.68	OMB No. 1545-0119 2003	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.		
		2a Taxable amount \$ 189801.68	Form 1099-R			
PAYER'S Federal Identification number 36-3050975		RECIPIENT'S Identification number 394-52-6671	2b Taxable amount not determined <input type="checkbox"/>	Total distribution <input type="checkbox"/>	Copy 2 File this copy with your state, city, or local income tax return, when required.	
RECIPIENT'S name, street address, city, state, and ZIP code CYRIL J BAUER 1863 IGLEHART AVENUE ST. PAUL MN 55104		3 Capital gain (included in box 2a) \$	4 Federal income tax withheld \$ 33440.00	5 Employee contributions or insurance premiums \$		EXHIBIT
Account number (optional) 0007 K111036745		7 Distribution code(s) 1	IRA/SEP/SIMPLE <input checked="" type="checkbox"/>	6 Net unrealized appreciation in employer's securities \$	8 Other \$ %	
Questions regarding your tax form, please call toll-free (888) 477-9700, Customer Service.		9a Your percentage of total distribution %	9b Total employee contributions \$	10 State tax withheld \$		
		12 State distribution \$	13 Local tax withheld \$	14 Name of locality \$	15 Local distribution \$	

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TOTAL P.04

DUPLICATE

CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code KEMPER INVESTORS LIFE INS CO 1600 MC CONNOR PARKWAY SCHAUMBURG IL 60196-6801		1 Gross distribution 189801.68	OMB No. 1545-0119 2003 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
PAYER'S Federal identification number 36-3050975		2a Taxable amount 189801.68	2b Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>	
RECIPIENT'S identification number 394-52-6671		3 Capital gain (included in box 2a) \$	4 Federal income tax withheld 33440.00	Copy B Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.
RECIPIENT'S name, street address, city, state, and ZIP code CYRIL J BAUER 1863 IGLEHART AVENUE ST. PAUL MN 55104		5 Employee contributions or insurance premiums \$	6 Net unrealized appreciation in employer's securities \$	
Account number (optional) 0007 K111036745		7 Distribution code(s) 1	8 Other \$ %	This information is being furnished to the Internal Revenue Service.
Outcalls regarding your tax form, please call toll-free (888) 477-8700, Customer Service.		9a Your percentage of total distribution %	9b Total employee contributions \$	
		10 State tax withheld \$	11 State/Payer's state no. MN	12 State distribution \$
		13 Local tax withheld \$	14 Name of locality	15 Local distribution \$

Form 1099-R

Department of the Treasury - Internal Revenue Service

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

RAE ORENE BAUER)	
CYRIL J. BAUER)	
)	Case No. 2-30738
Debtors)	Chapter 7
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MICHAEL J. IANNAcone,)	
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Plaintiff,)	
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v.)	Adversary No. 04-3099
)	
INTERNAL REVENUE SERVICE,)	
an agency of the UNITED STATES OF)	
AMERICA)	
Defendant.)	
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DECLARATION OF GARY E. SWENSON
IN SUPPORT OF THE MOTION FOR SUMMARY JUDGMENT

I, Gary E. Swenson, hereby declare as follows:

1. I am an Revenue Officer/Advisor/Reviewer in the Insolvency Section of the Internal Revenue Service for the state of Minnesota.

2. As an Revenue Officer/Advisor/Reviewer, part of my duties are analyzing and verifying taxpayer accounts, researching and correcting individual master file account balances related to bankruptcy. Further, I monitor Chapter 7 bankruptcies filed in Minnesota which may involve adversary actions or other unusual circumstances. In such capacity, I am familiar with the IRS files related to the above-captioned case.

3. This Declaration is being executed in support of the United States' Motion for Summary Judgment.

4. A third-party payor, such as Kemper Investors Life Insurance Co., throughout the year deposits withheld taxes from clients' accounts with the IRS. The clients' withheld taxes are deposited into the third-party payor's account with the IRS under its Employer Identification Number (EIN). A third-party payor issues Forms 1099-R to its clients by January 31 of the following year and reports to the IRS by the following March 1 reflecting the amount withheld and turned over to the IRS. The Forms 1099-R identify the taxpayer for whose benefit the taxes are withheld as well as the tax year and amount withheld.

5. As stated above, initially the withheld taxes are deposited in the third-party payor's account with the IRS. But not until the Forms 1099-R are filed are the funds identified to the IRS as withheld taxes of individual taxpayers. Upon receipt of the Forms 1099-R the IRS inputs the information into the IRS computer data bank for later matching and verifying with the individual filed returns. At this point the IRS does not do any type of investigation into the taxpayers' accounts, it simply inputs the information from the Forms 1099-R. Further, at the time the information from the Forms 1099-R is loaded, there is no need to, and the IRS employee does not, access the individual accounts.

6. As can be imagined, the IRS receives millions of Forms 1099 from various institutions in the normal course of business in one tax year. Accordingly, any investigation as to the source of the funds or the status of a taxpayer would be unduly burdensome.

7. The third-party payor files its Forms 1099-R with the IRS Martinsburg Computing Center (MCC) which is located in Martinsburg, West Virginia. Kemper timely filed the Forms by magnetic tape by March 1, 2004. There an IRS employee at MCC loaded the information from the

Form 1099-R at issue in the IRS computer on June 15, 2004.

8. Mr. Bauer's withheld taxes of \$33,440 were loaded on the IRS data bank on June 15, 2004. Presently the IRS is holding a credit of withheld taxes of \$33,440 in the name of Mr. Bauer relating to the IRA distribution in 2003 of \$189,801.68.

9. Based on the IRS computer records of Mr. Bauer, he has not filed a 2003 income tax return as of this date. Accordingly, his 2003 tax liability cannot be determined at this time and the taxes withheld have not been matched and verified with his yet to be filed return. However, the IRS computer records show that Mr. Bauer requested an extension of time to file his 2003 return until August 2004. Additionally wages of \$12,127 and withholding of \$800 was reported by Heaven Board Group, Inc. and wages of \$13 was reported by Qwest. Thus, wages of \$12,140, withholding of \$34,240 and a taxable distribution of \$189,901 have been reported for Bauer's 2003 tax year. Based on this information, Bauer's approximate tax liability for 2003 is \$52,141. This is based on the reported items, single filing status, standard deductions, etc. Additionally there is a 10% penalty on the early withdrawal from the IRA account which amounts to \$18,980. Thus, Bauer's total 2003 liability is approximately \$71,121.³⁷ Upon receipt of Bauer's 2003 tax return the IRS will match his tax liability and match and verify the withheld funds credited towards the liability and any overpayment will be refunded to taxpayer.

10. The insolvency section of the IRS in St. Paul is notified of Minnesota bankruptcies

³⁷The income tax on the distribution alone based on the same parameters would be approximately \$48,054. Thus, the total tax due on the distribution alone is \$67,034 (\$48,054 plus \$18,980).

where the IRS is a creditor. However, the IRS does not actively monitor every bankruptcy it gets notice of, only when an adversary is filed or some other unusual circumstance exist. This is partly due to the large number of Chapter 7 bankruptcies filed and an automated system that analyses and determines dischargeability.

11. On February 22, 2002, the IRS received electronic notification of this case by the Bankruptcy Noticing Center (BNC). On August 8, 2002 the IRS received amended schedules. The next notice received was in July 2003 regarding a notice to file claims. Since the debtor did not have outstanding pre-petition taxes, a proof of claim was not filed and the case was administratively closed. On January 4, 2004 the IRS received notice that debtors' discharge was revoked.

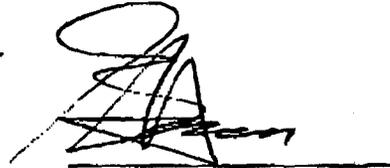
12. The IRS was not served with the Objection to the debtor's exemption, the Order denying debtor's exemption of the IRA account or the Trustee's adversary papers against Bauer and Kemper attempting to recover the IRA. It should be noted that the IRS receives numerous random bankruptcy pleadings. Thus, only pleadings relevant to the IRS are reviewed such as those where the IRS is a party. On February 19, 2004, the trustee notified me by telephone of the issue related to Bauer's IRA account. However, as of that date, Kemper's Forms 1099-R were not due and there was nothing on the IRS computer reflecting any withholding due to the IRA distribution to Bauer.

13. Normally the insolvency section does not monitor and is not concerned with post-petition taxes in Chapter 7 cases. The IRS routinely receives post-petition payments on post-petition tax liabilities and routinely applies them to the post-petition liabilities of debtors. In no circumstances does the IRS return or have a reason or obligation to not accept the post-petition payments. Although, the IRS insolvency section did not receive the payment at issue here, if it had, there is nothing that

was a distribution from an IRA account would not have alerted the IRS to treat it differently from any other post-petition tax payment.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Dated this 7th day of September, 2004.



GARY E. SWENSON

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

RAE ORENE BAUER)	
CYRIL J. BAUER)	
)	Case No. 2-30738
Debtors)	Chapter 7
_____)	
MICHAEL J. IANNAcone,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 04-3099
)	
INTERNAL REVENUE SERVICE,)	
an agency of the UNITED STATES OF)	
AMERICA)	
Defendant.)	
_____)	

ORDER

Upon motion of the United States and for good cause shown, it is hereby ORDERED, ADJUDGED and DECREED that the United States Motion for Summary Judgment is granted. Accordingly, plaintiff's complaint is dismissed.

Dated: _____

DENNIS D. O'BRIEN
UNITED STATES BANKRUPTCY JUDGE

APPROVED AS TO FORM:

/s/ Stephanie Page
STEPHANIE PAGE
Trial Attorney, Tax Division
U.S. Department of Justice
P.O. Box 7238, Ben Franklin Station
Washington, D.C. 20044
(202) 514-8219

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

RAE ORENE BAUER)	
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Debtors)	Chapter 7
_____)	
MICHAEL J. IANNAcone,)	
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Plaintiff,)	
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v.)	Adversary No. 04-3099
)	
INTERNAL REVENUE SERVICE,)	
an agency of the UNITED STATES OF)	
AMERICA)	
Defendant.)	
_____)	

CERTIFICATE OF SERVICE

I hereby certify that on September 7, 2004, I electronically filed the foregoing **UNITED STATES NOTICE OF MOTION FOR SUMMARY JUDGMENT, UNITED STATES' MOTION FOR SUMMARY JUDGMENT, MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT, DECLARATION OF GARY E. SWENSON IN SUPPORT OF THE UNITED STATES MOTION FOR SUMMARY JUDGMENT and (proposed) ORDER** with the Clerk of the Court using the CM/ECF system. I hereby certify that I have mailed by United States Postal Service the document to the following:

Michael J. Iannacone
Attorney for Trustee
8687 Eagle Point Blvd.
Lake Elmo, MN 55042

/s/ Stephanie Page
STEPHANIE M. PAGE