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**FILED**

OCT 05 2011

United States Bankruptcy Court  
San Jose, California  
UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re ] Case No. 08-53283-ASW  
BYRON JHA, ]  
Debtor. ]  
Chapter 13 ]

**MEMORANDUM DECISION RE MOTION FOR DAMAGES FOR VIOLATION OF THE AUTOMATIC STAY**

Before the Court is the motion ("Motion") by debtor Byron Jha ("Debtor") for damages against the United States of America, Internal Revenue Service ("IRS"), for violation of the automatic stay. The IRS concedes that the IRS violated the automatic stay by sending nine Notice of Intent to Levy letters to Debtor post-petition. Debtor also seeks a determination that the IRS violated the automatic stay by not revising the amount of withholdings from Debtor's post-petition wages that were subject to a letter sent by the IRS pre-petition to Debtor's employer setting the amount of taxes to be withheld from Debtor's wages. The IRS opposes that aspect of the Motion as well as Debtor's damages.

The Court heard lengthy oral argument on the Motion and the matter was taken under submission upon the filing of supplemental

1 pleadings by the IRS. Debtor is represented by Cathleen Cooper  
2 Moran, Esq. of Moran Law Group, Inc. Special Assistant United  
3 States Attorney Chong S. Hong, Esq. represents the IRS.

4 This Memorandum Decision constitutes the Court's findings of  
5 fact and conclusions of law, pursuant to Rule 7052 of the Federal  
6 Rules of Bankruptcy Procedure.

7  
8 I.

9 FACTS

10 Pre-petition, on or about August 3, 2007, Debtor provided a  
11 Form W-4 Employee's Withholding Allowance Certificate ("Withholding  
12 Request") to Debtor's employer requesting that Debtor's federal  
13 income tax withholding be based on single status with 5 withholding  
14 allowances.<sup>1</sup>

15 On April 17, 2008, the IRS sent a letter to Debtor ("Lock-in  
16 Letter")<sup>2</sup> informing Debtor that the IRS was going to instruct  
17 Debtor's employer to disregard the Withholding Request and instead  
18 instruct Debtor's employer to withhold income tax from Debtor's  
19 wages based on a marital status of single and no withholding  
20 allowances. The Lock-in Letter was sent based on a Withholding  
21 Compliance Referral dated February 29, 2008. The Withholding  
22 Compliance Referral was based on the fact that Debtor had owed  
23 taxes for every year since 1999 and Debtor had not voluntarily  
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25 <sup>1</sup> Exhibit B to the Declaration of Chong S. Hong in Support of  
26 Supplemental Response to Motion for Damages for Violation of Stay,  
filed on December 15, 2008 ("Hong Dec.").

27 <sup>2</sup> Exhibit B to Debtor's Motion for Damages Against the United  
28 States of America, Internal Revenue Service for Violation of the  
Automatic Stay, filed on September 17, 2008 ("Debtor's Motion") and  
attached to this Memorandum Decision.

1 changed Debtor's Form W-4.<sup>3</sup> Specifically, for the tax years 2001-  
 2 2007, Debtor underwithheld taxes as follows:

<b>Tax Year</b>	<b>Tax Per Return</b>	<b>Withholding Credit</b>	<b>Underwithholding</b>
2001	\$26,937	\$15,540	\$11,397
2002	\$26,026	\$7,876	\$18,150
2003	\$17,718	\$2,637	\$15,081
2004	\$10,931	\$7,211	\$3,720
2005	\$14,316	\$9,825	\$4,491
2006	\$11,639	\$6,898	\$2,495 <sup>4</sup>
2007	\$15,233	\$10,411	\$4,822

11 Debtor's bankruptcy schedules filed on July 8, 2008 show Debtor  
 12 owed the IRS an aggregate of \$145,575.00 in secured, priority and  
 13 unsecured taxes for the tax years 1999-2007.

14 The Lock-in Letter provided that if Debtor disagreed with the  
 15 IRS' determination of the withholding allowance, Debtor was to call  
 16 the IRS at a telephone number provided in the Lock-in Letter and  
 17 explain to the IRS why Debtor would be entitled to a different  
 18 marital status and/or number of withholding allowances. Debtor  
 19 could also contest the proposed withholding allowances in writing.  
 20 If the IRS did not hear from Debtor within 30 days from the date of  
 21 the Lock-in Letter, Debtor's employer was instructed to withhold  
 22 taxes at the status and allowance provided by the Lock-in Letter.  
 23 The Lock-in Letter provided that if Debtor believed at a later time  
 24 that Debtor was entitled to claim a different marital status and/or

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26 <sup>3</sup> Exhibit A to the Declaration of Cathleen Cooper Moran in  
 27 Support of Motion for Damages for Violation of Stay, filed on  
 July 22, 2009 ("Moran Dec.").

28 <sup>4</sup> Debtor made 2 estimated tax payments in 2006 in the amount  
 of \$1,123 each, resulting in total credits of \$9,144 for 2006.

1 more withholding allowances than the IRS determined, Debtor could  
2 complete a new Form W-4 as well as a written statement to support  
3 the claims made on the new Form W-4 and submit both documents to  
4 the IRS at an address provided in the Lock-in Letter. The Lock-in  
5 Letter withholding allowances took effect sometime after the pay  
6 date of May 23, 2008.<sup>5</sup> The Lock-in Letter increased the amount  
7 withheld by \$148.97 per two-week pay period.<sup>6</sup>

8 On June 23, 2008, Debtor filed a voluntary petition under  
9 Chapter 13 of the Bankruptcy Code. According to Debtor's schedules  
10 filed on July 8, 2008, Debtor is a single father with two minor  
11 children.<sup>7</sup> At the time Debtor filed Debtor's bankruptcy petition,  
12 Debtor earned \$5,384.57 per month working as an operations  
13 manager,<sup>8</sup> and his monthly expenses were \$4,855.00.<sup>9</sup> Debtor's only  
14 significant asset is a 2004 Dodge Caravan.<sup>10</sup>

15 Debtor scheduled secured debt on the 2004 Dodge Caravan and  
16 for income taxes owed to the IRS.<sup>11</sup> Debtor scheduled priority taxes  
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18 <sup>5</sup> Exhibit A to Declaration of Byron Jha in Support of Motion  
19 for Damages for Violation of Stay, filed on September 17, 2008  
20 ("Original Jha Dec.").

21 <sup>6</sup> Exhibit B to Original Jha Dec.

22 <sup>7</sup> See Schedule I.

23 <sup>8</sup> Schedule I shows Debtor earned \$5,384.57 per month working  
24 as an operations manager for Taymor Industries. This is Debtor's  
25 only source of income.

26 <sup>9</sup> See Schedule J.

27 <sup>10</sup> See Schedule A and Schedule B. Debtor's Schedule B lists  
28 personal property with a current market value of only \$6,305.00 --  
of which \$5,730.00 is attributable to the 2004 Dodge Caravan.

<sup>11</sup> The two secured claims noted on Schedule D is a tax lien by  
the IRS securing a claim of \$575.00 and a lien for Debtor's 2004  
Dodge Caravan in the amount of \$9,677.00.

1 owed to the IRS in the amount of \$18,500.00 on Schedule E. Debtor  
2 also scheduled \$163,995.00 in unsecured claims on Schedule F, of  
3 which \$126,500.00 was for income taxes owed to the IRS for the  
4 years 1999-2003, plus dischargeable penalties.

5 On June 24, 2008, Debtor's bankruptcy counsel, Ms. Moran,  
6 provided notice of the commencement of Debtor's bankruptcy case to  
7 the IRS Special Procedures office in San Jose.<sup>12</sup> On July 4, 2008,  
8 the Bankruptcy Noticing Center sent a Notice of Chapter 13  
9 Bankruptcy Case, Meeting of Creditors and Deadlines to the IRS.

10 On July 3, 2008, Ms. Moran left a substantive message for IRS  
11 attorney James Whitten.<sup>13</sup> On July 16, 2008, Ms. Moran called Mr.  
12 Whitten who referred Ms. Moran to IRS attorney Chong Hong.<sup>14</sup> On  
13 July 16, 2008, Ms. Moran called Mr. Hong and faxed to Mr. Hong a  
14 copy of the Lock-in Letter.<sup>15</sup>

15 Also on or about July 16, 2008, Debtor received in the mail  
16 nine separate Notices of Intent to Levy issued by the IRS relating  
17 to Debtor's delinquent taxes for the tax years 1999 through 2007.<sup>16</sup>  
18 On July 17, 2008, Ms. Moran called Mr. Hong and left a substantive  
19 message regarding the nine Notices of Intent to Levy.<sup>17</sup> The nine  
20 Notices of Intent to Levy caused Debtor increased stress such that  
21 Debtor took six vacation days from work and did not take Debtor's  
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23 <sup>12</sup> Moran Dec. at 1:24-26 and Exhibit A thereto.

24 <sup>13</sup> Moran Dec. at 2:2.

25 <sup>14</sup> Moran Dec. at 2:3-4.

26 <sup>15</sup> Moran Dec. at 2:5-6.

27 <sup>16</sup> Exhibit D to Debtor's Motion.

28 <sup>17</sup> Moran Dec. at 2:7-8.

1 children on vacation as planned, representing \$2,318.36 in  
2 earnings. Debtor spent an additional \$20 on medication for stomach  
3 distress. On July 21, 2008, Ms. Moran received a telephone call  
4 from Mr. Hong confirming that the IRS would not pursue any levies  
5 or liens against Debtor.<sup>18</sup>

6 On July 23, 2008, the IRS filed its proof of claim against  
7 Debtor asserting a secured claim of \$575.00; a priority claim of  
8 \$16,904.79; and an unsecured claim of \$124,588.85 for income taxes  
9 due for 1999-2007.

10 On August 6, 2008, Debtor filed an amended Chapter 13 plan to  
11 reduce the monthly plan payments from \$525 per month to \$300 per  
12 month for the first 12 months and provide for stepped-up plan  
13 payments thereafter because Debtor did not have sufficient income  
14 with the Lock-in Letter in place for Debtor to make the original  
15 proposed plan payments of \$525. The attorneys fees associated with  
16 the amendment to Debtor's plan total \$112.50.

17 Debtor filed this Motion on September 17, 2008 seeking damages  
18 for violation of the automatic stay for both the IRS sending the  
19 nine Notices of Intent to Levy sent post-petition as well as the  
20 IRS' failure to lift the Lock-in Letter post-petition.

21 The Lock-in Letter was in effect through December 2008.<sup>19</sup>

22 Debtor was entitled to a federal income tax refund of  
23 \$5,131.00 for the 2008 tax year.<sup>20</sup>

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<sup>18</sup> Moran Dec. at 2:9-10; Hong Dec. at 2:8.

<sup>19</sup> Declaration of Byron Jha in Support of Motion for Damages for Violation of Stay, filed on July 22, 2009 ("Jha Dec."), at 1:22-23.

<sup>20</sup> Jha Dec. at 1:24-25.

1 II.

2 ANALYSIS

3 A party seeking damages for violation of the automatic stay  
4 must prove by a preponderance of the evidence that: (1) a  
5 bankruptcy petition was filed; (2) the debtor is an individual;  
6 (3) the creditor received notice of the petition; (4) the  
7 creditor's actions were in willful violation of the stay; and  
8 (5) the debtor suffered damages. In re Henry, 328 B.R. 664, 667  
9 (Bankr. E.D.N.Y. 2005) (citations omitted). The first three  
10 elements are met in this case. The IRS concedes that the IRS'  
11 issuance of the nine Notices of Intent to Levy post-petition  
12 violated the automatic stay. The issues before the Court are  
13 whether: (1) the IRS' failure to lift the Lock-in Letter post-  
14 petition was a willful violation of the automatic stay; and  
15 (2) what, if any, damages, Debtor suffered as a result of any  
16 willful violation of the automatic stay.

17 **A. Lock-in Letter**

18 Debtor asserts that the pre-petition Lock-in Letter  
19 impermissibly asserts control over property of Debtor's bankruptcy  
20 in violation of Bankruptcy Code § 362(a)(3), which provides:

21 (a) Except as provided in subsection (b) of this  
22 section, a petition filed under section 301, 302, or  
23 section 5(a)(3) of the Securities Investor Protection Act  
of 1970, operates as a stay, applicable to all entities  
of --

24 . . .

25 (3) any act to obtain possession of property of the  
26 estate or of property from the estate or to exercise  
control over property of the estate;

27 11 U.S.C. § 362(a)(3). According to Debtor, Bankruptcy Code  
28 § 1306(a)(2) classifies post-petition earnings as property of the

1 bankruptcy estate. Because the Lock-in Letter required Debtor's  
2 employer to turn over wages in excess of the taxes owed for the tax  
3 year to which the Lock-in Letter applied, as demonstrated by the  
4 fact that Debtor received a federal income tax refund of over  
5 \$5,000 for the 2008 tax year, the compulsory overwithholding of  
6 Debtor's wages violated the automatic stay.

7 The IRS contends that lock-in letters sent pre-petition do not  
8 violate the automatic stay for three reasons. First, lock-in  
9 letters are not an attempt to collect pre-petition taxes. Instead,  
10 lock-in letters only target withholding for the current tax year.  
11 Because Debtor did not bifurcate Debtor's tax year, all taxes due  
12 in 2008 are post-petition taxes. See 26 U.S.C. § 1398(d). Second,  
13 monies withheld by an employer are not property of the bankruptcy  
14 estate and, rather, are held in trust for the IRS. Begier v.  
15 United States, 493 U.S. 53 (1990). Third, even if monies withheld  
16 by an employer are considered to be property of the bankruptcy  
17 estate, the issuance of a lock-in letter falls within the exercise  
18 of police and regulatory powers exception of Bankruptcy Code  
19 § 362(b)(4). Because the Court determines that the monies withheld  
20 by Debtor's employer pursuant to the Lock-in Letter were not  
21 property of the estate, the Court does not address the IRS'  
22 argument that leaving the Lock-in Letter in place falls within the  
23 exercise of police and regulatory powers exception of Bankruptcy  
24 Code § 362(b)(4).

25 **1. Nature and Purpose of Lock-in Letters**

26 As explained by the United States Tax Court:

27 In 1943, Congress required the withholding of income  
28 taxes at the source on wages, see Current Tax Payment Act  
of 1943, ch. 120, 57 Stat. 126, and this pay-as-you-go  
system for employees has been in place ever since.

1           Withholding alleviates the burden on wage earners of  
2           having to make large payments of tax at one time, and it  
3           benefits the Government not only by providing a more  
4           constant stream of receipts but also by protecting  
5           "against deaths, disappearances, and insolvencies, and to  
6           catch the itinerants who were moving from place to place  
7           with incomes taxable in the aggregate but with whom the  
8           Treasury could not keep pace." 13 Mertens, Law of  
9           Federal Income Taxation, sec. 47A.02, at 47A-8 (2005  
10          rev.).

11           The Commissioner has described income tax  
12          withholding as other than a tax in itself. Rev. Rul.  
13          60-220, 1960-1 C.B. 399; see sec. 3402; sec.  
14          31.3402(a)-1, Employment Tax Regs. During the taxable  
15          year, a taxpayer's liability is inchoate and not  
16          precisely determinable. After the close of the year,  
17          however, the taxpayer determines his or her liability,  
18          reports it on a return, and offsets the tax withheld  
19          against that liability. If there is excess withholding,  
20          it may be claimed as an overpayment, and in most  
21          instances it is promptly refunded to the taxpayer.

22           There are those who may seek to avoid withholding by  
23          claiming to be exempt therefrom or by overstating their  
24          withholding allowances on Form W-4. The Commissioner's  
25          Withholding Compliance Program is designed to deal with  
26          such situations:

27           The mission of the Withholding Compliance  
28          Program is to ensure that taxpayers who have  
29          serious under-withholding problems are brought  
30          into compliance with federal income tax  
31          withholding requirements. The program uses  
32          Form W-2 Wage and Tax Statement (W-2)  
33          information to identify taxpayers with  
34          insufficient withholding. The goal is to  
35          correct withholding to ensure that taxpayers  
36          have enough income tax withheld to meet their  
37          tax obligations. [IRM 5.19.11.1(1) (May 1,  
38          2006).]

39           Integral to the Withholding Compliance Program is  
40          the "Lock-in Letter":

41           Letters 2800C and 2801C, mailed to the employer  
42          and the taxpayer, respectively, are commonly  
43          known as the "lock-in letters". Letter 2800C  
44          instructs the employer to disregard the Form  
45          W-4 submitted by the taxpayer and withhold at  
46          the marital status and the number of allowances  
47          determined by the Service. Letter 2801C  
48          advises the taxpayer that the employer has been  
49          instructed to disregard the Form W-4 submitted  
50          by the taxpayer and withhold at the rate

1 specified in Letter 2800C. [IRM 5.19.11.3.2(1)  
2 (May 1, 2006).]

3 Internal Revenue Manual provisions contemplate  
4 taxpayer responses to "Lock-in Letters" and provide for  
5 redeterminations, specifically including a release of the  
6 "lock-in". E.g., IRM 5.19.11.3.9 (May 1, 2006); IRM  
5.19.11.3.10 (May 1, 2006). These provisions are based  
7 on authority granted by regulations. See sec.  
8 31.3402(f)(2) -1(g), Employment Tax Regs.

9 Davis v. Commissioner, T.C. Memo. 2008-238, 2008 WL 4703706, \*4  
10 (2008) (footnotes omitted).

11 The Court finds that the purpose of the Lock-in Letter was to  
12 insure Debtor's payment of taxes owed in 2008 by mandating Debtor's  
13 withholding allowance. The Lock-in Letter was issued solely  
14 because Debtor failed to provide for sufficient withholdings for at  
15 least seven years prior to the 2008 tax year. However, there is no  
16 evidence in the record that the Lock-in Letter attempted to collect  
17 taxes owed for any year prior to 2008.

18 The Lock-in Letter provided a 30-day opportunity for Debtor to  
19 provide information to the IRS and to seek an adjustment of the  
20 proposed withholding allowances. The Lock-in Letter also provided  
21 a mechanism for Debtor to seek adjustment to the withholding  
22 allowance after the initial 30-day period. Specifically, the Lock-  
23 in Letter provided in relevant part:

24 If you disagree with our determination please call  
25 us at the number shown below to explain why you are  
26 entitled to a marital status and/or number of withholding  
27 allowances (or complete exemption from withholding)  
28 different from that shown above. Please have the  
following information available to discuss. (If you file  
jointly you must have the same information available for  
your spouse.)

1. Form W4 and worksheet.
2. Most current pay stub. (If you have more than one  
job, the most current pay stubs for all of your  
jobs.)

- 1 3. Number of allowances you (and your spouse) are  
2 currently claiming on your Form(s) W-4.  
3  
4 4. The number of allowances you (and your spouse) are  
5 entitled to claim.  
6  
7 5. The Social Security Number and/or dates of birth for  
8 any children claimed on your return and a copy of  
9 your most recent Schedule A deductions (if any).

6 If you prefer, you may write to us at the address  
7 shown below. Please send a written statement to support  
8 your claim explaining why you are entitled to a marital  
9 status and/or number of withholding allowances (or  
10 complete exemption from withholding) different from that  
11 shown above.

12 In either case if we do not hear from you within 30  
13 days from the date of this letter, your employer(s) has  
14 been instructed to withhold at the status and allowances  
15 shown above. If you later believe that you are entitled  
16 to claim a different marital status and/or more  
17 withholding allowances (or complete exemption from  
18 withholding) than we determined, you can complete a new  
19 Form W-4 and a written statement to support the claims  
20 made on the Form W-4. You must submit the Form W-4 and  
21 the written statement to us at the address shown below.

22 Lock-in Letter at pages 1-2.

23 Debtor's counsel, Ms. Moran, contacted the IRS on April 25,  
24 2008 with respect to the Lock-in Letter. The IRS would not speak  
25 with Ms. Moran because the Tax Information Authorization Form, IRS  
26 Form 8821, signed by Debtor in March 2008 did not cover the current  
27 tax year, 2008. Ms. Moran concluded that by the time Ms. Moran  
28 obtained an updated IRS Form 8821 to include the 2008 tax year,  
Debtor would have filed Debtor's bankruptcy petition and the Lock-  
in Letter would be withdrawn upon the filing of Debtor's bankruptcy  
case. There is no evidence in the record that Debtor himself  
sought an adjustment to the proposed withholding allowances during  
the 30-day opportunity provided in the Lock-in Letter. There is  
also no evidence in the record that either Debtor or Debtor's  
counsel later completed a new Form W-4 and a written statement to