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Executive Office for United States Trustees

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## Handbook for Chapter 7 Trustees

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This Handbook should well serve to update and enhance the administration of chapter 7 cases.

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Director  
Executive Office for  
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June 2002

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# **CHAPTER 1**

## **INTRODUCTION**

## CHAPTER 1 – INTRODUCTION

### A. PURPOSE

The United States Trustee<sup>1</sup> is charged with the responsibility of establishing, maintaining, and supervising panels of private trustees, and of monitoring and supervising cases under chapter 7 of title 11 of the United States Code (“Bankruptcy Code”). The chapter 7 trustee, as the estate representative responsible for the recovery, preservation, liquidation, and distribution of chapter 7 estates, serves as a fiduciary to various parties in interest in a case. The goal of the United States Trustee is to establish a system that allows for the complete, economical, equitable and expeditious administration of chapter 7 cases, while allowing the trustee to exercise appropriate business and professional judgment in performing the trustee’s fiduciary duty.

This Handbook represents a statement of operational policy and is intended as a working manual for chapter 7 trustees under United States Trustee supervision. This Handbook is not intended to represent a full and complete statement of the law. It should not be used as a substitute for legal research and analysis. The trustee also should be familiar with the Bankruptcy Code, Federal Rules of Bankruptcy Procedure (“FRBP”), any local bankruptcy rules, and relevant case law.

Any reference in this Handbook to the masculine in referring to trustees, also includes the feminine. All statutory references herein refer to the Bankruptcy Code, 11 U.S.C. § 101 et seq., unless otherwise indicated.

### B. THE BANKRUPTCY LAWS

The Bankruptcy Code consists of eight chapters:

- Chapter 1: General Provisions;
- Chapter 3: Case Administration;
- Chapter 5: Creditors, the Debtor and the Estate;
- Chapter 7: Liquidation;
- Chapter 9: Adjustment of Debts of a Municipality;
- Chapter 11: Reorganization;
- Chapter 12: Adjustment of Debts of a Family Farmer with Regular Annual Income;  
and;
- Chapter 13: Adjustment of Debts of an Individual with Regular Income.

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<sup>1</sup>All references to United States Trustee shall include the United States Trustee’s designee, unless otherwise indicated.

## **CHAPTER 8**

# **ADMINISTRATION OF A CASE**

## CHAPTER 8 – ADMINISTRATION OF A CASE

The trustee should consider the likelihood that sufficient funds will be generated to make a meaningful distribution to creditors prior to administering a case as an asset case. This section describes a variety of issues for the trustee to consider.

### A. DETERMINATION AND ADMINISTRATION OF NO-ASSET CASES

Prior to administering a case as an asset case, the trustee must consider whether sufficient funds will be generated to make a meaningful distribution to creditors. If the trustee determines after the § 341 meeting that the case is a no-asset case, then the trustee must timely execute and file a Report of No Distribution (NDR). § 704(9).

Pursuant to the Amended Memorandum of Understanding (dated April 1, 1999) (“AMOU”), which delineates the respective responsibilities of the clerk of the bankruptcy court, the trustee and the United States Trustee in the case closing process, the trustee shall submit the NDR to the United States Trustee and the court within 60 days after the initial examination of the debtor at the § 341(a) meeting. If the trustee submits the original NDR to the United States Trustee, then the United States Trustee shall file the NDR with the court within five days of receipt. The trustee should retain a copy of the NDR in the estate file.

The purpose of the NDR is to close administration of the case. An NDR certifies that the trustee has reviewed the schedules, investigated the facts, and determined that there are no assets to liquidate for the benefit of creditors. It also certifies that the trustee has examined the debtor’s claimed exemptions and concluded that there is no purpose served to object to their allowance, and that all security interests and liens against non-exempt property are properly documented, perfected, and not subject to attack as preferences or otherwise voidable. A sample Trustee’s Report of No Distribution is attached at Appendix B.

If assets are subsequently discovered, the trustee should: (1) seek to have the case reopened, and (2) withdraw the NDR in writing to administer the assets. See Chapter 8.V below for additional procedures concerning reopening closed cases. The trustee should seek to deny or revoke the debtor’s discharge if the debtor failed to disclose the assets. See Chapter 6.B.6 regarding objections to discharge.

Pursuant to § 330(b), the trustee receives a \$60 fee in each case administered. The timing of the payment of this fee for no-asset cases varies by district. Generally, the clerk of the bankruptcy court will not submit no-asset cases to the district court for payment of the trustee’s fee until either the no-asset report is filed, the discharge order is entered, or the case is closed by the court, depending upon the local jurisdiction. Failure to timely and properly file NDRs may result in an appropriate remedial action.

## **B. CLAIMS BAR DATE**

In most districts, a notice of insufficient assets to pay dividends is provided to creditors as part of the § 341(a) meeting notice. FRBP 2002(e). Promptly upon determination that the administration of a case will generate funds to pay creditors, the trustee must ensure that the clerk of the bankruptcy court provides notice to creditors to file proof of claims on or before a certain date. FRBP 3002(c)(5).

## **C. EXEMPTIONS**

A debtor must list property claimed as exempt on the schedule of assets filed with the court. FRBP 4003 (a). Only individuals may claim exemptions; corporations and partnerships may not. The trustee must object to improper debtor exemptions within 30 days after the conclusion of the § 341(a) meeting or the filing of any amendment to the list or supplemental schedules, unless, within such period, further time is granted by the court. FRBP 4003(b). See FRBP 4003(b) and Taylor v. Freeland and Kronz, 503 U.S. 638 (1992). The objecting party has the burden of proving that the exemptions are not properly claimed. If an objection is not filed in a timely manner, the exemption will be allowed by the court.

The trustee should object to a claimed exemption if to do so benefits the estate. The trustee may use the § 341(a) meeting to gain information on the debtor's claimed exemptions. FRBP 1009 allows the debtor to amend the bankruptcy schedules as a matter of course at any time before the case is closed. The debtor shall give notice of the amendment to the trustee and to any entity affected thereby. Thus, where the debtor has incorrectly exempted assets that would be exempt under another section if claimed properly, or has exempted assets that provide no equity for the estate after accounting for secured claims and properly claimed exemptions, the trustee probably would not want to object. However, if allowing the improperly claimed exemption would remove assets from the estate that should be available for payment of creditor claims, the trustee must object.

Specific exemptions are not addressed in depth in this Handbook. Section 522 sets forth allowable exemptions under federal bankruptcy law. The trustee must know which states have opted out of the federal exemptions. If a state has opted out, the state property exemptions apply instead of those provided in § 522(d), although other non-bankruptcy federal exemptions will apply. If a state has not "opted out," a debtor may still elect either state or federal exemptions.

The trustee also should be mindful of the "Servicemembers Civil Relief Act" and its impact on judicial and administrative proceedings. See Chapter 6.A for further information.

## D. ABANDONMENTS

Abandonments of property are governed by § 554. A trustee should abandon any estate property that is burdensome or of inconsequential value to the estate. Property should be abandoned when the total amount to be realized would not result in a meaningful distribution to creditors or would redound primarily to the benefit of the trustee and professionals.

In determining whether property has consequential value to the estate, the trustee should consider a number of issues, for example:

1. The amount, validity and perfection of purported security interests against such property. Since the trustee has a duty to use the trustee's avoidance powers under §§ 544, 545, 547, and 548, to the extent a purported lien is invalid or could be avoided by the trustee, the property should not be abandoned if the value thereof without the lien would benefit the estate.
2. The value of the property. Value can be determined in various ways. The trustee can consult with the debtor and the debtor's attorney, have the secured party provide documentation as well as the pay-off statement, obtain price lists, conduct physical inspections or appraisals, and use common sense. The precision with which value is determined often depends on the margin between the lien or encumbrance and the estimated value of the property.
3. Tax considerations, including any § 724(b) issues.
4. Administrative expenses and litigation costs to be borne by the estate resulting from the recovery and sale of the property.

The trustee should be able to justify the decision to abandon estate property. Any documentation in support of this decision should be kept in the estate file.

Scheduled property that is not administered before the case is closed is deemed abandoned upon entry of the order closing the estate. § 554(c). However, the trustee should not rely on the deemed abandonment provisions of § 554(c) where property may expose the estate to some type of liability. An order granting relief from stay does not remove property from the estate. The trustee should immediately abandon fully secured property or uninsured property of no value to the estate. Immediate consideration should be given to property of no value to the estate which may be hazardous to the health or safety of the general public. Such property should be abandoned after consultation with appropriate federal, state, and local authorities.

Creditors are entitled to notice of a proposed abandonment. § 554(a). A notice of abandonment should identify each asset to be abandoned by reference to the description provided in the debtor's schedules and any unlisted assets should be clearly described. The notice should also provide such additional information as is needed to demonstrate the basis upon which the decision to abandon was made, such as: (a) the amount of secured claims exceeds the value of the asset; (b) the costs of recovering and/or liquidating the asset are estimated to exceed its value to the estate; (c) the expenses of preserving the asset are estimated to exceed its value to the estate; and (d) any other information that would assist creditors in evaluating the proposed action of the trustee.

## **E. TAX CONSIDERATIONS**

### **Overview**

Particularly with respect to tax issues, this Handbook contains only an abbreviated summary of the provisions which may be of interest to chapter 7 trustees. The Handbook is not intended to answer all of the questions that might arise in each bankruptcy case. Tax advice should be sought on a case-by-case basis when the need arises. See also IRS Publication No. 908 (Bankruptcy).

Sections 346 and 728 of the Bankruptcy Code, as well as § 1398 and §1399 of the Internal Revenue Code, 26 U.S.C. § 1, *et. seq.*, set forth special tax provisions with which the trustee should be familiar. These sections generally provide that the trustee must prepare and file appropriate income tax returns for any estate income earned during the administration of the estate. (If the debtor has not already done so, the trustee also may consider filing pre-petition tax returns, especially where it appears the estate would be entitled to a refund. The trustee cannot sign an individual tax return for a period that ended before the bankruptcy filing. If the debtor will not sign the return, the trustee can have the returns prepared and then ask the taxing authority to file the return.)

In preparing estate tax returns, the trustee should review the debtor's prior year returns. If the debtor is unwilling or unable to provide copies of these returns, the trustee can request copies from the IRS using Form 4506. Such requests should be directed to the Service Center where the debtor's tax returns were filed. 26 U.S.C. § 6103(e)(4)-(5). The trustee may wish to contact the local IRS Special Procedures Unit to determine if it can obtain the returns more quickly.

Under certain limited circumstances, the IRS may grant the trustee relief from filing a particular estate tax return. The trustee may wish to consult with the IRS Special Procedures Unit for further information. See also Rev. Rul. 84-123, 1984-2 Cum. Bull. 244 and Rev. Proc. 84-59, 1984-2 Cum. Bull. 504.

## **Individual Chapter 7 Debtors**

For both federal and state tax purposes, the individual and the bankruptcy estate are treated as separate taxable entities, and a separate tax identification number is required for the estate. If a husband and wife file a joint petition under § 302, absent substantive consolidation, two separate estates and two separate taxable entities are created. Each estate obtains its own tax identification number and files its own tax returns.

The trustee must file a federal income tax return in an individual chapter 7 case for any year in which gross income of the estate equals or exceeds the exemption amount under 26 U.S.C. § 151(a) plus the basic standard deduction under 26 U.S.C. § 63(c)(2)(D) for a taxpayer filing as married filing separately. (For example, the filing threshold for 2000 is \$6,475.) The trustee also must file state income tax returns if the estate of an individual debtor has net taxable income for the entire period after the order for relief during which the case is pending. § 728(b).

The trustee files a return for an individual's estate using Form 1041 (U.S. Income Tax Return for Estates and Trusts) as a transmittal form with a Form 1040 (U.S. Individual Income Tax Return) together with appropriate forms and schedules. The tax to the estate is computed generally in the same manner as for an individual and the rate schedules used are those for married individuals filing separate returns under 26 U.S.C. § 1(d), pursuant to 26 U.S.C. § 1398(c). For joint debtors, a separate Form 1041 and the related attachments are filed for each spouse's estate.

The gain on the sale of an individual chapter 7 debtor's residence is excluded from gross income of the debtor's bankruptcy estate to the extent provided by 26 U.S.C. § 121. The estate succeeds to the holding period and character of the property under 26 U.S.C. § 1398(g)(6), and the estate is treated as the debtor with respect to such asset under 26 U.S.C. § 1398(f)(1). See In re Bradley, 222 B.R. 313, 318 (Bankr. M.D. Tenn. 1998); In re Popa, 218 B.R. 420, 428 (Bankr. N.D. Ill. 1998), aff'd sub nom. Popa v. Peterson, 238 B.R. 395 (N.D. Ill. 1999).

The estate is entitled to deduct administrative expenses allowed under § 503 and any fees and charges assessed by the court to the extent such deductions are not otherwise disallowed by other provisions of the Internal Revenue Code. 26 U.S.C. § 1398(h).

Generally, the debtor's tax attributes are transferred to the estate upon commencement of the case. The attributes are determined as of the first day of the taxable year in which the petition is filed, generally this is January 1<sup>st</sup> of the year of filing, but if the debtor makes a short-year election, the attributes are determined as of the date of filing. The debtor's discharge may affect the use of tax attributes by the estate. Consideration should be given to the effects of 26 U.S.C. § 108 on the debtor's tax attributes.



The debtor in an asset case can make a short-year election which terminates the debtor's taxable year on the date before the petition is filed and begins a second taxable year on the date of filing. 26 U.S.C. § 1398(g)(2). If the debtor makes this election, any tax owing for the pre-petition short year is treated as a priority tax claim against the estate.

The trustee has the option to follow the individual debtor's taxable year (usually the calendar year) or adopt a fiscal taxable year. 26 U.S.C. § 1398(j)(1). The trustee also is permitted to change the estate's annual accounting period once without the approval of the Secretary of the Treasury, as otherwise required. These options enable the trustee to do some tax planning to minimize any tax liability and to expedite closure of the case.

The trustee must disclose to the debtor all information contained in the estate tax returns that can affect the debtor's future or past returns since the debtor acquires the tax attributes of the estate upon its closing.

### **Partnership and Corporate Chapter 7 Debtors**

(Note: Limited liability corporations (LLCs) and limited liability partnerships (LLPs) are treated the same as partnerships.)

The filing of a bankruptcy petition by a partnership or corporation does not create a separate taxable entity. There is no break in the accounting period of the partnership or corporation and the return, filed under the debtor's tax identification number, must reflect the pre- and post-petition income and deductions. The trustee files a corporate income tax return using Form 1120 (U.S. Corporate Income Tax Return) or Form 1120S (U.S. Income Tax Return for an S Corporation) and a partnership tax return on Form 1065 (U.S. Partnership Income Tax Return), with appropriate forms and schedules attached to each.

Unless a corporation is exempt from income tax under 26 U.S.C. § 501(a), corporate returns must be filed by the trustee regardless of whether the corporation has income. 26 U.S.C. 6012(a). The trustee must file state income tax returns for a corporation unless the corporate debtor lacks post-petition net taxable income for the entire period after the order for relief during which the case is pending. § 728(b). Upon application to the IRS District Director, the IRS may waive the requirement to file federal returns if the corporate debtor has ceased business operations and has neither assets nor income. See Rev. Rul. 84-123, 1984-2 Cum. Bull. 244 and Rev. Proc. 84-59, 1984-2 Cum. Bull. 504.

For partnership cases, the chapter 7 trustee must file the federal and state tax returns regardless of the amount of gross income.