UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Mart Dwaine Kolb and Karen McCall Kolb,

Debtors.

C/A No. 02-05079-W

JUDGMENT

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").

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
August 26, 2002.

02-101
45

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 28 2002

mccoy for cr

DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE, jqmt indiv.

VANNA L. DANIEL

Deputy Clerk

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:	C/A No. 02-05079-W
Mart Dwaine Kolb and Karen McCall Kolb,	**ORDER**
Debtors.	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 June 20, 2002 indicating Mart Dwaine Kolb and Karen McCall Kolb ("Debtors") owe it $25,531.91, and the claim is based upon Debtors' income tax liability for the 1998 tax period. As part of its claim, the Service asserts that it owes Debtors a tax refund for the 2001 tax period in the amount of $3,309.00 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 Debtors owe for prior tax liability.[1] Further, the Service argues that Debtors 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 Debtors' 2001 tax refund against the 1998 tax liability Debtors owe. Debtors object to the Motion and argue that they can adequately protect the Service's interest through plan payments and offer to amend their Plan to provide for the Service as a secured creditor to the extent of the refund.[2]

---

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

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

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

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 nonbankruptcy 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, nonbankruptcy 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 Debtors a tax refund for their overpayment of taxes and Debtors owe the Service for tax liability for the 1998 tax year. Third, both debts arose before the commencement of Debtors' bankruptcy case. Debtors owe a debt based upon their 1998 tax liability, and this debt arose before their

petition date of April 26, 2002. The Service owes Debtors a refund based upon their 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 Debtors; and (3) the debt the Service owes Debtors was not incurred postpetition.

Debtors admit the Service has a valid right of setoff but argue that their receipt of the refund is necessary to their reorganization plan because they have had unexpected and urgent expenses. In addition, Debtors assert that they have provided adequate protection for the Service's interest in the refund by providing payment of the Service's allowed claim in full as a §507 priority creditor, or, if allowed, Debtors will amend their Plan to provide for the Service as a secured creditor to the extent of the refund.

In the Court's view, Debtors' offer of adequate protection is insufficient to stop the Court from granting relief from the automatic stay and allowing the Service to set off the 2001 tax refund. First, the Court notes that the Plan filed on July 29, 2002 has not yet been confirmed. Cf. In re Dozier, C/A No. 02-02000-W slip op. at 6 (Bankr. D. S.C. Aug. 26, 2002) (finding no adequate protection where Debtor offered to make payments under a confirmed plan). Second, the present Plan does not provide for the Service as a partially secured creditor despite the Service's previously filed claim to which there has been no objection by Debtors, Debtors'

admission that they expected the refund when they filed the case, and Debtors' admission that the Service has a valid right of setoff. See id. (finding no adequate protection for payments under a confirmed plan when the plan did not properly treat the Service's claim as partially secured). Finally, if Debtors have had unexpected legitimate expenses, they can make further amendment to their Plan before confirmation. According to the clear language of §553, the Service's right to setoff is not easily defeated. For these reasons, the Court concludes that payment to the Service under the Chapter 13 Plan, as Debtors propose, is not adequate protection in this case. Not only is Debtors' 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.

John E. Waites
UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
August 26, 2002.

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 28 2012

mccoy for cr

DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE, jgmt indux

VANNA L. DANIEL

Deputy Clerk