UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF WASHINGTON

| | |
|---|---|
| In Re:<br>VANETTEN, CARL M.,<br>Debtor. | No. 99-01962-W13<br>MEMORANDUM DECISION |

THIS MATTER came on for hearing before the Honorable Patricia C. Williams on August 4, 1999 and November 1, 1999 upon the Chapter 13 Trustee's objection to confirmation of the debtor's plan. The basis for the Trustee's objection to confirmation is that the debtor is not devoting future federal income tax refunds to fund the plan even though a claim for past due child support is to be satisfied by the plan.

**FACTS**

11 U.S.C. § 1325(b)(1)(B) provides that if an objection to confirmation of the plan is filed, the court may not approve the plan unless it provides that all of the debtor's projected disposable income be applied to make payments under the plan. The only evidence before the court of the debtor's projected disposable income in this case is that contained in the court file, primarily the debtor's proposed Chapter 13 plan and schedules, including Schedule "I". Those documents reflect that the debtor's gross monthly income is wages of $1,995.60



FILED
DEC 10 1999
T.S. McGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

ENTERED DEC 13 1999

[including overtime] or roughly $23,940 per year. Schedule "I" reflects a monthly withholding from his wages of $225 for social security and payroll taxes. The debtor's net monthly income is then $1,770.60 according to Schedule "I". The debtor is single and has one child of whom he apparently now has custody as Schedule "J" shows no expense for current child support and an expense for day care.

The plan proposes a monthly payment of $740 for 37 months. The plan will pay a continuing claim secured by the debtor's home and payment in full for a priority claim filed by the Department of Social and Health Services of the State of Washington. That priority claim represents past due child support and is in the amount of $1,668.25. Unsecured creditors will receive nothing under the plan.

**ISSUE**

If a Chapter 13 plan proposes to satisfy a significant priority claim for past due child support, must the debtor devote future federal income tax refunds to fund the plan?

**DISCUSSION**

The Trustee proposes that this court rule that all Chapter 13 debtors whose plans propose to satisfy a priority claim for delinquent child support be required to submit their federal income tax returns to fund their plan. Although both federal and state public policy favors the enforcement and collection of delinquent child support obligations, the method by which the Trustee seeks to accomplish this policy is not supported by 11 U.S.C. § 1325.

Since *In re Anderson*, 21 F.3d 355 (9th Cir. 1994), it has been recognized that a Chapter 13 Trustee can require payment of all projected but not all actual disposable income to a plan. In that case,

the Trustee required all Chapter 13 debtors to sign a "Best Efforts Certificate" which was an agreement by the debtors to pay all actual disposable income to the Trustee. The Trustee would periodically review the debtors' financial status and then adjust their plan payments to reflect their actual disposable income. The Ninth Circuit held that such a blanket requirement to pay actual disposable income was contrary to 11 U.S.C. § 1325(b)(1)(B) which provides that a plan must require payment of "all of the debtor's projected disposable income" as of the date of confirmation. The court further held that the Trustee's unilateral adjustment of plan payments contravened § 1329 as the Trustee could only request a modification of plan, not unilaterally modify it without court approval.

Unlike the situation in the *Anderson* case, here the Trustee has no blanket requirement that all debtors agree to devote actual disposable income to the plan or even that all debtors devote federal income tax refunds to the plan. Rather, the requirement sought to be imposed by the Trustee is that those debtors who have significant priority claims for past due child support devote any actual income tax refunds to the plan.

One of the bases for the Trustee's position is the Tax Refund Interception Program which arises under 26 U.S.C. § 6402(c). That program assists state governments in collecting past due child support. When an individual is identified as owing a specific amount of past due support by the state, that information is sent to the IRS which determines whether the individual is entitled to a tax refund. If one is due, the IRS intercepts the refund and pays the refund (to the extent it does not exceed the support owed) to the state. The procedure is set

forth in 42 U.S.C. § 664(a)(3)(A) and 45 C.F.R. 303.72. The Congressional policy of enforcing delinquent child support obligation is so strong that 26 U.S.C. § 6305 provides the IRS with full collection power resulting in the taxpayer's assets being seized to satisfy past due support obligations. That strong Congressional policy is also apparent in the Bankruptcy Code which excepts child support obligations from discharge and provides priority status to such claims. 11 U.S.C. § 507(a)(7).

Absent this bankruptcy proceeding, any federal income tax refunds of the debtor would be intercepted and paid to the state's Department of Social and Health Services for application to the debtor's past due child support obligation. The Trustee argues that if debtors such as this one are not required to devote income tax refunds to the funding of the plan, the strong federal policy favoring collection of child support debt is abrogated at least to the extent it is implemented by the Tax Interception Program. Such debtors would be able to avoid their obligation to devote income tax refunds to the payment of past due child support contrary to the policy and obligations expressed in 26 U.S.C. § 6402(c).

The Trustee is correct in his conclusion that if debtors with significant past due child support are not required to commit federal income tax refunds to fund a Chapter 13 plan, those debtors will avoid the effects of the Tax Refund Interception Program. However, the avoidance of a program which automatically intercepts income tax refunds is simply another benefit of commencing a bankruptcy proceeding. The intercept program is a device or procedure to collect a debt, albeit a debt with a strong social policy of repayment. Many debt collection

procedures or devises are nullified or disrupted by a bankruptcy proceeding.[1] The Bankruptcy Code may and does modify many substantive rights of those who hold claims against the debtor. There is nothing in the federal statutes authorizing the Tax Refund Interception Program which renders the Bankruptcy Code inapplicable to the Program. The issue of whether any Chapter 13 debtor must devote future income tax refunds to the plan is to be determined by the application of the Bankruptcy Code.

A Chapter 13 debtor is required to devote "projected disposable income" to the funding of a plan. 11 U.S.C. § 1325(b)(1)(B). Procedurally then, in order to require a debtor to devote income tax refunds or any other source of income to a plan, the issue must first be raised in an objection to confirmation, and the Trustee, after review of the individual case, has the burden of coming forward with some evidence that the debtor may receive such income. Although not addressing the issue of past due child support, the appellate court stated in *In re Heath*, 182 B.R. 557, 559 (9th Cir. BAP 1995):

> The Trustee's requirement in these cases, that the debtors submit any future tax refunds they receive toward payment under their plan, regardless of whether any refund could be projected as of the effective date of the plan, runs afoul of *Anderson*. Like the trustee in *Anderson*, the Trustee is requiring the debtors here to submit actual rather than projected income to the plan payments.

The inclusion in the plan of a past due child support claim does not change this analysis. The analysis of whether debtors should be required to devote federal income tax refunds to the funding of a plan

---

[1]No issue has been raised concerning the right of the IRS to continue to intercept income tax refunds post-bankruptcy filing.

requires a case-by-case analysis of whether that debtor is likely to receive any such income tax refunds. If so, assuming that the refunds constitute disposable income, they must be devoted to the plan regardless of the nature of claims to be paid by the plan. If refunds are not projected, the debtor cannot be required to agree to devote any such refunds to the funding of the plan. This would be equivalent to a requirement to devote actual disposable income which is contrary to the holding in *Anderson, supra*. As discussed in *In re Heath* and *In re Kuehn* 177, B.R. 671 (D. Ariz. 1995), tax refunds may be projected based upon the debtor's Schedule "I" which reflects that deductions from wages for social security and taxes is above the standard deductions for that particular debtor. Schedule "I" in this case demonstrates a withholding of $225 per month for social security and payroll taxes from gross wages of $1,995.60. There is no evidence that this debtor is "over withholding" or that a tax refund is likely to be received.

The Trustee argues that if not required to devote income tax refunds to a plan, debtors my be tempted to either manipulate wage deductions pre-confirmation or change them post-confirmation in order to received a tax refund. Pre-confirmation manipulation of withholding would ordinarily be detected by the Trustee and by the court from a review of Schedule "I". The Trustee is familiar with the standard payroll deductions for social security and federal taxes and those are readily available to him. If the Trustee believes over withholding may be present, but that the evidence of Schedule "I" itself is not sufficient, he can always request copies of actual pay records or ask questions concerning withholding at the 341 meeting. There may be other easily obtainable evidence that income tax refunds are projected such as

a debtor's admission of a history of receiving such refunds or copies of tax returns from prior years.

Post-confirmation manipulation would not benefit the debtor as the debtor would be "robbing Peter to pay Paul." If wage deductions are increased after confirmation that simply decreases the net income available to the debtor for living expenses but does not change the amount due under the plan. The debtor would be forced to reduce regular living expenses, which as part of the confirmation process the court has already determined to be reasonable. The debtor would in effect be "robbing Peter" (reducing amount available for living expenses) to "pay Paul" (receive a tax refund).

The Trustee, based upon a review of the schedules and plan or, if necessary, other easily obtainable information, should be able to meet his burden of producing evidence of his contention that income tax refunds are projected. Once such evidence is submitted, the debtor will continue to have the ultimate burden of proof that the proposed plan complies with the requirements of the Code, including the requirement that all projected disposable income is devoted to the funding of the plan.

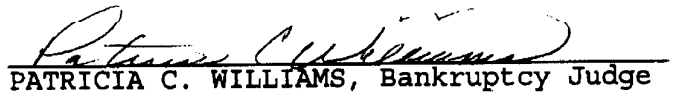
**CONCLUSION**

A debtor who proposes to satisfy a priority claim for past due child support is not required to devote future federal income tax refunds to the plan unless the Trustee first puts the debtor's disposable income at issue by raising an objection to plan confirmation and meeting his burden of producing evidence that income tax refunds constitute projected disposable income. In this case, Schedule "I" contains no such evidence and no other evidence has been presented. The

plan filed March 31, 1999 is confirmed and an order will be entered accordingly.

The Clerk of the Court is directed to file this Memorandum Decision and provide copies to counsel.

DATED this 10th day of December, 1999.



PATRICIA C. WILLIAMS, Bankruptcy Judge