UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK
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IN RE:

JZMC ENTERPRISES, INC., CASE NO. 87-01269

Debtor
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APPEARANCES:

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STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT
CONCLUSIONS OF LAW AND ORDER

This matter came before the Court on the motion of JZMC Enterprises, Inc., d/b/a Seneca Outdoor Sports ("Debtor") for an order finding the Internal Revenue Service ("IRS") in civil contempt for the violation of the automatic stay imposed pursuant to §362(a) of the Bankruptcy Code, 11 U.S.C.A. §§101-1330 (West 1979 & Supp. 1988) ("Code") and for an award of punitive damages and attorneys' fees pursuant to Code §362(h). The initial oral argument was held in Utica, New York on January 25, 1988 and an evidentiary hearing for the taking of testimony was set down for

February 26, 1988. Thereafter, the IRS moved for summary judgment on February 10, 1988, which the Court denied after oral argument on February 22, 1988, and advised the parties that the previously scheduled evidentiary hearing would go forward.

Upon the filing of memoranda of law subsequent to the evidentiary hearing, which incorporated the legal memoranda submitted by both parties on behalf of the summary judgment motion, and the accompanying affidavits for the sole purpose of impeachment, the instant matter was submitted for decision March 11, 1988. While this matter was sub judice, the Debtor's case converted from a Chapter 11 to a Chapter 7 and was restored to the Court's pending docket June 28, 1988 after the appointed Trustee indicated his intention to proceed with the motion.

## FACTS

The Debtor filed a voluntary petition under Chapter 11 of the Code on September 10, 1987 and listed the IRS as holding a $4,500.00 claim. Shortly thereafter, the Clerk of the Bankruptcy Court notified the IRS of the Debtor's Chapter 11 filing pursuant to Fed.R.Bankr.P. 2002(j)(3). On October 2, 1987, the IRS filed a proof of claim in the amount of $12,820.66, including interest, for unpaid unemployment taxes for the tax period ending December 31, 1987 and for unpaid withholding taxes for the tax periods ending March 31, 1987, June 30, 1987, and September 30, 1987. On October 15, 1987 the Clerk mailed to the IRS, and to all creditors, the form Order setting the date for the meeting of

creditors to be held pursuant to Code §341, which included the fixing of times for filing dischargeability complaints and proofs of claim pursuant to Code §§523(c) and 501 and notice of the automatic stay triggered by the filing, pursuant to Code §362(a). In an amended Schedule A-1 filed November 9, 1987, the IRS was listed as holding an unliquidated priority claim in the amount of $12,820.66.

On the afternoon of November 5, 1987, Rosalie Scalise ("Scalise"), a Revenue Officer in the IRS' Collection Division at the Utica branch office, came to the Debtor's office and stayed for fifteen to twenty minutes. During this time, she questioned Debtor's President and sole officer, director and shareholder, H. Michael Claire ("Claire") about the Debtor's pre-petition taxes, business assets and operations. Eventually, Scalise spoke on the telephone to Debtor's attorney who asked her to stop her investigation and leave the premises. At this point, the parties' accounts diverge.

At the evidentiary hearing on February 26, 1988, the Debtor called Claire and then, as an adverse witness, Scalise. When the Debtor rested, the IRS moved for dismissal pursuant to Rule 41(b) of the Federal Rules of Civil Procedure ("Fed.R.Civ.P."), as incorporated by Fed.R.Bankr.P. 7041. The Court reserved decision and the IRS called Scalise, after which it renewed the Rule 41(b) motion.

ARGUMENTS

Claire testified that Scalise came uninvited to his office when he was alone, showed him her credentials and began to question him about the Debtor's tax returns and general tax information. He stated that he was unable to answer since his wife was more familiar with the records and the accounts, which his accountant was in possession of, and that he told Scalise that the corporation was in Chapter 11 and she should speak to its attorney. Claire further testified that Scalise told him he was liable for the corporation's taxes and that he may have to come down to the IRS office. He stated that he asked her to leave four or five times and then had her speak with his attorney over the telephone who also asked her to leave. Claire recalled that although Scalise didn't yell or scream, she appeared visibly angry at having to leave, slamming her papers together. On re-direct examination, he stated that there were a total of three telephone calls between himself and the Debtor's attorney.

On cross-examination, Claire admitted that the Debtor-in-possession had no accountant and that its prior accountant denied holding any corporate records. On re-cross examination, he conceded acknowledging in his affidavit, which accompanied the Debtor's papers opposing the IRS' motion for summary judgment, only two telephone calls and making no reference to four or five requests to leave.

The Debtor also maintains that Scalise hung up the telephone on its attorney and continued to seek information from Claire despite

his repeated requests to direct her inquiries to the Debtor's counsel. During direct examination as an adverse witness in the Debtor's main case, Scalise denied being asked to stop questioning Claire by Debtor's attorney and stated that she did not ask him any more questions after being asked to leave. The Debtor contends that throughout the interview she was "abusive and threatening. . .[,] caused alarm on the part of the debtor's President and others working on behalf of the debtor corporation and interrupted the normal business activities of the debtor." Motion For Issuance of Contempt Order, Award of Attorney's Fees And Imposition Of Punitive Damages Against The Internal Revenue Service For Violation Of U.S.C. 362(a), at para. 5 (Dec. 4, 1987).

The Debtor points out that Scalise's unannounced visit to its business premises, even if on invitation, did not authorize her to threaten or harass the Debtor and vitiated the automatic stay's "breathing spell." Response In Opposition To IRS Motion For Summary Judgment, at p.4 (Feb. 19, 1988). The Debtor argues that this constitutes a willful and blatant violation of the stay under Code §362(a)(1) and (6) and is violative of the Court's order informing the IRS of the stay triggered by the filing.

The Debtor maintains that it was not Congress' intent to exempt the IRS from restrictions placed on other creditors, id., and that the automatic stay provisions are an express waiver of the federal government's sovereign immunity. Affidavit In Support Of Debtor's Motion For Award Of Attorney's Fees Incurred In Prosecuting Contempt Motion Against The Internal Revenue Service,

para. 5 (Mar. 4, 1988). To that end, it requests an award of $1,560.33 in attorney's fees and expenses as a priority administrative expense. Id.

Scalise testified that the purpose of her investigation of the Debtor was to assess its tax liability. She stated that this required a full compliance check, which included determining if the taxpayer was up to date and ascertaining the liability of a responsible person, such as Claire, for the one hundred per cent penalty. Scalise testified that she was unable to interview Claire as to his potential penalty because he would not answer her. She stated that she never asked for the payment of taxes and only left certain forms with Claire. Scalise testified that after being asked to leave by the Debtor's attorney on the telephone, she gathered up her things, asked no further questions, left no more forms and was out of the office in five minutes. She denied raising her voice, calling him names or using foul language.

On cross-examination, Scalise stated that she hung up the telephone on the Debtor's attorney without saying goodbye. She admitted asking to see "records" and said that Claire neither asked nor told her to leave. Scalise perceived her duties with regard to the Debtor as to obtain verification of compliance and that under the applicable IRS procedures she was required to secure tax returns, if available, or to procure the information necessary thereto. She stated that if Claire had had such information she would have assisted him in preparing a tax return.

The IRS argues that its actions were required, not prohibited,

by law in that Scalise was not attempting to collect the Debtor's pre-petition taxes but was rather trying to 1) establish the Debtor's post-petition compliance with the internal revenue laws, 2) obtain the Debtor's corporate income tax return due May 1987, and 3) investigate and determine Claire's personal tax liabilities. Memorandum In Support Of United States Of America's Motion For Summary Judgment, at 3 (Feb. 8, 1988). It further asserts that the automatic stay only protects debtors and applies solely to pre-petition claims. Id. at 4. Finally, citing to 26 U.S.C.A. §§7601 and 7602 (West 1967 & Supp. 1988), the IRS contends that the stay does not prevent the determination of the Debtor's pre-petition tax liability in light of the Treasury's information gathering authority in furtherance of tax investigations. Id. at 5.

The IRS also asserted that the activities of securing tax returns or information necessary to complete them did not fall within any of the prohibited categories of Code §362(a). Post-Trial Memorandum Of The United States, at 1 (received and filed Mar. 11, 1988). It maintained that even if the automatic stay included its revenue officer's actions, said prohibition was "so vague and tenuous as applied to this situation as to make any finding of a willful violation wholly without support." Id. at 2. The IRS contended that the Debtor had failed to meet its burden of proof on willfulness and damages and noted the presumption of good faith and obedience of the law accompanying its revenue officer's "inherently credible" testimony. Id. at 2-3. It also asserts that punitive damages as authorized by Code §362(h) are

inappropriate here based on the facts of the case and for reasons of public policy and prohibited by the United States' express reservation of punitive damages arising out of tort claims pursuant to 28 U.S.C.A. §2674 (West 1965). While not contesting the reasonableness of the attorney fee application, the IRS states that the non-meritoriousness of the Debtor's motion on all fronts warrants a denial of said fees as well. Id. at 7.

## JURISDICTIONAL STATEMENT

The Court has jurisdiction of this core proceeding pursuant to 28 U.S.C.A. §§1334(b) and 157(a), (b)(1), (b)(2)(A), (B) and (O) (West Supp. 1988). The instant contested matter is governed by Rules 9014 and 7052 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.").

## ISSUE

Whether the automatic stay as authorized by Code §362(a)(1) and (6) operates to void the IRS' activities in connection with determining the pre and post-petition tax obligations of the Debtor and the potential "responsible person" tax liability of the Debtor's President for pre-petition periods, pursuant to 26 U.S.C.A. §6672 (West Supp. 1988), and entitles the Debtor to a finding of civil contempt and an award of attorney's fees and punitive damages?

DISCUSSION AND CONCLUSIONS OF LAW

Subject to certain enumerated exceptions, the automatic stay triggered by the filing of a petition under Code §§301, 302 and 303 acts to void any actions taken that affect the debtor or property of the estate. See Code §362(a), (b); Stringer v. Huet (In re Stringer), 847 F.2d 549, 552 (9th Cir. 1988); 48th Street Steakhouse, Inc. v. Rockefeller Group, Inc. (In re 48th Street Steakhouse, Inc.), 835 F.2d 427, 431 (2d Cir. 1987); 2 COLLIER ON BANKRUPTCY §362.04 (L. King 15th ed. 1988). The stay is "applicable to all entities", including governmental units. Code §§ 362(a), 101(14). Indeed, the structure and legislative history of Code §362 confirms that the stay is "an express waiver of sovereign immunity of the Federal government, and an assertion of the bankruptcy power over State governments under the Supremacy Clause notwithstanding a State's sovereign immunity." S.REP. NO. 598, 95th Cong., 2d. Sess. 51, reprinted in 1978 U.S.CODE CONG. & ADMIN. NEWS 5787, 5837 ("Senate Report"); H.R.Rep. No. 598, 95th Cong. 1st Sess. 342, reprinted in 1978 U.S.CODE CONG. & ADMIN. NEWS 5963, 6299 ("House Report"). See also, In re Memorial Hospital of Iowa County, Inc., 82 B.R. 478, 481 (W.D.Wis. 1988).

While generally directed toward pre-petition claims, the stay's broad applicability is not necessarily limited to such claims because activities linked to post-petition claims might also dilute the fundamental breathing spell afforded by the stay or

foment preferential creditor treatment, which it is designed to prevent. See, e.g., Code §362(a)(3); Senate Report at 49-51, 1978 U.S.CODE CONG. ADMIN. NEWS at 5835-5837; House Report at 340-342, 1978 U.S.CODE CONG & ADMIN. NEWS at 6296-6299.

> The automatic stay thus imposes a moratorium on all actions against the debtor or its property and assets. It ensures a respite for the debtor so that it may attempt to reorganize or decide to liquidate and promotes the overriding bankruptcy policy of equal distribution of a debtor's assets among creditors.

S.I. Acquisition, Inc. v. Eastway Delivery Serv. (In re S.I. Acquisition, Inc.), 817 F.2d 1142, 1146 (5th Cir. 1987) (citation omitted); see also Fidelity Mort. Investors v. Camelia Builders, Inc., 550 F.2d 47 (2d Cir.), cert. denied, 429 U.S. 1093 (1976), reh'g denied, 430 U.S. 1093 (1977).

Those who willfully violate the automatic stay face monetary sanctions, covering actual damages, costs, attorneys' fees and punitive damages pursuant to Code §362(h), and fines for civil contempt for violation of specific bankruptcy court orders can issue under Code §105. See, e.g., In re Newport Offshore, Ltd, 17 B.C.D. 1337 (Bankr.D.R.I. 1988) (and cases cited therein). But see In re Sequoia Auto Brokers, Ltd., 827 F.2d 1281 (9th Cir. 1987).

It is fairly well settled that, absent special or unusual circumstances, the automatic stay pursuant to Code §362(a) does not extend to non-debtors since to do so would weaken its potency and allow entities to reap the benefits of a bankruptcy

filing without shouldering the corresponding burden. See Ingersoll-Rand Financial Corp. v. Miller Mining Co., 817 F.2d 1424, 1427 (9th Cir. 1987); Teachers Ins. & Annuity Ass'n of America v. Butler, 803 F.2d 61, 65 (2d Cir. 1986). Such unusual circumstances have been where 1) the debtor is the real party in interest, 2) a non-debtor's interest in property is intertwined with that of the debtor's interest, 3) the litigation sought be enjoined would be binding on the debtor, 4) to not extend the stay would adversely impact upon the ability of the debtor to formulate a Chapter 11 plan or implement a confirmed plan, or 5) to not extend the stay would frustrate the purpose, intent and integrity of the Code. See A.H.Robins Co., v. Piccinin, 788 F.2d 994, 999-1006 (4th Cir.), cert. denied, ___ U.S. ___, 107 S.Ct. 251 (1986) (citations omitted). Thus, unless the bankruptcy estate would be adversely impacted by action taken against a non-debtor party, the stay may not be extended to non-debtors, even though the non-debtor may be personally or professionally related to the debtor. See In re 48th Street Steakhouse, Inc., supra, 835 F.2d at 431.

Statutory authority for extending the stay to non-debtors is found in Code §105. Upon application by a party who bears the burden of persuasion on the merits, Code § 105 empowers the bankruptcy court in its discretion to expand the stay to non-debtor entities after balancing the relevant interests. See In re S.I. Acquisition, Inc., supra, 817 F.2d at 1146 n.3; A.H. Robins., Inc. v. Piccinin, supra, 788 F.2d at 1002-1003; All Seasons Resorts, Inc. v. Milner (In re All Seasons Resorts, Inc.), 79 B.R. 901 (Bankr. C.D.Cal. 1987). Additionally, such a stay can

be granted pursuant to the "inherent power of courts under their general equity powers and in the efficient management of the[ir] dockets." In re S.I. Acquisition, Inc., supra, 817 F.2d at 1146 n.3 (quoting Williford v. Armstrong World Ind., Inc., 7l5 F.2d 124, 127 (4th cir. l983)).

Similarly, in a tax context, the Second Circuit has recently held that Code §505, which authorizes the bankruptcy court to determine tax liability, does not extend to non-debtors, rejecting a literal interpretation of the statute. See Brandt-Airflex Corp. v. Long Island Trust Co, N.A. (In re Brandt-Airflex Corp.), 843 F.2d 90 (2d Cir. 1988) (citing with approval, inter alia, United States v. Huckabee Auto Co., 783 F.2d 1546 (11th Cir. 1986)). The Huckabee court further noted that "[i]t is therefore irrelevant that the penalty, if assessed will adversely affect the corporate debtor's reorganization. See United States v. Huckabee, supra, 783 F.2d at 1549. See also LaSalle Rolling Mills, Inc. v. United States (In re La Salle Rolling Mills, Inc.), 832 F.2d 390 (7th Cir. 1987) (bankruptcy court cannot enjoin collection of tax from principal shareholders of Chapter 11 debtor); A To Z Welding & Mfg. Co., Inc. v. United States of America, 803 F.2d 932 (8th Cir. 1986) (same); Book v. Internal Revenue Service (In re Book), 87 B.R. 55 (Bankr. C.D.Ill. 1988) (bankruptcy court cannot enjoin collection of tax from Chapter 13 debtor's ex-wife). Thus, the IRS is free to investigate and determine the potential "responsible person" liability Claire may have pursuant to 26 U.S.C.A. §6672. See In re Brandt-Airflex Corp., supra, 843 F.2d

at 95-96.[1]

The remaining issue before the Court concerns Scalise's visit with regard to her compliance check of the Debtor's pre and post-petition tax liabilities.

It is uncontested that Scalise spent no more than twenty minutes at the Debtor's office inquiring about its pre and post-petition taxes and the testimony disclosed her questioning to be fruitless. This can by no means be construed as the kind of commencement or continuation of an action or proceeding against the Debtor within the meaning of Code §362(a)(1). Furthermore, the record does not disclose any actual damage as a result of her visit beyond Claire's and the Debtor's unsupported allegations that business was disrupted.

Moreover, even assuming her appearance temporarily interrupted the Debtor's business day, the record does not support a finding that it was of the duration or intensity to compromise the Debtor's "breathing spell" provided by the automatic stay under the Code. Additionally, the Court is persuaded by Scalise's uncontroverted testimony that she did not try to obtain the payment of any pre or post-petition tax and thus concludes that

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[1] The Court also notes that no unusual circumstances exist to warrant the extension of the Code §362(a) stay to Claire, e.g. any potential threat to reorganization presented by the alleged disruptive impact of Scalise's visit has been rendered moot by virtue of the case's conversion to Chapter 7 on May 20, 1988 and the trustee's displacement of the Debtor's officers, including Claire, in directing the liquidation. Furthermore, the Debtor never applied to extend the stay to Claire under Code §105. Finally, the Court does not find this to be an appropriate situation to invoke its inherent equity powers and extend the stay to Claire nunc pro tunc.

her visit also did not amount to an act to obtain possession of, or exercise control over, property of the estate, as prohibited by Code §362(a)(3). While not dispositive, the fact that Claire, as the representative of the alleged "victim" Debtor, appears to be an experienced businessman, goes far to alleviate the Court's concern for debtors who may be taken advantage of by sophisticated creditors like the IRS.[2]

The Court is of the belief that the IRS' actions through its agent, albeit brief, fell within the broad ambit of Code §362(a)(6) and constituted a first step toward collecting, assessing and recovering the Debtor's pre-petition tax liability, as prohibited by Code §362(a)(6).[3] However, inasmuch as the purpose of Scalise's visit with regard to the Debtor is questionable given the IRS' timely filing of a proof of claim, the evidence presented does not demonstrate the willfulness necessary to prevail under Code §362(h). Scalise's purported discourtesy alone, while perhaps disagreeable, does not approach the flagrant disregard or arrogant defiance of the Code that characterizes willfulness. See Tel-A-Communications Consultants, Inc. v. Auto-

[2] A different result might have been mandated had the facts been otherwise; such as if, for example, the IRS filed liens post-petition, see, e.g., In re Santa Rosa Truck Stop, Inc., 74 B.R. 641 (Bankr. N.D.Fla. 1987), or if an IRS agent dropped in unannounced and uninvited to a farmhouse and confronted the farmer-debtor, an easily intimidated man, with minimal schooling, about not filing income tax for years past.

[3] As the IRS chose not to defend its actions as falling under the automatic stay exception of Code §362(b)(9) - the issuance of a notice of tax deficiency, the Court will not raise it sua sponte.

Use (In re Tel-A-Communications Consultants, Inc.), 50 B.R. 250, 255 (Bankr. D.Conn. 1985); Nash Phillips/Copus, Inc. v. El Paso Floor, Inc. (In re Nash Phillips/Copus, Inc.), 78 B.R. 798, 803 (Bankr. W.D.Tex. 1987). See, e.g., In re Elegant Concepts, Ltd., 67 B.R. 914 (Bankr. E.D.N.Y. 1986). The lack of actual damages pleaded and proven also supports this conclusion. Not all automatic stay violations trigger the Code §362(h) sanctions. See Aponte v. Aungst (In re Aponte), 82 B.R. 738, 742 (Bankr. E.D.Pa. 1988).

Moreover, assuming without deciding that it has such powers, the Court does not find an order of civil contempt to be available against the IRS due to the absence of a truly specific bankruptcy court order from which the issue of compliance would arise. See Fidelity Mort. Investors v. Camelia Builders, Inc., supra, 550 F.2d at 51; Wagner v. Ivory (In re Wagner), 74 B.R. 898, 902 (Bankr. E.D.Pa. 1987). The "form" Order mailed October 15, 1987 by the Clerk does not constitute the kind of order necessary to invoke a contempt.[4]

Accordingly, it is hereby

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[4] Based upon the conclusions reached herein, the Court need not reach the issue of whether or not 28 U.S.C.A. §2674 prohibits the assessment of punitive damages against the IRS for what it characterizes as a statutory tort and the related status of the United States' sovereign immunity.

Similarly, the Court need not address the efficacy of the IRS' information gathering powers pursuant to 26 U.S.C.A. §§7601 and 7602 within the instant bankruptcy proceeding. In passing, the Court notes that United States v. Cadalso, 51 AFTR 2d 1079 (N.D.N.Y. 1982), relied upon by the IRS, pre-dates the adoption of the nationwide bankruptcy rules, pursuant to 28 U.S.C.A. §2075, which were effective August 1, 1983 and contained analogous procedures for the gathering of information. See Fed.R.Bankr.P. 2004, 2005.

ORDERED

1. That Debtor's motion for an order of contempt and an award of punitive damages and attorneys fees is denied.[5]

Dated at Utica, New York

this day of September l988

STEPHEN D. GERLING
U.S. Bankruptcy Judge

[5] By virtue of this result, the Court has, in effect, granted the IRS' motion to dismiss under Fed.R.Bankr.P. 7041 which it had reserved on at the close of both the Debtor's and the IRS' case.