UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

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| IN RE: | C/A No. 02-02000-W |
| Lionel Dozier, | **JUDGMENT** |
| Debtor. | Chapter 13 |

Based upon the attached Order of the Court, the Court grants the Motion to Lift Automatic Stay to Set Off Tax Refund (the "Motion") filed by the United States of America on behalf of the Internal Revenue Service (the "Service").

John E Waites

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
August 21, 2002.

ENTERED
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C.H.B.

Jdgt. 02-99

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CERTIFICATE OF MAILING

The undersigned deputy clerk of the United States Bankruptcy Court for the district of South Carolina hereby certifies that a copy of the document on which this stamp appears was mailed on the date listed below to:

AUG 26 2002

DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE, + Atty Barnett for IRS

CONNIE H. BROOKS
Deputy Clerk

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

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| IN RE: | C/A No. 02-02000-W |
| Lionel Dozier, | **ORDER** |
| Debtor. | Chapter 13 |

THIS MATTER comes before the Court upon the Motion to Lift Automatic Stay to Set Off Tax Refund (the "Motion") filed by the United States of America on behalf of the Internal Revenue Service (the "Service"). The Service filed a Proof of Claim on April 22, 2002 indicating Lionel Dozier ("Debtor") owes it $3,425.96, and the claim is based upon Debtor's income tax liability for the 1999 tax period. The Service asserts that it owes Debtor a tax refund for the 2001 tax period in the amount of $1,550.00 and that the Service's claim is secured in the amount of the refund. Pursuant to 11 U.S.C. §553, the Service moves to set off the amount of the refund from the amount Debtor owes for prior tax liability.[1] Further, the Service argues that Debtor cannot offer adequate protection as an alternative to the tax refund that the Service now possesses. Accordingly, the Service asks the Court to grant its motion, lift the automatic stay, and allow the Service to set off Debtor's 2001 tax refund against the 1999 tax liability Debtor owes. Debtor objects to the Motion and argues that the debt owed for prior tax liability is treated in the confirmed Plan and that these plan payments protect the Service's interest.[2] Debtor asks

[1] Further references to the Bankruptcy Code shall be by section number only.

[2] Debtor's Plan provides for payments to the Service as a priority claimant in the allowed amount of its claim on a pro-rata basis.





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the Court to dismiss the Motion and to order the Service to release the refund owed to Debtor.

Section §553 authorizes the setoff of claims in certain circumstances. For a right of setoff to exist under §553(a), a party must demonstrate the following elements: (1) it has a right of setoff under non-bankruptcy law; (2) the right arises from a mutuality of debts; (3) the mutual debts both arose prior to the commencement of the case; and (4) the right of setoff is not subject to an exception listed in §553(a)(1-3) or (b). See 2 John B. Butler, III, The Bankruptcy Handbook, §28.2 (1997). The right of setoff, however, is impacted by the automatic stay. Section 362(a)(7) stays the exercise of the right of setoff of any debt owing to the debtor that arose before the commencement of the case against any claim against the debtor. The automatic stay does not defeat a right of setoff, but, if a creditor wants to exercise its right of setoff, the creditor must first obtain relief from the stay. See Sheinfeld et al., Collier on Bankruptcy Taxation, ¶TX5.08[7] (15th ed. rev. 2001).

Addressing the elements of setoff, the Court finds that the Service meets these requirements. First, non-bankruptcy law allows the Service a right of setoff. Internal Revenue Code §6402(a) provides that the Secretary of the Treasury may credit the amount of a taxpayer's overpayment against any liability owed with respect to an internal revenue tax. Next, there is mutuality of debts. "The basic test of mutuality is not the similarity of the obligation but whether debts are owed by both sides." Id. at ¶TX5.08[5]. This element is satisfied as the Service owes Debtor a tax refund for his overpayment of taxes and Debtor owes the Service for tax liability for the 1999 tax year. Third, both debts arose before the commencement of Debtor's bankruptcy case. Debtor owes a debt based upon his 1999 tax liability, and this debt arose before his petition date of February 19, 2002. The Service owes Debtor a refund based upon his overpayment for

the tax period of 2001, and this debt also arose prepetition. "If a debtor files a [bankruptcy petition] after the end of a calendar year, any refund attributable to the preceding calendar year will be a prepetition tax refund and will be subject to the IRS right of setoff against prepetition tax claims." Id. at ¶TX5.08[6] (noting further that this analysis is applicable even if a refund is not claimed until after the bankruptcy petition is filed). Finally, it appears that the Service's right of setoff is not affected by any of the exceptions listed in §553 as (1) the Service's claim has not been disallowed; (2) the Service's claim was not transferred to it by an entity other than Debtor; and (3) the debt the Service owes Debtor was not incurred postpetition.

Although the Service satisfies the elements to obtain a setoff, there is case authority in the Fourth Circuit that indicates it may not be entitled to set off because Debtor's Plan has been confirmed. In United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985), the Service filed a motion wherein it sought relief from the automatic stay in order to set off a portion of the debtors' tax refund against an unpaid tax deficiency for a previous year. The court concluded that the Service's retention of a portion of the debtors' refund, which the Service described as an administrative freeze to preserve the status quo until the stay expired, was a violation of the automatic stay.[3] See id. at 1006-07. In addition, the court addressed the district court's ruling that the Service should turn over the tax refund because the debtors' confirmed plan treated the debt owed to the Service and these plan payments provided adequate protection for the Service's secured claim. The Fourth Circuit ruled that it did not need to decide whether the Service was a

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[3] This ruling would likely be different today in light of Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 21 (1995) wherein the United States Supreme Court held that a creditor's temporary refusal to pay a debt that is subject to a setoff does not violate the automatic stay as this temporary refusal does not constitute a setoff.

secured creditor by virtue of its right of setoff or whether it was unsecured but assured of payment by virtue of §507 priority. Because the parties stipulated that the trustee had at that time sufficient funds to pay the Service's claim in full and because the confirmed Chapter 13 plan treated the debt owed to the Service, the court denied the motion for relief from the stay and ordered the trustee to make payments to the Service according to the terms of the plan. See id. at 1008.

Another court in the Fourth Circuit that has faced similar issues also denied the Service's application to offset a refund it owed a debtor. In United States v. Driggs, 185 B.R. 214 (D. Md. 1995), the debtor's confirmed plan provided for the debtor to pay its tax liability to the Service in full plus interest over a six year period. Further, the plan specifically prohibited any creditor from asserting any setoff right against the debtor. Despite the fact that the plan containing this language had been confirmed, the Service filed a motion requesting a setoff. The court noted the interplay between the binding effect of a confirmed plan pursuant to §1141(a) and the ability to offset a debt owed under §553, and the court concluded that, in that case, the binding effect of a confirmed plan took precedence over a right to setoff. See id. at 215. Guided by the reasoning of Reynolds, the court ruled that it was proper for the bankruptcy court to refuse to permit the Service to offset the debtor's tax refund. See id.

At first blush, it appears that this Court may deny the Motion based upon the principle of Reynolds that a creditor is bound by the terms of a confirmed plan that treats the creditor's debt. See Reynolds, 764 F.2d at 1007-08. However, in a more recent case, Deutchman v. Internal Revenue (In re Deutchman), 192 F.3d 457, 461 (4th Cir. 1999), the Fourth Circuit held that a confirmed plan must clearly and accurately characterize the creditor's claim throughout the plan

if it is to be given a binding effect. Therefore, the issue before the Court is whether the confirmed Plan clearly and accurately characterizes the Service's claim.

In this case, the Proof of Claim filed on April 22, 2002 indicated that the Service was partially secured by virtue of having a right of setoff. Further, §506(a) provides that a creditor holding a valid right of setoff is to be treated as the holder of a secured claim to the extent of the setoff right. Accordingly, the Service is a secured creditor to the extent of the refund it owes Debtor as the Service satisfies the elements of setoff. Despite the Service's assertion of a partially secured status, Debtor has not filed an objection to the Service's claim and does not treat the Service as a secured creditor in his Plan, which was confirmed on April 30, 2002. While the form language of the Plan reads, "If a tax creditor files a claim purporting to be a secured claim but does not timely object to confirmation of this plan, then the claim may be paid as a priority claim," the Court believes this language alone is insufficient under the Deutchman standard to convert the Service's partially secured status to a claim that is unsecured but has §507 priority. Indeed, Debtor did not specifically name the Service in his Plan, identify the Service as having a secured claim, or address the right of setoff. There is no specific provision or term that is sufficient to affect the Service's secured interest in the refund or to extinguish the Service's right to assert a setoff as was the case in Driggs. Applying the holding of Deutchman to the case at bar, the Court concludes that Debtor's Plan did not identify and properly treat the Service's secured claim and that this conspicuous absence in Debtor's Plan is not a clear and accurate characterization of the Service's claim so as to preclude the Service's right of setoff. See also In re Koenig, C/A No. 00-11188-W, slip op. at 3 (Bankr. D. S.C. Dec. 7, 2001) (holding that a generally worded plan providing for a non-debtor third party to make payments on a vehicle

being held by the debtor did not extinguish the creditor's lien or prohibit the creditor from foreclosing its lien on the vehicle to dispossess the debtor). Accordingly, the Court rules that the terms of the confirmed Plan do not prohibit or bar the Service's right to set off the refund.

Finally, the Court considers whether Debtor has offered adequate protection to the Service that would satisfy the Service's Motion in lieu of relief from the automatic stay. Although Debtor appears to be current in his payments to the Chapter 13 Trustee due to a Wage Order, the Court concludes that payment to the Service under the Chapter 13 Plan, as Debtor proposes, is not adequate protection in this case. Not only is Debtor's case in a very early stage and without a history indicating consistent and timely payments, but the Plan is patently flawed as it does not provide for payment of the Service as a partially secured claimant. As a result, the motion for relief from the automatic stay should be granted.

**CONCLUSION**

From the arguments discussed above, it is therefore

**ORDERED** that the Service's Motion is granted.

**AND IT IS SO ORDERED.**

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
August 21, 2002.

CERTIFICATE OF MAILING

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