

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

<b>IN RE:</b>	)	
	)	
<b>GALEN BEACH,</b>	)	<b>Case No. 01-14473</b>
<b>VICKIE BEACH,</b>	)	<b>Chapter 7</b>
	)	
<b>Debtors.</b>	)	
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	)	
<b>J. MICHAEL MORRIS, Trustee,</b>	)	
	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>Adversary No. 02-5246</b>
	)	
<b>GALEN BEACH,</b>	)	
<b>VICKIE BEACH,</b>	)	
	)	
<b>Defendants.</b>	)	
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**ORDER AND JUDGMENT**

This matter came before the Court for evidentiary hearing on September 17, 2003, following the Tenth Circuit Bankruptcy Appellate Panel’s reversal and remand<sup>1</sup> of this Court’s order revoking debtors’ discharge entered on March 3, 2003 (“Revocation Order”).<sup>2</sup> After hearing further presentation of evidence by the parties on remand, the Court issues its findings of fact and conclusions of law regarding the trustee’s motion for default judgment and sanctions on his adversary complaint to revoke debtors’ discharge.

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<sup>1</sup> *In re Beach*, No. KS-03-021 (10th Cir. BAP August 7, 2003).

<sup>2</sup> Adv. No. 02-5246, Dkt. 24, Revocation Order.

### **Nature of Case**

The chapter 7 trustee J. Michael Morris filed this adversary proceeding on September 26, 2002 to revoke the discharge of debtors Galen and Vickie Beach pursuant to 11 U.S.C. § 727 for noncompliance with this Court's February 25, 2002 order ("Turnover Order") requiring debtors to turnover their 2001 federal and state tax returns.<sup>3</sup> The matter is before the Court on the trustee's motion for default judgment on his adversary complaint.<sup>4</sup>

### **Procedural History**

The debtors' bankruptcy case was filed on September 17, 2001. Shortly after filing, the Trustee issued his standard letter requesting, among other things, copies of the debtors' 2001 federal and state tax returns. Debtors responded on January 15, 2002 declining to produce the returns and asserting that the Trustee lacked the authority to secure this turnover and that the debtors were not required to file returns.

Thereafter, on January 22, 2002 the Trustee moved to compel turnover of the returns.<sup>5</sup> The debtors again objected by filing a motion to dismiss for lack of jurisdiction and argued that, pursuant to 26 U.S.C. § 6103, the trustee had no right to demand the tax returns.<sup>6</sup> This Court entered a Turnover Order on February 25, 2002 requiring the debtors to file their 2001 tax returns by April 15, 2002, and requiring the debtors to turnover to the trustee "full signed copies of their year 2001 federal and state

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<sup>3</sup> No. 01-14473, Dkt. 38, Turnover Order.

<sup>4</sup> No. 02-5246, Dkt. 13.

<sup>5</sup> No. 01-14473, Dkt. 26.

<sup>6</sup> No. 01-14473, Dkt. 29.

income tax returns” when filed, as well as a portion of any refund the debtors might receive.<sup>7</sup> The Court found that § 6103 did not apply to trustees in the administration of bankruptcy cases.

Debtors appealed and the Turnover Order was affirmed by the Tenth Circuit Bankruptcy Appellate Panel (“BAP”).<sup>8</sup> The BAP issued its mandate on August 19, 2002. Debtors received their discharge on July 8, 2002.<sup>9</sup>

Following the appeal debtors still did not produce their 2001 tax returns to the Trustee and, on September 26, 2002, the Trustee filed this adversary proceeding seeking revocation of the debtors’ discharge for violation of court orders pursuant to 11 U.S.C. § 727 and sanctions. Debtors were properly served with a summons and the adversary complaint and, on October 24, 2002, filed a pleading called a “Conditional Acceptance”<sup>10</sup> wherein they recited that the trustee’s demand to perform is “conditionally accepted upon the trustee identifying the instrument that Debtor(s) have signed which creates an attachment of equity jurisdiction between Debtors and the United States which requires Debtors to file a tax return . . . .” The Conditional Acceptance goes on to state that the Trustee must “evidence quality proof of claim of . . . every visible/invisible contract with exists between the Debtors and the United States . . . .” The document also states that, pursuant to Uniform Commercial Code § 9-210, the trustee is required to provide records within 72 hours of the pleading or be held to have dishonored the acceptance and to have stipulated that the debtors have no duty to file returns.

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<sup>7</sup> No. 01-14473, Dkt. 38.

<sup>8</sup> *In re Beach*, 281 B.R. 917 (10th Cir. BAP 2002).

<sup>9</sup> No. 01-14473, Dkt. 71.

<sup>10</sup> Adv. No. 02-5246, Dkt. 4.

Upon review of the Conditional Acceptance, the Court ordered the debtors to appear and show cause why it should not be stricken and the debtors appeared on November 14, 2002. After a hearing, this Court found that the debtors Conditional Acceptance did not rise to the dignity of either an answer or proper responsive pleading under the Federal Rules of Civil Procedure and that the Conditional Acceptance did not fairly meet the allegations of the complaint as required by Fed. R. Civ. P. 8(b). The Court struck the Conditional Acceptance and the debtors filed no other answer or motion and to this day remain in default of answer to the trustee's adversary complaint.<sup>11</sup>

On December 20, 2002 the trustee filed the instant motion for default judgment and for sanctions on his revocation complaint and set the motion for hearing on February 13, 2003.<sup>12</sup> Debtors filed a response, again setting forth their views concerning the existence of visible/invisible contracts binding them to file tax returns and this Court's lack of equity jurisdiction over them.<sup>13</sup> With the response, debtors also filed a "Notice of Dishonor" purportedly issued under Uniform Commercial Code § 3-505 arguing that there was no "attachment of equity jurisdiction" between debtors and the United States as well as other points argued in the Conditional Acceptance.

Immediately prior to the February hearing the debtors delivered to the Trustee an unsigned copy of a document purporting to be their 2001 federal tax return. Based upon the trustee's representations at the February hearing that the tax return was fraudulent, but without the trustee offering the return and the Court admitting the return into evidence (the hearing was set on the Court's regular non-evidentiary motion docket), the Court granted the motion for default judgment and revoked

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<sup>11</sup> Adv. No. 02-5246, Dkt. 7.

<sup>12</sup> Adv. No. 02-5246, Dkt. 13.

<sup>13</sup> Adv. No. 02-5246, Dkt. 15.

debtors' discharge pursuant to § 727(d)(3), holding that the debtors had effectively refused to obey its order that proper tax returns be filed for 2001 and that copies of them be delivered to the trustee.<sup>14</sup>

The debtors appealed the Revocation Order.<sup>15</sup> On August 7, 2003 the Tenth Circuit BAP reversed the Revocation Order and remanded the case for further proceedings, holding that the Court's order was not supported by the evidence since the tax return itself was not admitted into evidence and was not part of the record.<sup>16</sup>

After the BAP reversed and remanded for further proceedings, the matter was set for evidentiary hearing on September 17, 2003 at which time the Court received further evidence upon which the following findings are based.

#### **Findings of Fact**

Immediately prior to the February 13, 2003 hearing on the trustee's motion for default judgment, the debtors delivered to the trustee's office a copy of their 2001 federal income tax return. The document delivered was admitted as Exhibit 27. Exhibit 27 purports to be a 2001 Federal Income Tax return, but it is not signed by either debtor. Defendants assert that they mailed a tax return to the IRS Service Center in "Kansas, Mo 64999 [sic]" on February 12 and that it was received in Kansas City on February 14, 2003.<sup>17</sup>

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<sup>14</sup> See Revocation Order entered March 3, 2003. Adv. No. 02-5246, Dkt. 24. This Court also assessed sanctions against debtors in the amount of \$2,288.44, the amount of fees and expenses incurred by the trustee pursuing turnover of the tax returns.

<sup>15</sup> On April 8, 2003 during the pendency of the appeal, the trustee submitted and filed the debtors' 2001 federal tax return with the Court. The trustee represented that he had received the federal tax return from the debtors on December 11, 2002. See Adv. No. 02-5246, Dkt. 35. The attached return is unsigned by debtors and appears to be identical to Exhibit 27.

<sup>16</sup> *In re Beach*, No. KS-03-021 (10th Cir. BAP August 7, 2003).

<sup>17</sup> See Exhibit A, a certified mail receipt.

On the return, the defendants report wage income (line 7) of \$72,964 and state that their adjusted gross income (line 35) is \$72,964. On line 38 of the return, the defendants claim itemized deductions in the amount of \$75,038 yielding net taxable income of \$-2,074. After availing themselves of the standard exemptions in the amount of \$6,000, debtors claim a refund of all their withheld W-2 tax as well as all excess Social Security tax in the aggregate amount of \$10,089. Reviewing debtors' Schedule A (Itemized Deductions), it appears that their principal deduction is on line 27 in the *total amount of their wages* as listed on line 7. The basis for this deduction is "Unrestricted Claim of Right 26USC1341 [sic]."

Attached to their return is an "Affidavit and Statement" in support of the filing wherein they state under oath that they are exercising a "claim of right" adjustment under 26 U.S.C. § 1341.<sup>18</sup> They assert this claim of right, stating as follows:

- (a) The Affiant [sic] is claiming a natural right.
- (b) The natural right is a right to make a living.
- (c) The amount being claimed is compensation for personal labor that was received as repayment of debt that was owed to Affiant.
- (d) The debt owed was for my personal labor furnished.
- (e) No profit was made.

In the Affidavit, debtors also assert that their claim is based in the tax regulations and in particular, that a repayment or even exchange or compensation for personal labor is not listed as a taxable item of gross income in "CFR 26 Section 1.861-8(a)(3)."

Dennis Suddeth, a Bankruptcy Advisor with the Internal Revenue Service in Wichita, Kansas

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<sup>18</sup> See Exhibit 27.

testified pursuant to subpoena and stated that as of June 9, 2003, the IRS determined that what the debtors filed was a “non-processable” return and that, in his experience, returns are not processable when they are unsigned. He also stated that, according to IRS records, the debtors remain in default of returns for the years 2000 and 2001.

The Court concludes from this evidence that the debtors had not and have not filed federal tax returns for the years 2000 and 2001 that are in a processable form. Moreover, it is apparent that the debtors failed to provide the purported 2001 return until the eve of the February 13 hearing on the trustee’s motion for default judgment and sanctions.

The February 2002 Turnover Order required debtors to provide full *signed* copies of their 2001 federal *and state* income tax returns by April 15, 2002 and the BAP’s mandate affirming this Order was entered on August 19, 2002. At best, the debtors delayed providing these returns as ordered for six months and then only provided Exhibit 27, the unsigned federal tax return.

Defendants have engaged in a pattern of conduct which can only be characterized as one of delay and abuse of the bankruptcy process. This pattern commenced with the debtors’ filing their voluntary petition which contained their Social Security numbers with the digits transposed. A week later, they amended their petition to reflect the correct numbers. On March 26, 2002, on the motion of the United States Trustee, this Court ordered the debtors to provide to the United States Trustee’s office self addressed, stamped envelopes for each creditor listed on the matrix as well as to three credit bureaus, Equifax, Experian, and Transamerica, within 10 days of the order.<sup>19</sup> The order provided that if the debtors failed to comply, the case would be dismissed.

Debtors appealed this order to the BAP, but failed to prosecute the appeal and the BAP

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<sup>19</sup> No. 01-14473, Dkt. 49.

dismissed it on April 22, 2002.<sup>20</sup> On March 16, 2002, debtors filed a certificate of service in the main case certifying that they had “send [sic] out our amended social security number” to a list of creditors.<sup>21</sup> The list does not include the credit reporting agencies and omits complete addresses for the IRS and the Kansas Department of Revenue. The attorney for the United States Trustee, Richard Wieland, testified that his office never received the addressed and stamped envelopes that the Court ordered debtors to provide.

The trustee introduced into evidence several items of correspondence he has received from the debtors and from notaries public in Utah who purport to act for the debtors. The debtors wish to resolve their concerns with the trustee as a “private” matter and view the Trustee’s action of bringing debtors’ failure to comply with his requests to the Court’s attention as breaches of contract or violations of sections of the Uniform Commercial Code.<sup>22</sup> When the debtors testified, they indicated that they did not really understand what these letters and demands meant, except that they believe that what a notary public certifies has the force of law and must be obeyed. The debtors also testified that they were advised to pursue this course of action by one Tom Smith, a resident of Utah, who has assisted them in the preparation of their bankruptcy papers (including the “Conditional Acceptance”) as well as the 2001 federal tax return. Exhibits 29 through 38 are copies of this correspondence. Summarizing these documents, it appears that when the trustee did not agree to the private settlement of his claims against the debtors, a Notice of Dishonor and Certificate of Protest were issued by a

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<sup>20</sup> See No. 01-14473, Dkt. 47 and Dkt. 63; *In re Beach*, No. KS-02-023 (10th Cir. BAP April 22, 2002)

<sup>21</sup> No. 01-14473, Dkt. 48.

<sup>22</sup> Debtors offer no authority for the proposition that any part of the Uniform Commercial Code is relevant to this proceeding.

notary public in Utah providing, inter alia, that service of the protest “shall serve as evidence that your refusal to pay/performance is without lawful cause given, creates estoppel against you, as drawee, to the matters at hand and that Vicki and Galen Beach have exhausted all of their administrative remedies.”<sup>23</sup> Exhibit 38 is a demand by debtors for payment of \$500,000 by the trustee, stating that when the trustee failed to respond to the debtors’ “Administrative Presentment,” he consented to “having his name entered on a UCC-1 form as a debtor in the amount of \$500,000 of which nothing has been paid.” The demand grants the trustee 10 days in which to pay, failing which the claimants (the Beaches) may file an involuntary bankruptcy against him or notify the United States Trustee of this “unpaid secured debt.”

### **Conclusions of Law**

When the debtors’ Conditional Acceptance was found to be insufficient and struck by the Court, the debtors were in default of answer or responsive pleading and the trustee was entitled to default judgment on his adversary complaint.<sup>24</sup> Judgment should therefore be entered on the Trustee’s complaint seeking to revoke debtors’ discharge.

But even if the Trustee was not entitled to default judgment, it appears from the great weight of the evidence presented in a half-day trial that the Debtors have violated this Court’s Turnover Order as well as other orders.

The 2001 federal tax return presented by the debtors to the trustee some 6 months after the BAP’s affirmance of the Turnover Order is questionable at best and fraudulent at worst. It is unsigned and, moreover, it asserts entitlement to an itemized deduction for all of debtors’ wages. It relies on section 1341 of the Internal Revenue Code which, even cursorily read, applies only where taxpayers have included items in gross income in a prior taxable year because it appeared they had an

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<sup>23</sup> See Ex. 36 and 37.

<sup>24</sup> See Fed. R. Civ. P. 8, 12 and 55(b)(2).

unrestricted right to the item. The general rule stated in § 1341(a) is that a deduction is allowable in the current year where it is established after the prior year that the taxpayer did not have an unrestricted right to the item.<sup>25</sup> This code section simply does not avail the debtors of the right to deduct all of their wages from gross income. The debtors did not sign their return; rather they signed an affidavit stating that because their wages are not profit, they are not recognized as income under the Internal Revenue Code. This is nonsense. What the debtors produced to the trustee did not amount to compliance with this Court's Turnover Order that "full signed copies of their 2001 federal and state income tax returns" be timely filed and provided to the trustee.

Debtors freely admitted at trial that they have never filed their 2001 Kansas Income Tax return, another violation of this Court's Turnover Order. Their explanation that Tom Smith is preparing the return does not excuse their failure to comply with the Turnover Order.

Debtors clearly violated this Court's order that they provide envelopes and stamps to the United States Trustee's Office so that all of their creditors and the three credit reporting agencies could be notified of their correct social security number. Although they did file a certificate of mailing such notices to their creditors, the Court notes that no addresses are given on that certificate for either the taxing authorities or the credit agencies. Debtors' various excuses for the transposition of their social security numbers are inconsistent and not credible and are more evidence of their attempts to abuse the bankruptcy system.

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<sup>25</sup> 26 U.S.C. § 1341 governs the computation of tax where the taxpayer repays a substantial amount held under claim of right. It was intended to provide tax relief to a taxpayer who might be disadvantaged because in the year of repayment, when taxpayer can take deduction, he might be in lower tax bracket than in year in which he received income. *See Missouri Pac. R. Co. v. United States*, 423 F.2d 727 (Ct. Cl. 1970), *supplemented* 427 F.2d 727 (Ct. Cl. 1970), *modified on other grounds*, 433 F.2d 1324 (Ct. Cl. 1970), *cert. denied* 404 U.S. 830 (1971) (Case involving freight and passenger rate overcharges received by railroad and reported as taxable income that was repaid in subsequent years).

Finally, the series of correspondence sent by debtors to the trustee, commencing with the Conditional Acceptance, and culminating in their demand that the Trustee pay them \$500,000 simply makes no sense. Taking them at their word, the debtors have taken the advice of Tom Smith and attempted to resolve this dispute not within the confines of this Court or pursuant to its jurisdiction (which they invoked when they filed their case), but rather through a process of private dispute resolution based upon a concatenation of unrelated sections from different articles of the Uniform Commercial Code and a hitherto unrecognized “ghost” judiciary where notaries are the highest judicial officers and where notaries’ attestations are binding as a matter of law. It is tragic that these debtors, who appear to have real debt problems, have been seduced by Internet-based charlatans to take these bizarre actions which place their discharge in peril.

Debtors are duty-bound to cooperate with the Trustee in the administration of their cases.<sup>26</sup> They have a duty to surrender to the trustee any recorded information or books and records relating to property of the estate.<sup>27</sup> This includes tax returns and the refunds which may flow from them.<sup>28</sup> Debtors are, of course duty-bound to obey this Court’s lawful orders. Debtors who fail to cooperate or who fail to obey a lawful order of the Court are subject to having their discharges revoked under §727(d)(3). Standing alone, debtors’ failure to comply with the Turnover Order would be sufficient to warrant this relief. Their pattern of conduct outlined above merely aggravates their failure. As recently as September 30, 2003, debtors wrote to the Court arguing that they have fully complied with the Court’s order and that should this Court rule otherwise, or find that their return was insufficient, they will again appeal. This further illustrates debtors’ intransigence. The Clerk is ordered to docket

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<sup>26</sup> 11 U.S.C. § 521(3).

<sup>27</sup> 11 U.S.C. § 521(4).

<sup>28</sup> *See In re Beach*, 281 B.R. at 921.

this letter as a pleading in the adversary proceeding.

The Court concludes that the debtors' actions violated this Court's Turnover Order and other orders noted herein, that their discharges should be revoked pursuant to 11 U.S.C. § 727(d)(3), and that a separate judgment to that effect shall issue this day. The Court has reserved the matter of the trustee's request for sanctions against debtors. The Clerk will set an evidentiary hearing on the sanctions and issue notice to the parties of such setting.

Dated this 10th day of November, 2003.

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ROBERT E. NUGENT  
CHIEF BANKRUPTCY JUDGE  
UNITED STATES BANKRUPTCY COURT  
DISTRICT OF KANSAS

## CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the **Order and Judgment** was deposited in the United States mail, postage prepaid on this 10th day of November, 2003, to the following:

J. Michael Morris  
Klenda, Mitchell, Austerman &  
Zuercher, LLC  
301 N. Main  
Suite 1600  
Wichita, KS 67202

Sarah Newell  
Klenda, Mitchell, Austerman &  
Zuercher, LLC  
301 N. Main  
Suite 1600  
Wichita, KS 67202

Richard Wieland  
U.S. Trustee's Office  
500 Epic Center  
301 N. Main  
Wichita, KS 67202

Galen and Vickie Beach  
3228 Northwood Ct.  
Newton, KS 67114

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Janet Swonger,  
Judicial Assistant