

Did Debtor Err by Withholding Taxes from Payment of Wage Claims Transferred to Claims Trader?

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United States Debt Recovery I, LLC, a firm specializing in acquiring claims against bankrupt companies, filed a motion today with the Delaware bankruptcy court asserting that Aventine Renewable Energy Holdings, Inc. improperly withheld taxes from its payments on account of priority wage claims that U.S. Debt Recovery acquired from Aventine's employees. Aventine's first amended joint plan of reorganization, which was confirmed on February 24, 2010, classified priority wage claims in Class 1. Allowed Class 1 claims were entitled to receive "(A) Cash equal to the amount of such Allowed Other Priority Claim, or (B) such less favorable treatment as to which such Debtors or Reorganized Debtors and the holder of such Allowed Other Priority Claim have agreed in writing."

U.S. Debt Recovery acquired approximately \$107,000 in priority wage claims from Aventine's employees. However, Aventine paid it only \$68,605.98 on account of the allowed claims and notified it that the remaining \$39,200 was being withheld for tax purposes. U.S. Debt's motion asserts that, because the payment was made to it as the acquirer of the claims rather than the employees, Aventine's decision to withhold taxes has caused both U.S. Debt and the employees to be "subject to inaccurate, unjustified and simply incorrect tax liabilities." While it acknowledges that the Internal Revenue Code requires a corporation to withhold taxes from wage claim payments to employees, U.S. Debt Recovery asserts that the IRC, the Bankruptcy Code, and court opinions are all silent as to whether withholding is required when the claims have been transferred and the debtor's payments are being made to a successor in interest.

Aventine's tax withholding leads to an "improper and unjustified" result, according to U.S. Debt Recovery, because (1) employees risk being taxed twice (first when they reported the payment that they received for selling their claims and second from Aventine's W-2 reporting payment in full on the claims) and (2) U.S. Debt Recovery being taxed on the full amount of the claim payment from Aventine, despite it having paid the employees to acquire their claims (the amount of the payments to the employees for the claims is not disclosed). Therefore, U.S. Debt Recovery is asking the court to enforce its proposed solution, which Aventine apparently rejected prior to today's motion:

- Aventine would amend or file a 941 report removing or omitting the wage claims to either receive a refund of amounts paid to taxing authorities or avoid remitting amounts to taxing authorities related to these wage claims.
- Aventine would pay the full amount of the withholding to U.S. Debt Recovery and issue a 1099 to U.S. Debt Recovery.



- U.S. Debt Recovery would take "responsibility for any and all taxes owed on the wage claims and agree[] to report all 1099s to the employees" for the amounts paid to the employees by U.S. Debt Recovery to acquire the claims.

The motion is scheduled to be heard by Bankruptcy Judge Kevin Gross on June 22, 2010. Objections are required to be filed by June 15th at 4:00 p.m. (Eastern).

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