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U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF WASHINGTON

In Re: JANET M. BLUMER, Debtor(s).	No. 01-06048-W13 MEMORANDUM DECISION RE: AMERICAN GENERAL FINANCE CLAIM

THIS MATTER came on for hearing before the Honorable Patricia C. Williams on March 27, 2002 for confirmation of the Chapter 13 Plan. Debtor was represented by John Bury and the Chapter 13 Trustee appeared through Joseph Harkrader. The court reviewed the files and records herein, heard argument of counsel, and was fully advised in the premises. The court now enters its Memorandum Decision.

On October 18, 2001, the debtor filed her Second Amended Chapter 13 Plan which provided for monthly payments of $619.80 for 60 months and created a base of $37,188. A secured car loan will be paid through the Plan at the rate of $293.34 monthly. The plan also separately classifies debtor's unsecured obligation of $18,714.80 to American General Finance or to Variable Annuity Life Insurance Company (hereinafter "VALIC"). It is undisputed that this is a repayment of a loan of the debtor from her retirement fund which is in the form of an annuity insurance policy. It is

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similar to the repayment of a loan from a 401(K) plan in that the repayment of the loan essentially increases the debtor's annuity or retirement fund to its pre-borrowing level. The debtor basically repays herself, although the annuity cannot be drawn against until the debtor reaches a certain age and meets other conditions. If the loan is not repaid, the loan is reported to the Internal Revenue Service as a taxable distribution from the annuity.

No Proof of Claim has been filed by VALIC. However, an Amended Schedule "F" schedules VALIC's claim. By declaration, the debtor states that the first payment was due on September 15, 2001, roughly two months after the Chapter 13 petition was filed. The payment was to be $337.23 per month for some unknown period. Under the Plan, the obligation is separately classified and is to be paid through distribution under the Plan at the rate of $250 a month "after priority creditor paid in full." Assuming this refers to the Kootenai County claim,[1] that claim is $3,396.03 and is to be paid after satisfaction of all attorney fees through the Plan. Those fees are $600 pre-petition, and whatever future fees are incurred and approved. Consequently, it cannot be determined when the payments to VALIC will commence, but it is clear that the obligation will not be paid in full upon completion of the Plan. The Proofs of Claims reflect total unsecured claims of $43,892.11. The Trustee estimates that at the end of the 60 month plan, VALIC would have received $15,000.00. This calculation does not include

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[1]Kootenai County has a secured claim for real estate taxes but was erroneously placed in the priority claim classification. The court assumes this secured claim will be placed into the correct classification and paid pro rata with the secured car loan after satisfaction of attorney fees.

the post-petition attorney fees of $1,705.00 approved by the court.

The Chapter 13 Trustee, in his financial analysis, estimates that if the separate classification is allowed, without consideration of any post-petition attorney fees, unsecured creditors would receive slightly more than 15 percent on their claims. Thus unsecured creditors will receive approximately 11 percent. VALIC would receive approximately 83 percent of its claim.

A review of the case law regarding repayment of retirement fund loans reveals no cases directly on point. Reported decisions involve debtors with loan payments being deducted from their wages. Those debtors, post-petition, seek to have the payroll deductions continue. The reported decisions focus on the question whether the payroll deductions for the loan payments constitute disposable income under 11 U.S.C. § 1325(b) or are an expenditure necessary for the support of the debtor.

Decisions from various courts in the Ninth Circuit which have considered whether repayment of loans from retirement funds are necessary expenses or disposable income have held that such determination must be made on a case-by-case basis. The reported decisions have uniformly concluded that the payroll deduction must be discontinued as repayment is not necessary for the support of the debtor. The repayment amount then becomes disposable income which can be utilized to increase the plan payments. *In re Estes*, 254 B.R. 261 (Bankr. D. Idaho 2000); *In re Mills*, 246 B.R. 395 (Bankr. S.D. Cal. 2000). In general, debtors cannot repay borrowing from their retirement funds as repayment of the obligation is not necessary for the support of the debtor.

The analysis and results of Ninth Circuit decisions are consistent with courts in other jurisdictions which have also analyzed the issue in the context of 11 U.S.C. § 1325(b). *In re Harshbarger*, 66 F.3d 775 (6th Cir. 1995); *In re Ames*, 195 F.3d 177 (3rd Cir. 1999).

In reported cases, typically the analysis is one of disposable income, but the issue has also been posed as one of substantial abuse under 11 U.S.C. § 707(b). *In re Mills*, 246 B.R. 395 (S.D. Cal. 2000). Again, the ultimate question becomes whether the loan repayment is necessary for the support of the debtor or constitutes disposable income. Somewhat factually similar to the instant situation is *In re Smith*, 207 B.R. 888 (9th Cir. B.A.P. 1996) which involved a debtor paying monthly insurance premiums apparently for a policy which was primarily an estate planning or retirement device. Again, the analysis was whether that monthly premium constituted disposable income or was necessary for the support of the debtor.

The overwhelming majority of courts which have considered situations involving payroll deductions applied to repayment of loans made from retirement funds have concluded that debtors must discontinue the payroll deduction as the loan repayment constitutes disposable income.

In the present situation, no payroll deduction is involved. The issue of disposable income under 11 U.S.C. § 1325 has not been raised. Rather, the debtor proposes to separately classify the claim under 11 U.S.C. § 1322(b)(1) and pay it through the Plan. In this situation, the debtor attempts to do indirectly through separate classification what the debtor normally would be precluded

from doing directly through payroll deduction.

Debtor argues that the separate classification of the VALIC obligation is appropriate under 11 U.S.C. § 1322(b)(1).

Amfac Distribution Corp. v. Wolff (In re Wolff), 22 B.R. 510 (9th Cir. B.A.P. 1982), set forth a four-part test for determining whether discrimination among classes of claims violates 11 U.S.C. § 1322(b)(1). The test is (1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination. *Amfac* at 512. See also *In re Labib-Kigarash*, 271 B.R. 189 (9th Cir. B.A.P. 2001).

The classification has a rational basis as the nature of the obligation differs from other unsecured claims. Debtor argues that it is necessary to the debtor's rehabilitation, as a failure to repay the obligation will result in a post-petition tax liability. Debtor estimates this liability would be approximately $1,000. Debtor maintains that the separate classification is proposed in good faith and that there will be a meaningful repayment to the general unsecured class which is not disproportionate to the repayment of the separate class.

It is true that the nature of this obligation differs from the obligations to other members of the separate class. Repayment of this obligation as to VALIC will ultimately increase the now depleted fund which is ultimately payable to the debtor. Although payments are to be disbursed to a third party, those payments benefit the debtor as they will eventually innure to her. The

nature of the obligation does not justify a separate classification.

The repayment to this class of approximately 83 percent is disproportionate to the proposed distribution of 11 percent to the general unsecured class. It is of no comfort to the general unsecured class that by paying such disproportionate amount to VALIC, debtor may avoid a post-petition tax liability of $1,000. Nor does the creation of that post-petition obligation necessarily render the debtor's plan infeasible. Once any post-petition tax obligation matures and is liquidated, the debtor should have the financial ability to satisfy it. The debtor has gross income of $3,017 per month, steady employment, no dependants and has proposed a 60 month Plan with a base of $37,188. Although $1,000 is certainly a significant sum for the debtor, any post-petition liability of that amount should not render the Plan infeasible.

CONCLUSION

The debtor has proposed the separate classification in good faith, but has not met the other standards necessary for separate classification of this unsecured claim. Consequently, confirmation will be denied. Debtor has until **June 14, 2002** to file an Amended Plan or her Chapter 13 proceeding will be dismissed. A separate order to that effect will be entered by the court.

DATED this 24th day of May, 2002.

PATRICIA C. WILLIAMS, Bankruptcy Judge