



ORDERED in the Southern District of Florida on April 19, 2007.

A. Jay Cristol, Judge
United States Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

IN RE:

THE HILLARD DEVELOPMENT
CORPORATION, et al.

Debtor.

CASE NO. 90-27588-BKC-AJC
CHAPTER 11 CASE
(ADMINISTRATIVELY
CONSOLIDATED)

IN RE:

HILLARD DEVELOPMENT CORPORATION,
d/b/a PILGRIM MANOR NURSING HOME,
d/b/a PROVIDENT NURSING HOME,
FEI: 58-1538435

Debtor.

CASE NO. 98-25061-BKC-AJC

**ORDER GRANTING DEBTOR'S MOTION FOR SUMMARY JUDGMENT, DENYING
UNITED STATES' MOTION FOR SUMMARY JUDGMENT OR PARTIAL SUMMARY
JUDGMENT, OVERRULING OBJECTION TO MOTION FOR FINAL DECREE AND
CLOSING CASE**

THIS CAUSE initially came before the Court upon the Debtor's and the United States' cross motions for summary judgment with respect to the Debtor's objection to claims of the

Internal Revenue Service (“IRS”). While the summary judgment motions were under advisement, the Court considered the Debtor’s final report and motion for final decree, as well as the US’s (hereafter “IRS”) objection thereto. The IRS objected to the Court issuing a final decree and closing the case while the summary judgment motions remained pending. By this order, the Court grants summary judgment in favor of the Debtor, overrules the United States’ objection as moot and directs the Clerk of Court to issue a final decree and close this case.

The issue presented to the Court in the motions for summary judgment is whether the IRS is entitled to penalties and interest on penalties for Debtor’s failure to timely pay taxes or whether reasonable cause exists to abate the penalties. It is undisputed that all IRS tax obligations have been paid; however, the taxes were admittedly paid beyond the dates they were due, and the IRS asserts the Debtor’s failure to *timely* pay the taxes was a result of “willful neglect”, thus entitling it to penalties and interest thereon. The Debtor argues that its tardiness in paying the taxes was not due to “willful neglect” but rather the extenuating circumstances under which the Debtor found itself operating.

The Court, having now considered all motions and exhibits thereto (which include 41 exhibits from the IRS alone), and having heard argument of counsel for the parties, having taken judicial notice of all the court papers filed in the administratively consolidated cases (which include over 600 docket entries) and related adversary proceedings, enters this order granting summary judgment in favor of the Debtor. The Court concludes from the record that the Debtor’s belated payment of taxes was not due to “willful neglect” but rather its unfortunate position of being underfunded, and therefore unable to pay the taxes, while it was wrestling to maintain the very basic operations and quality conditions for the benefit of the hundreds of

elderly and infirm patients in its nursing homes.

In football, it is customary to issue a penalty for “piling on”. In this case, it appears that the government team, consisting of the Commonwealth of Massachusetts (“CWM”) and the United States, may well be guilty of such a foul. First, without question, and by proceedings adjudicated beyond appeal, CWM was guilty of severe foul play in this case. Now, we find the United States, through the IRS, “piling on” with unreasonable conduct in persecuting an otherwise unfortunate, but well-meaning Debtor. It is well to remember that our founding fathers saw it appropriate to add the Bill of Rights to our Constitution for the purpose of “keep[ing] government off of the backs of the people”, as Justice William O. Douglas was so prone to say.

In this case, the victim of the foul play is not a person, but a corporation whose purpose was to provide food, shelter and medical attention to elderly citizens who were, in most case, unable to fend for themselves. While perhaps not protected by all of the Bill of Rights because of its corporate status, this victim is certainly entitled to fair treatment in the determination of whether it should be subject to punishment in the form of penalties.

The IRS would have this Court rely on the Sixth Circuit’s decision in Brewery v. US, 33 F.3d 589 (6th Cir. 1994) to justify its entitlement to penalties upon a showing that the taxes were not timely paid. The standard argued by the IRS is too harsh. This Court agrees with the other circuits which have adopted a more reasonable standard based upon inability to pay. See Diamond Plating Co. v. US, 390 F.3d 1035, 1038 (7th Cir. 2004); Synergy Staffing, Inc. v. US, 323 F.3d 1157 (9th Cir. 2003); Van Camp & Bennion v. US, 251 F.3d 862 (9th Cir. 2001); East Wind Ind., Inc. v. US, 196 F.3d 499 (3d Cir. 1999); Fran Corp. v. US, 164 F.3d 814 (2d Cir. 1999); In re Slater Corporation, 190 B.R. 695 (Bankr. S.D.Fla. 1995); and In re Savage, 179 B.R.

342 (Bankr. S.D.Fla. 1995). For the following reasons, the Court determines that under the facts and circumstances of this case, it is appropriate to not impose the penalties.

BACKGROUND

This case involves objections by the Debtor to IRS claims for pre and post-petition addition-to-tax – a/k/a “penalties” – assessed against the Debtor due to its failure to timely deposit and pay employment taxes for certain tax periods in 1997, 1998, 2001, 2002 and 2003. The Debtor objects to the claims on the basis it had “reasonable cause” for belatedly paying these taxes because CWM refused to fully and timely reimburse the Debtor through CWM’s Medicaid program for expenses incurred by the Debtor in operating its two nursing homes located in CWM during the tax period in issue. From the record before the Court, the Debtor has established “reasonable cause” to justify not imposing tax penalties. A recitation of the history of this case is necessary to understand the context in which these circumstances arise.

UNDISPUTED FACTS

On October 19, 1990 the Debtor filed its first Chapter 11 petition with this Court ("Hillard I"). During the course of Hillard I, the Debtor filed an adversary proceeding against the CWM (Adv. Pro. No. 91-1197-BKC-AJC-A) seeking the reimbursement of costs. CWM sets the Debtor’s rates of reimbursement under Medicaid and the Debtor received the vast majority of its funds to operate its nursing homes from CWM through the Medicaid program.

In 1993, the Debtor and CWM entered into a stipulation for settlement of the adversary proceeding that provided for the Debtor’s Medicaid rates of reimbursement. CWM agreed in its Stipulation for Settlement and Dismissal of Adversary Complaint (CP 24, Adv. Pro. No. 91-1197-BKC-AJC-A) that it would not disallow certain costs of the Debtor. However, CWM

subsequently violated the stipulation and agreed order by disallowing costs used in calculating the Debtor's rates of reimbursement, and another adversary was filed in 1994 (Adv. Pro. No. 94-467-BKC-AJC-A).

As a consequence of CWM's violations, on October 10, 1996, this Court entered its Order on Evidentiary Hearing, and on October 30, 1996, a Final Judgment was entered against CWM. In the October 10, 1996 Order on Evidentiary Hearing, this Court found that CWM breached the parties agreement to set Medicaid rates of reimbursement for 1994, 1995, and 1996 based upon base years of 1992 and 1993 and, contrary to the agreement, recouped amounts for overpayments and set its Medicaid rates of reimbursement through disallowance of costs, imposition of ceilings or other limitations of costs that were waived under the settlement agreement. This Court found that the Debtor had been underfunded in 1995 and 1996, and that it continued to suffer damages by being underfunded and imposed sanctions against CWM because it improperly disallowed costs which caused the Debtor to be underfunded.

The Order On Evidentiary Hearing contains detailed findings of fact by this Court which demonstrated CWM willfully violated the prior stipulation and agreed order entered by this Court. Sanctions were imposed by this Court for such willful violations by CWM in the amount of damages sustained by the Debtor, as well as for damages that would be sustained by Debtor in the future. CWM was then enjoined from further violating the agreed order, stipulation, and mutual release previously entered into by the parties.

This Court found that, as of October 10, 1996, CWM owed the Debtor the sum of \$1,004,340.98. The Court further ordered CWM to pay the Debtor an additional sum of \$41,000.00 per month so that the Debtor would not be underfunded in accordance with the prior

stipulation and agreed order. This Court also imposed sanctions in the amount of the judgment (\$1,004,340.98) plus \$41,000.00 per month. *See* Order on Evidentiary Hearing and Final Judgment, CP 210 and 221, respectively, in Case No. 90-27588-BKC-AJC and Adv. Pro. No. 94-467-BKC-AJC-A. This Court specifically stated, on page 18, paragraph 9 of the Order on Evidentiary Hearing, "Hillard is being deprived of approximately \$41,000.00 per month since January 1996 as a result of the Commonwealth's refusal to comply with the stipulation and order."

In November 1997, the Debtor and CWM entered into another settlement agreement. Yet despite the judgment and subsequent settlement, the Debtor did not receive any funds from CWM until November 26, 1997. CWM then made payment only for the prior underfunding for the years 1994, 1995, and 1996 through September of that year. The Debtor paid its tax liability plus interest for the fourth quarter of 1997; and, the proofs of claim filed by the IRS do not seek payment for any tax liability for that period.

After the Debtor and CWM had supposedly settled their dispute, CWM thereafter willfully and intentionally changed the methodology for determination of rates of reimbursement for Medicaid patients contrary to the settlement agreement reached between the parties. CWM enacted legislation that specifically eliminated the benefits of the settlement agreement with the Debtor. CWM also changed the maximum period for the cost reports that are utilized to determine rates of reimbursement. These actions substantially damaged and continued to damage the Debtor. This action by CWM was known by CWM prior to execution of the settlement agreement, but was willfully and fraudulently not disclosed to Debtor, the effect of which was later found to be a fraud upon this Court. The Debtor depended on the revenue from

Medicaid reimbursement for, at that time, its three hundred elderly residents of its two nursing homes located in the Commonwealth of Massachusetts. (See Exhibit 41 to the IRS's motion for summary judgment.)

The Debtor filed an Emergency Motion for Relief from Orders and for Sanctions in the adversary proceeding with CWM (Adv. Pro. No. 94-0467-BKC-AJC-A). The Court denied the emergency motion without prejudice, stating that "[i]t is distressing to note that, though the Debtor is not without remedies, the Debtor is without money and power. The Defendant, on the other hand, is loaded with power, money and, unfortunately, a great deal of hate, ill-will and bad feelings toward the Debtor." (CP 280 in Adv. Pro. No. 97-0467-BKC-AJC-A).

CWM thereupon filed a Motion for Entry of Amended Order with Respect to Plaintiff's Motion for Relief from Orders and for Sanctions, but that motion was denied. In its order, this Court reiterated that CWM enacted legislation that only affected the Debtor and that the legislation was intended to and effectively did hinder the reorganization efforts of the Debtor. *See Order Denying Defendant's Motion for Entry of Amended Order* (CP 282 in Adv. Pro. No. 97-0467-BKC-AJC-A).

As a result of the above-described fraud on this Court and Debtor, Debtor was unable to pay its creditors in the normal course of business. Consequently, on July 20, 1998, Debtor had no choice but to file a second bankruptcy petition ("Hillard II"). At the time the Debtor filed Hillard II, it was owed the sum of \$2,587,703.73, as listed in Schedule B of its petition, under Accounts Receivable, by private pay residents, Medicaid and Medicare. This amount was separate and distinct from the claim against CWM pursuant to the judgment, which was listed as an amount in excess of \$3,000,000.00.

In Hillard II, the Debtor filed an Emergency Motion for Turnover of monies owed to it by CWM (CP 3 in Case No. 98-25061-BKC-AJC). The motion was denied without prejudice to the filing of an adversary proceeding, but the Court noted for the record:

The Commonwealth, through its activities, once again demonstrates its low, mean-spirited, cold-hearted, nasty approach to a problem which involves the care of Commonwealth's citizens who are unable to care for themselves. The Commonwealth has demonstrated its insensitivity to the problem at hand and shows that it is willing to spend massive amounts of energy jerking around health care providers with technical and jurisdictional arguments, without any care or concern of the possible adverse affects its approach may have on the health, welfare, and safety of its citizens who are in the care of these health care facilities.

On August 31, 1998, the Debtor amended its schedules to list the settlement agreement [between the Debtor and CWM] as an executory contract, and thereafter filed its Motion for Relief From Orders, Motion for Sanctions, or in the Alternative, Motion to Reject Executory Contract. CWM opposed the motion and, after a hearing, the Court entered an order permitting the Debtor to reject as an executory contract the November 4, 1997 settlement agreement. *See* Order on Debtor's Motion for Relief from Orders, Motion for Sanctions, or, in the Alternative, Motion to Reject Executory Contract (CP 167 in Case No. 98-25060-BKC-AJC). This Court then entered an order reopening Case No. 90-27588-BKC-AJC (Hillard I) and administratively consolidating it with the present case. The order further reinstated the 1996 Order on Evidentiary Hearing and Final Judgment (CP 168 in Case No. 98-25060-BKC-AJC).

The Debtor soon filed another adversary proceeding against CWM on November 3, 1998 (Adv. Pro. No. 98-2370-BKC-AJC-A). The Debtor prevailed in the adversary proceeding, but CWM filed numerous appeals concerning the various orders entered by the Court. On remand from the District Court, this Court made certain findings of fact that the actions of CWM were

the direct cause of the Debtor being required to file Hillard II and that CWM had engaged in misconduct. This Court further determined that it had the inherent power to vacate a judgment upon proof that fraud had been perpetrated upon the Court. *See* Order on Remand, CP 58 in Adv. Pro. No. 98-02370-BKC-AJC-A.

While the appeals were proceeding, the Debtor was forced to close Pilgrim Manor Nursing Home in August 2002. In the order authorizing the closure, the Court specifically found that as of June 30, 2002, the Debtor was owed \$7,273,892.17 by CWM and that the judgment continued to accrue at the rate of \$82,000.00 per month, plus interest. The Court also found that during 2002 and prior, Pilgrim Manor was forced to operate at a substantial loss every month as a result of improper reimbursement by CWM, including disallowance of reimbursable costs and failure of CWM to make any payments on the judgment. Most importantly, this Court made the following finding at paragraph K of the order:

Based upon the foregoing, the Court can only find that the actions of the Commonwealth of Massachusetts are vile and disgusting, malicious and unconscionable, and solely aimed at eliminating the operation of Pilgrim Manor Nursing Home. As a result of the actions by the Commonwealth of Massachusetts, lives have been disrupted – not only for the Debtor’s residents but for those friends and family members who visit the residents at Pilgrim Manor Nursing Home as they will now have to travel much greater distances to other nursing homes where the residents will be/are being transferred. The residents and those who care for or are related to the residents will no doubt suffer untold and immeasurable misery as a result of the appalling, vicious and unconscionable actions of the Commonwealth of Massachusetts.

The Debtor eventually prevailed on appeal and, on August 26, 2003, CWM, through its bond company, finally paid the Debtor on its judgment in the amount of \$8,931,355.42.

Thereafter, the Debtor sought and did pay all remaining tax liabilities.

IRS CLAIMS

The following proofs of claims have been filed by the IRS in this matter:

A. Proof of Claim ("POC") No. 31, dated November 3, 1998, in the amount of \$331,143.35; as amended by POC No. 46, dated June 24, 1999, in the amount of \$386,137.71; as amended by POC No. 50, dated July 12, 2000, in the amount of \$380,636.70; as amended by POC No. 56, dated May 10, 2004, in the amount of \$380,636.70; as amended by POC No. 62, dated August 8, 2004, in the amount of \$377,539.09; as amended by POC No. 64, dated October 18, 2004, in the amount of \$97,161.01.

B. Request for Payment ("RP") No. 42, dated March 31, 1999, in the amount of \$785,354.65; as amended by RP No. 44 (Amend. No.1), dated May 25, 1999, in the amount of \$77,144.76; as amended by RP No. 45 (Amend. No. 2), dated June 24, 1999, in the amount of \$2,066.34; as amended by RP No. 47 (Amend. No. 3), dated January 28, 2000, in the amount of \$13,418.92; as amended by RP No. 48 (Amend. No. 4), dated February 7, 2000, in the amount of \$5,983.00; as amended by RP No. 49 (Amend. No. 5), dated July 13, 2000, in the amount of \$46,396.92. All such Request for Payments were found to be invalid and stricken by this Court in its order dated January 3, 2001 (CP 268).

C. RP No. 51, dated November 4, 2003, in the amount of \$641,821.27; as amended by RP No. 52 (Amend. No. 1), dated February 18, 2004, in the amount of \$647,961.51; as amended by RP No. 53 (Amend. No. 2), dated March 19, 2004, in the amount of \$723,472.00; as amended by RP No. 54 (Amend. No. 3), dated April 2, 2004, in the amount of \$715,394.28; as amended by RP No. 55 (Amend. No. 4), dated May 10, 2004, in the amount of \$515,749.23; as amended by RP No. 57/58 (Amend. No. 5), dated June 22, 2004, in the amount of \$264,427.67; as

amended by RP No. 60 (Amend. No. 6), dated July 21, 2004, in the amount of \$212,075.54; as amended by RP No. 61 (Amend. No. 7), dated August 5, 2004, in the amount of \$203,939.18; as amended by RP No. 63 (Amend. No. 8), dated September 1, 2004, in the amount of \$135,175.50.

All taxes, *and interest on taxes*, have been paid by the Debtor, and the IRS has acknowledged payment of all taxes and interest. The payments made to the IRS are as follows:

- A. \$82,201.63 paid on April 21, 2004.
- B. \$255,829.17 paid on June 9, 2004.
- C. \$10,742.88 paid on July 29, 2004.
- D. \$269,298.58 paid on October 7, 2004.

The payment reflected in subparagraph A was made on April 21, 2004 after the IRS filed RPs 52 through 54. The payment reflected in subparagraph B was made pursuant to Court Order dated June 9, 2004 (CP 507). The payment in subparagraph C was for the balance owed on FUTA taxes, plus interest for the tax year 2001. The payment in subparagraph D was for the pre-petition claim for tax and interest on tax of the IRS (CP 541).

SUMMARY JUDGMENT STANDARD

To prevail on a motion for summary judgment, the movant must meet the criteria set forth in Rule 56 of the Federal Rules of Civil Procedure, made applicable to contested matters under Rule 9014 and Rule 7056, Fed. R. Bankr. P. Rule 56(c) states in pertinent part:

"The Judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issues as to any material facts and that the moving party is entitled to a judgment as a matter of law."

Summary judgment is appropriate only where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317,

106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). The moving party bears the burden of meeting this exacting standard. Adickes v. S.H. Kress & Co., 398 U.S. 144, 157 (1970). In determining whether summary judgment is appropriate, the facts and inferences from the facts are viewed in the light most favorable to the non-moving party, and the burden is placed on the moving party to establish both the absence of a genuine issue of material fact and that it is entitled to judgment as a matter of law. Matsushita Elec. Indus. Co. Ltd. v. Zenith Radio Corp., 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986).

Summary judgment should only be entered when the moving party has sustained its burden of showing the absence of a genuine issue as to any material fact when all of the evidence is reviewed in the light most favorable to the nonmoving party. Sweat v. Miller Brewing Co., 708 F.2d 655 (11th Cir. 1983). All doubt as to the existence of a material fact must be resolved against the moving party. Hayden v. First Nat'l Bank of Mt. Pleasant, 595 F.2d 994, 996 (5th Cir. 1979) quoting Gross v. Southern Railroad Co., 441 F.2d 292 (5th Cir. 1964).¹ A fact is material if it “might affect the outcome of the suit under governing law.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 106 S. Ct. 2505, 2510, 91 L. Ed. 2d. 202, 211 (1986).

The party seeking summary judgment bears the initial responsibility of informing the court of the basis for its motion, identifying those portions of the pleadings, depositions, answers to interrogatories, and affidavits, if any, which it believes demonstrates the absence of a genuine issue of material fact. Celotex, 477 U.S. at 323, 106 S. Ct. at 2553. In determining whether the moving party has met its burden of establishing that there is no genuine issue as to any material

¹ In Bonner v. City of Pritchard, 661 F.2d 1206, 1209 (11th Cir. 1981), the Eleventh Circuit adopted as binding precedent all decisions handed down by the former Fifth Circuit before October 1, 1981.

fact and that it is entitled to judgment as a matter of law, the court must draw inferences from the evidence in the light most favorable to the non-movant and resolve all reasonable doubts in that party's favor. Spence v. Zimmerman, 873 F.2d 256 (11th Cir. 1989); Samples on Behalf of Samples v. City of Atlanta, 846 F.2d 1328, 1330 (11th Cir. 1988). The Eleventh Circuit has explained the reasonableness standard as follows:

In deciding whether an inference is reasonable, the Court must 'cull the universe of possible inferences from the facts established by weighing each against the abstract standard of reasonableness.' [citation omitted]. The opposing party's inference need not be more probable than those inferences in favor of the movant to create a factual dispute, so long as they reasonably may be drawn from the facts. When more than one inference reasonably can be drawn, it is for the trier of fact to determine the proper one.

WSB-TV v. Lee, 842 F.2d 1266, 1270 (11th Cir. 1988).

If a reasonable fact finder evaluating the evidence could draw more than one inference from the facts, and if that inference introduces a genuine issue of material fact, then this Court should not grant the summary judgment motion. Augusta Iron & Steel Works v. Employers Ins. of Wausau, 835 F.2d 855, 856 (11th Cir. 1988). A dispute about a material fact is "genuine" if the "evidence is such that a reasonable jury could return a verdict for the non-moving party."

Anderson v. Liberty Lobby, 477 U.S. at 248, 106 S. Ct. at 2510. The inquiry is "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." Liberty Lobby, 477 U.S. at 251-52.

However, the mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment. A fact is material if it "might affect the outcome of the suit under governing law." Liberty Lobby, 477 U.S. at 248. There is no

genuine issue for trial if the record, taken as a whole, does not lead a rational trier of fact to find for the non-moving party. Matsushita Elec. Indus., 475 U.S. at 574. “If the evidence is merely colorable or is not significantly probative, summary judgment may be granted.” Liberty Lobby, 477 U.S. at 249-250 (citations omitted). Once the motion is supported by a prima facie showing that the moving party is entitled to judgment as a matter of law, a party opposing the motion may not rest upon the mere allegations or denials in its pleadings; rather, its response must show that there is a genuine issue for trial. Liberty Lobby, 477 U.S. at 249-250 Matsushita Elec. Indus., 475 U.S. at 587.

CONCLUSIONS OF LAW

I. The Debtor did not willfully neglect to pay its taxes timely, but rather reasonable cause prevented the timely payment.

When a taxpayer fails to timely pay tax and to make timely employment tax deposits, the taxpayer will be liable for “additions-to-tax. See IRC §§6651(a)(2) and (3), 6656. Under certain circumstances, however, a taxpayer may avoid liability for these additions-to-tax by demonstrating that its failure to timely meet its employment tax obligations did not result from “willful neglect,” but rather was due to “reasonable cause”. See US v. Boyle, 469 U.S. 241, 245, 105 S.Ct. 687, 689 (1985) (defining “willful neglect” as “a conscious intentional failure” or one resulting from “reckless indifference”). From the record before the Court, the Debtor has shown that reasonable cause exists, thus penalties may be waived or abated and Debtor’s objections may be sustained.

Courts are split on the issue of which standard governs reasonable cause. This Court declines to follow Brewery, 33 F.3d at 589 which found that, as a matter of law, financial hardship cannot qualify as reasonable cause. As the Court previously stated, this standard is too harsh. Instead, this

Court chooses to follow the majority of circuits, including the Eleventh Circuit, which have adopted a more reasonable standard based upon inability to pay. See, e.g., In re Sanford, 979 F.2d 1511 (11th Cir. 1992); Diamond Plating, 390 F.3d at 1035; Synergy Staffing, 323 F.3d at 1157; Van Camp & Bennion, 251 F.3d at 862; East Wind Ind., 196 F.3d at 499; Fran Corp., 164 F.3d at 814; Slater, 190 B.R. at 695; and Savage, 179 B.R. at 342.

A taxpayer who exercises ordinary business care and prudence and is nevertheless unable to pay the tax or would suffer undue hardship if he paid the tax on time, establishes reasonable cause. See Sanford, 979 F.2d at 1514, n.8. Reasonable cause may also be shown if the taxpayer convincingly demonstrates that a disability beyond its control rendered it unable to exercise ordinary care. Boyle, 469 U.S. at 248, n.6, 105 S.Ct. at 691, n.6. For a taxpayer incapable of meeting objective standards of ordinary business care and prudence, the disability alone could be an acceptable excuse for a late filing. Id.

In determining whether a taxpayer was unable to pay taxes despite the exercise of ordinary business care and prudence, consideration must be given to all facts and circumstances of the taxpayer's financial situation. Slater, 190 B.R. at 695. A debtor who pays its available funds to other creditors rather than the United States does not *per se* require a finding of willful neglect when all other facts and circumstances are considered. See, e.g., East Wind Ind., 196 F.3d at 499 and Fran Corp., 164 F.3d at 814 (court must examine all facts and circumstances of the taxpayer's financial situation).

In East Wind Ind., as a result of actions taken by employees of a federal agency, the taxpayers were not paid monies due and owing to them for work performed and for goods delivered and accepted by the agency, payments were intentionally and substantially delayed, and other misconduct

by the agency occurred. 196 F.3d at 499. In examining the facts and circumstances affecting the taxpayers' financial situation, the court found that the taxpayers' financial ability and cash flow was entirely dependent upon government contracts and that the ability to pay their debts, including the trust fund taxes, was controlled by the governmental agencies. The court found that the failure to pay trust fund taxes under these circumstances did not constitute willful neglect. The non-payment of trust fund taxes does not constitute willful neglect where the non-payment results through no fault of the taxpayer or is caused by some act of nature or other act beyond the control of the taxpayer. East Wind Ind., 196 F.3d at 508. See also, Savage, 179 B.R. at 348 (intentional tortuous misconduct against a debtor rendering the corporation financially unable to comply with its tax obligations could constitute reasonable cause). The court further found that paying available funds to creditors whose services were essential to maintaining the operation of the business did not constitute a conscious intentional failure or reckless indifference, and thus did not amount to willful neglect. East Wind Ind., 196 F.3d at 508-509. Accordingly, the penalties were abated.

In this case, the Debtor was entirely dependent upon CWM for the funds it supplied the Debtor which constituted the majority of Debtor's operating capital. CWM's failure and refusal to pay the Debtor timely was an act beyond the Debtor's control which negatively impacted the Debtor's cash flow. As a result of the impact of CWM's misconduct, this Debtor was unable to pay the IRS while it was struggling to pay creditors who were providing necessary services to the elderly residents of the Debtor's nursing homes. Payment to these other creditors was essential to maintaining the proper level of care for its elderly residents and to ensuring their health, safety and welfare. Under these circumstances, the Court concludes there was no willful neglect in not paying the IRS timely as reasonable cause existed.

The Debtor endured over a decade of litigation and appeals with CWM. When the Debtor finally received the funds on August 26, 2003, all administrative expenses, including those of the IRS, were paid. The IRS' pre-petition claim was paid shortly after confirmation.

This case closely resembles the case of Glenwal-Schmidt v. U.S., 42 AFTR 2d 78-5817, Case No. 77-0902 (D.D.C. 1978), 1978 SWL 4527. In such case, a contractor entered into a contract with the United States Navy. During the term of the contract which spanned three years, various disputes arose. During that time period, the Navy withheld progress payments due and owing to the contractor. In order not to default on the contract, the contractor was required to continue working and completing the contract. The contractor used its limited cash to pay only those essential subcontractors and suppliers and did not timely deposit withholding taxes for two quarters in the approximate amount of \$76,000.00. Subsequent to the completion of the project, the Navy paid the contractor a lump sum of almost \$1 million. The court found that taxpayer had the right to rely upon the Navy to comply with its obligations under the contract and could not have foreseen that the Navy would not comply with such contract requirements. The court found that reasonable cause existed for the failure to timely deposit the withholding taxes and that the penalties should be forgiven.

Here, the Debtor had no reason to believe that CWM would not honor its settlement agreement entered November 1997. But instead of honoring its obligations, CWM engaged in a series of intentional and willful acts, including the passage of legislation that effectively nullified the settlement agreement, causing Debtor to be consistently underfunded for five years and resulting in the filing of a second Chapter 11 petition.

Once the funds were finally received from the bond company, the Debtor filed its motion to pay administrative expenses to the IRS. After a hearing held June 9, 2004, the Court authorized the

Debtor to pay the IRS the sum of \$255,829.17, which was delivered to the IRS that very day by counsel for the Debtor. This administrative expense was actually paid prior to confirmation, when all administrative claims are typically paid.

Another case which supports the elimination or disallowance of penalties is Matter of American Biomaterials Corp., 954 F.2d 919 (3rd Cir. 1992). In American Biomaterials, a debtor filed a motion in bankruptcy court to reduce the IRS' proof of claim by the amount of the penalties assessed. In this case, two officers of the debtor embezzled certain funds from the corporation which incapacitated the corporation and rendered the debtor unable to comply with the Internal Revenue Code. While the returns were filed, no payment of the tax liability had been paid even at the time of the appeal four years later. The Third Circuit found that the corporation was not responsible for the fraud by the officers. The court found that the assessment of tax penalties against the corporation was improper due to the embezzlement by its officers.

So too, in this case, the Debtor could not have foreseen the tortuous and intentional actions of CWM which caused the Debtor to be underfunded and the Debtor should not be penalized for its consequential inability to timely pay the taxes. Although the Third Circuit emphasized that its opinion was addressing the issue of intentional criminal conduct, this Court sees no difference in the intentional criminal conduct displayed by the rogue officers in American Biomaterials and the intentionally malicious conduct of CWM in depriving the nursing homes, and ultimately its 300 elderly residents, of the necessary funds due the Debtor for required maintenance and care of the residents to ensure their health, safety and welfare.

The DIP Reports and the charts prepared by the Debtor (Exhibit 41 to the IRS's Motion) show a wide variation in the monthly revenue received by the Debtor from CWM and extraordinary

fluctuations in the amount of the cash balances carried by the Debtor over this period. These reports have not been challenged by the IRS, who argues instead that the taxes could have been timely paid with some of this revenue. In fact, the IRS ignores receivables due from CWM for billings which are stated in every DIP Report. For example, the March 2001 DIP Report shows a balance owed of \$2,219,464. The DIP Report also shows underfunding in collection of the accounts receivable, apart from the Judgment, of almost \$300,000.00 per month in the first quarter of 2001 alone. The DIP Reports indicate the Debtor had absolutely no control over how much it would receive from CWM at any particular time and Debtor conservatively used whatever funds it had for the benefit of the nursing home residents. The Debtor obtained no benefit for itself; it used its limited resources to feed the nursing home residents and provide them medical attention when necessary. Unfortunately, CWM's malicious actions eventually drained the Debtor financially so that it was forced to close both the Pilgrim Manor Nursing Home and the Provident Nursing Home.

Had CWM paid the Debtor what it owed as a result of the underfunding, the IRS would have been paid on time and had no claim for any period. As of the time of the filing though, CWM owed the Debtor \$902,000.00 plus \$1,907,247.90 for sanctions and accrued interest. This sum would have been more than sufficient to pay the IRS.

Post-petition, CWM owed the Debtor, as of March 31, 2001, another \$1,312,000.00, plus \$1,312,000.00 for sanctions, along with interest, for an aggregate total of \$5,433,242.90, plus accrued interest. This too would have been more than sufficient to pay the IRS.

The financial chart prepared by the IRS supports the position of the Debtor. The Debtor's weak financial condition caused by the misconduct of CWM began to worsen in the year 2001. For example, the cash available to the Debtor fell from \$250,228.71 on February 28, 2001 to \$57,279.88

at the end of March 2001, and continued in its downward direction through September 30, 2002 when the Pilgrim Manor Nursing Home was closed. After such time, while there were some sporadic increases, the trend was primarily downward so that on May 31, 2003 and July 31, 2003 the available cash was less than \$1,000.00. The IRS ignores those portions of the DIP Reports that show that the accounts payable were increasing from approximately \$400,000.00 in 2001 to over \$1.2 million in August 2003, which is clearly indicative of the cash poor situation of the Debtor caused by CWM. Finally, the DIP Reports show that the Debtor did not collect what it billed every month to CWM, the primary source of its income, in some months being underfunded by several hundreds of thousands of dollars.

The Court notes that the bulk of the penalties assessed by the IRS are for tax periods ending June 30, 2002 and September 30, 2002. During these quarters, Pilgrim Manor Nursing Home was forced to close due to the actions of CWM. The closure of the Pilgrim Manor Nursing Home resulted in the loss of over half of the monthly revenue received by the Debtor. The Court believes these circumstances justify the element of reasonable cause for paying the subject taxes belatedly.

The case relied upon by the IRS, PARCC Health Care v. US, 238 F.Supp.2d 435 (D. Conn. 2002), is distinguishable from the case before this Court. In PARCC Health Care, there was no fraudulently obtained agreement by the state of Connecticut, there was no intentional and willful misconduct by the state of Connecticut and the state of Connecticut did not owe the nursing home approximately \$9,000,000.00. Furthermore, unlike the nursing home in the Connecticut case, the Debtor paid those creditors whose services were necessary for properly caring for the health, safety and welfare of the elderly residents of its nursing homes as shown by the cost reports, DIP Reports, and other financial documents. No objections have been filed by the IRS with respect to those

necessary and essential expenses.

From the record before the Court, and in light of the cases cited, the Debtor has established reasonable cause exists so as to avoid the imposition of penalties. Debtor's failure to timely pay the taxes was solely the result of its inability to pay due to the malicious and intentional actions of CWM in not funding the Debtor, as more fully set forth in this order and prior orders of this Court. These actions were beyond the control of the Debtor and establish reasonable cause, rather than willful neglect, in paying the taxes belatedly. Accordingly, any penalty claimed by the IRS must be stricken and the Debtor's objections sustained.

II. The IRS' waiver argument is unpersuasive.

The IRS argues that the Debtor did not timely object to Claim No. 64 and therefore waived any objection to its claim. This argument is unpersuasive. In Claim No. 64, the IRS seeks \$97,161.01 from the Debtor for penalties and interest on penalties for the periods ending December 31, 1997 and March 31, 1998, which are pre-petition periods. The IRS' argument attempts to utilize the original claims bar date of 1999 to establish the deadline for the Debtor to object to the IRS' Claim No. 64. If that were the case, the IRS would be prohibited from amending its proof of claim, which it did on at least four separate occasions *after* the claims bar date. The IRS' argument that no objections can be posed to claims amended after the bar date makes no sense and is wholly unfair. Such is not contemplated under the language of the Federal Rules of Bankruptcy Procedure.

It actually appears to the Court that the IRS may have waived any additional claim it believes it has for amounts due in the fourth quarter of 2003. The IRS, on April 2, 2004, claimed it was owed \$205,294.00 for the fourth quarter of 2003 (RP 54). This claim was amended approximately two weeks later and, at that time, the IRS was paid in full on April 21, 2004. The Debtor paid the IRS

the sum of \$82,201.63 representing the "Balance due for the fourth quarter of 2003." See Exhibit "A" to Debtor's Motion for Summary Judgment. That check that was deposited by the IRS and effectively eliminates any additional claim for the fourth quarter of 2003.

To say that the Debtor received a "windfall" when it was finally paid on its judgment against CWM merely shows the IRS' misunderstanding of the facts and circumstances in this case. This case has a very long and tortured history, and the misdeeds of CWM are legion; but, it appears the IRS has disregarded these very significant and material events in its arguments. The Debtor obtained no benefit for itself; it has paid only those amounts due under its confirmed plan, including the payments to the IRS. The Debtor paid all taxes and interest until the date of payment and the IRS was paid before all other creditors. The Court sees no willful neglect in the Debtor's actions and concludes reasonable cause existed to prevent the timely payment of tax to the IRS, therefore the IRS is not entitled to any additions-to-tax.

III. The Debtor is not entitled to attorney's fees and costs.

The Debtor has sought attorneys fees and costs under 26 U.S.C. §7430. Section 7430, title 26, United States Code, provides that a court shall award to a prevailing party other than the United States, fees and other expenses unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust. Although the Court has concluded that the record demonstrates reasonable cause existed to justify the belated payment of taxes to the IRS, the Court cannot conclude the position of the IRS was not substantially justified. The history of this case spans the course of nearly 2 decades and approximately 600 docket entries. The IRS' argument, though not well-taken, was not without merit based on the voluminous and convoluted record herein.

BASED UPON THE FOREGOING, it is

ORDERED AND ADJUDGED as follows:

1. The Motion for Summary Judgment or, in the Alternative, for Partial Summary Judgment filed by the Internal Revenue Service is DENIED and the Debtor's Motion for Summary Judgment against the Internal Revenue Service is GRANTED.
2. The Debtor's objections to the penalties and interest on penalties sought by the IRS are SUSTAINED and the IRS' claims for such penalties and interest thereon are STRICKEN.
3. The Debtor's request for attorneys fees and costs is DENIED.
4. The IRS' objection to the Final Report and Motion for Final Decree is OVERRULED as moot, and the Clerk is directed to issue a Final Decree and close this case.
5. Any relief not specifically granted herein is denied.

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COPIES FURNISHED TO:

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