

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

No. 92-12605
Chapter 13

ROBERT SCOTT DAVIS
DONNA E. DAVIS

Debtors

MEMORANDUM

Appearances: Richard L. Banks, Cleveland, Tennessee, Attorney for Debtors,
Robert Scott Davis and Donna E. Davis

M. Kent Anderson, Assistant U.S. Attorney, Chattanooga, Tennessee,
Attorney for Internal Revenue Service

R. THOMAS STINNETT, UNITED STATES BANKRUPTCY JUDGE

The Internal Revenue Service (IRS) has filed a motion to lift the automatic stay imposed by Bankruptcy Code § 362. 11 U.S.C. § 362(a). The IRS wants the stay lifted so that it can set off income tax refunds owed to the Chapter 13 debtors, Robert and Donna Davis, against income tax that they owe. The Davises owe the income tax for 1992, the year that they filed their Chapter 13 case. The income tax refunds are for 1993 and 1994, years during which the Davises were carrying out their Chapter 13 plan. (The Davises are still carrying out the plan.)

The relevant facts are as follows. The Davises filed their Chapter 13 case in June 1992. The court confirmed their Chapter 13 plan in July 1992. The plan provides for full payment of all priority claims. The IRS has filed a proof of claim for a secured claim of \$11,250.47 and a priority claim of \$2,295.43. The claims are for taxes for the years 1988 through 1991. The Davises filed their 1992 income tax return in September 1993. It indicated a tax debt to the IRS of \$1,076.68. They filed their 1993 return in August 1994. It indicated that they had overpaid their taxes for 1993 and were due a refund of \$974.97. The Davises filed their 1994 income tax return in April 1995. It indicated that they had overpaid their taxes again and were entitled to a refund of \$239.00. The IRS filed its motion to lift the stay on June 28, 1995.

The Davises have raised several arguments against the setoff. The arguments treat the Davises' debt for the 1992 taxes as a prepetition debt to the IRS. The arguments are as follows. First, the IRS cannot collect the Davises' prepetition debt for the 1992 taxes by setting off its postpetition debt to the Davises for the 1993 and 1994 refunds; a creditor cannot collect the debtor's prepetition debt to it by setting off its postpetition debt to the debtor. Second, the IRS's prepetition claim for the 1992 taxes was

an unsecured claim when the Davises filed their Chapter 13 case and is provided for in the confirmed Chapter 13 plan as an unsecured priority claim; the IRS cannot convert the claim into a claim secured by the Davises' postpetition refunds. Third, the Davises' confirmed Chapter 13 plan provides for payment of the 1992 taxes (as a prepetition priority claim) from the money the Davises are paying to the Chapter 13 trustee; the IRS is bound by the plan and cannot collect from the Davises' other postpetition income, namely the tax refunds, since the plan preserves that income for the Davises' use free from the debts that are provided for in the plan.

These arguments must fail because they depend on treating the IRS's claim for the 1992 tax as a prepetition claim. Judge Kelley has held that income tax for the year in which the debtor files a Chapter 13 case is a postpetition debt. *In re Ryan*, 78 B.R. 175 (Bankr. E. D. Tenn. 1987). This decision has not been overruled, and the same result has been reached by other courts. *United States v. Ripley (In re Ripley)*, 926 F.2d 440 (5th Cir. 1991); *In re Hudson*, 158 B.R. 670, 673 (Bankr. N. D. Ohio 1993).

The third argument could still apply *if* the postpetition debt for the 1992 taxes was provided for by the Chapter 13 plan. However, a confirmed Chapter 13 plan provides for a postpetition tax debt only if the creditor has filed a proof of claim for the debt. 11 U.S.C. §§ 1305(a)(1) & 1322(b)(6); *Hester v. Powell (In re Hester)*, 63 B.R. 607 (Bankr. E. D. Tenn. 1986). Since the IRS has not filed a proof of claim for the 1992 income tax, the Davises' Chapter 13 plan does not provide for the claim.

The question, then, is whether the IRS can set off its postpetition debt for the refunds against the Davises' postpetition debt for the 1992 taxes. Bankruptcy Code § 553 provides for setoff of mutual prepetition debts. 11 U.S.C. § 553. This could give rise to a

negative implication: since the statute allows setoff of mutual prepetition debts, then the Bankruptcy Code does not allow setoff in any other situation. The wording of § 553 does not support this implication. Section 553(a) begins: “Except as otherwise provided in this section and in sections 362 and 363 . . . this title does not affect the right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case . . . against a claim of such creditor against the debtor that arose before the commencement of the case” 11 U.S.C. § 553(a). In other words, § 553 preserves (with some exceptions) a creditor’s right under non-bankruptcy law to set off mutual prepetition debts. This does not lead to the conclusion that the bankruptcy statutes disallow setoff of mutual postpetition debts. The bankruptcy statutes do not deal with setoff of mutual postpetition debts. *Mohawk Industries, Inc. v. United States (In re Mohawk Industries, Inc.)*, 82 B.R. 174 (Bankr. D. Mass. 1987); see also *Dery v. General Motors Corp. (In re Fordson Engineering Corp.)*, 25 B.R. 506 (Bankr. E. D. Mich. 1982).

Furthermore, the Bankruptcy Code does not create a seamless web of bankruptcy law. A section or subsection that provides a result for one particular situation does not necessarily imply the opposite result in all other similar situations; more basic rules may govern. *In re Keaton*, 182 B.R. 203 (Bankr. E. D. Tenn. 1995). The court concludes that § 553 does not disallow setoff of mutual postpetition debts.

Bankruptcy Code § 362 imposes an automatic stay on many collection activities by creditors. 11 U.S.C. § 362(a). For the purpose of argument, the court assumes the automatic stay applies to the setoff in question in this proceeding. The automatic stay does not absolutely bar setoff in all situations. Certainly it is not an absolute bar in this situation. It only gives rise to the question of whether the stay should be lifted.

A confirmed Chapter 13 plan leaves the Chapter 13 debtor with postpetition income to pay postpetition debts. Postpetition income tax is one of those postpetition debts that the Chapter 13 debtor is expected to pay from postpetition income. Indeed, the amount that a debtor must pay under the plan, in order to meet the disposable income requirement, is based on the debtor's income after payment of the correct amount of income tax. 11 U.S.C. § 1325(b)(1)(B). *Cf. In re Rhein*, 73 B.R. 285 (Bankr. E. D. Mich. 1987); *In re Heath*, 182 B.R. 557 (Bankr. 9th Cir. 1995). Of course, income tax is generally withheld by the debtor's employer before payments to the Chapter 13 trustee.

In these circumstances there is no need for a general rule against setoff of postpetition refunds against postpetition tax debts. Disallowing setoff should not be necessary to assist a Chapter 13 debtor in carrying out the confirmed plan. The Davises have not argued that their receipt of the refunds is vital to their ability to carry out their Chapter 13 plan.

Income tax withholding during the year often fails to match the true amount of tax as calculated after the end of the tax year. As a result the taxpayer ends up owing tax or being entitled to a refund from the IRS. The Davises have not argued that the IRS somehow managed to have too much tax withheld in 1993 and 1994 as a means of collecting the 1992 tax debt. As far as the court can tell, the Davises' underpayment in 1992 and their overpayment in 1993 and 1994 occurred in the normal course of events.

The IRS certainly did not retain the 1993 and 1994 refunds as a method of building up a reserve to collect any later tax debts the Davises might owe. The Davises already owed a postpetition tax debt for 1992.

The Davises argue that the IRS violated the automatic stay by setting off the refunds before it filed its motion for relief from the stay. The Davises filed their 1993 tax return in August 1994. It showed that the Davises were entitled to a refund of \$974.97. The IRS did not pay the refund to the Davises and did not file the motion to lift the stay until June 1995. A delay by the IRS in paying a refund may or may not amount to a setoff. *Compare In re Price*, 134 B.R. 313 (Bankr. N. D. Ill. 1991) and *Rozel Industries, Inc. v. Internal Revenue Service (In re Rozel Industries, Inc.)*, 120 B.R. 944 (Bankr. N. D. Ill. 1990). The evidence is not sufficient for the court to say that the IRS's delay amounted to a setoff before it filed the motion for relief from the stay.

In any event, a creditor's violation of the automatic stay does not, by itself, justify denial of the creditor's motion for relief from the stay. *Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.)*, 749 F.2d 670 (11th Cir. 1984); *In re Midway Industrial Contractors Inc.*, 167 B.R. 139 (Bankr. N. D. Ill. 1994). In this situation the court believes that relief should be granted. The Davises never brought any action regarding the IRS's alleged violation of the automatic stay by failing to pay the refunds. They raised the argument only in response to the IRS's motion to lift the stay. Moreover, the Davises have not proved any good reason why they should receive the refunds before paying their postpetition taxes to the IRS. The court will enter an order allowing the setoff by the IRS.

This Memorandum constitutes findings of fact and conclusions of law as required by Fed. R. Bankr. P. 7052.

At Chattanooga, Tennessee.

BY THE COURT

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

[entered November 3, 1995]