Current Hot Topics in Chapter 13

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A Look at Attorney Fees in Dismissed Cases After *Harris*

The United States Supreme Court ruled in the case of *Harris v. Viegelahn*, 135 S.Ct. 1829 (2015) that the Chapter 13 trustee could not disburse funds on hand at the time of conversion to creditors. The opinion addressed the split of decisions in the lower courts regarding the disposition of the funds on hand with the Chapter 13 Trustee at the time of a post confirmation conversion of a Chapter 13 case to one under Chapter 7 of the Bankruptcy Code.

In *Harris,* the debtor converted his Chapter 13 case post confirmation to a Chapter 7 case. At the time of the conversion, the Chapter 13 Trustee (the "Trustee"), had $5,519.22 on hand. As part of the Trustee's case closing procedures, the Trustee disbursed funds to debtor's counsel for an outstanding fee award and also distributed funds to the debtor's creditors pursuant to the confirmed plan. Post conversion, the debtor took issue with the Trustee's disbursements arguing that the Trustee lacked authority to disburse his post petition wages after conversion and sought a refund of the disbursed funds by the Trustee to creditors. The Bankruptcy court granted the debtor's motion and the District Court affirmed. The Fifth Circuit, however, reversed finding that the Trustee was required to distribute the debtor's wages on hand upon conversion to the debtor's creditors as the creditor's claims to the undistributed funds were superior to the debtor. *In re Harris*, 757 F. 3d 468, 481 (5th Cir. 2014). The debtor appealed the issue to the Supreme Court. The Supreme Court unanimously held that any post-petition wages not yet distributed by the Chapter 13 Trustee are required to be returned to the debtor (absent a bad faith conversion).

The Court's decision was premised on Section 348(f)(1)(A) that provides when a case is converted from Chapter 13 to Chapter 7, "property of the estate in the converted case shall consist of property of the estate, as of the filing of the petition, that remains in the possession of

or is under the control of the debtor on the date of conversion." The Court reasoned that Section 348(f)(1)(A) removed the post petition wages from the Chapter 7 estate and, as a result, the earnings were not part of the "pool of assets that may be liquidated and distributed to creditors." 135 S.Ct. at 1837. The only exception to this rule was the case where a debtor converts in bad faith. In that instance, Section 348(f)(2) would be triggered and all property, *as of the date of conversion,* would be property of the estate. *Id.*

In finding that post petition wages are excluded from the Chapter 7 estate and not available to creditors, the Court held that returning the funds to the debtor was consistent with the statutory construction of Section 348 and in harmony with the "fresh start" contemplated by the Bankruptcy Code. 135 S.Ct. at 1838. If Chapter 13 trustees were permitted to disburse the very same earnings that were excluded and to the same creditors, such a finding would be incompatible with the statutory design of Section 348(f)(1)(A). *Id.*

The Chapter 13 trustee in *Harris* argued that making disbursements to creditors upon conversion was part of her "wind up" duties as provided for under 11 U.S.C. 1326. The Supreme Court rejected this argument based on Section 348(e) of the Bankruptcy Code which terminates the services of the Chapter 13 Trustee upon conversion. The Court found that the Trustee's duties upon conversion are limited to those specified in Federal Rule of Bankruptcy Procedure 1019(4) and (5) and do not include disbursing funds on hand to creditors. *Id.* The Court found that "the moment a case is converted from Chapter 13 to Chapter 7, however, the Chapter 13 trustee is stripped of authority to provide that "service." *Id*. In making this finding, the Court held that the trustee's duties to disburse pursuant to Sections 1326(a)(2) and 1327(a) cease to apply upon conversion. *Id.* As a result, the Supreme Court held that the Chapter 13 trustee should have disbursed the funds to the debtor and not to creditors.

Following *Harris,* the next logical question is whether the *Harris* decision is applicable to cases that are dismissed rather than converted? The decisions are split on this issue. In the pre-confirmation context, the courts that have held that the Chapter 13 trustee may pay attorney fees upon dismissal make a distinction between Section 348(e) and Section 349. Unlike Section 348, Section 349 does not "terminate the service of any trustee." As a result, the Chapter 13 trustee has a duty to disburse pursuant to 11 U.S.C. §1326(a)(2), including payment of §503(b) administrative expense claims such as attorney fees, before disbursing funds to the debtor. [1]

In the post-confirmation dismissal context, some courts that have considered this question have ruled that the funds held by the Chapter 13 trustee must be returned to the debtors. These courts have rejected the notion that Section 1326(a)(2) controls when a case is dismissed post-confirmation and instead have relied on Section 349(b) to require the funds returned to the

[1] *See Jeffrey P. White & Assocs., P.C. v. Fessenden (In re Wheaton)*, 547 B.R. 490, 497-99 (1st Cir. B.A.P. Apr. 14, 2016)(*Harris* does not apply at dismissal before confirmation and § 1326(a) requires payment of § 503(b) attorney fees from funds on hand before returning funds to the debtor); *In re Merovich*, 547 B.R. 643, 647-49 (Bankr. M.D. Pa. Apr. 6, 2016)(in the pre-confirmation dismissal context, §1326(a)(2) controls over §349(b) requiring return of funds to the debtor after payment of administrative expenses, including attorney fees; court noted that *In re Michael* was not overruled by *Harris)*.; *In re Hightower*, 2015 WL 5766676, at *5-*6 (Bankr. S.D. Ga. Sept. 30, 2015)(unpublished)(*Harris* does not apply in unconfirmed case. The trustee retains authority to disburse funds pursuant to 11 U.S.C. §1326(a)(2). Trustee's request for a finding of "cause" to disburse funds on hand to creditors denied as creditors never requested adequate protection payments and the plan did not so provide. The funds on hand required to be paid to the debtor as required by §1326(a)(2)); *In re Ikegwu*, 2015 WL 5608357 (Bankr. D. Md. Sept. 23, 2015)(In the pre-confirmation dismissal context, *Harris* does not preclude the payment of compensation to debtor's counsel by the Chapter 13 trustee.); *In re Brandon*, 537 B.R. 231, 235-238 (Bankr. D.Md. Sept. 10, 2015)(In pre-confirmation dismissals or conversions, *Harris* does not preclude ordering the Chapter 13 trustee to pay attorney's fees to debtor's counsel from funds on hand; Court distinguished conversions governed by § 348(e) from dismissals governed by §349 since §349 does not terminate the services of a trustee. The Chapter 13 trustee remains in office and is bound by the provisions of §1326(a)(2). Court found that an assignment of funds in the retainer agreement to be an independent basis for the trustee to pay debtor's counsel); *In re Kirk*, 537 B.R. 856, 859-63 (Bankr. N.D. Ohio Aug. 27, 2015)(Court distinguished *Harris*, finding that at dismissal before confirmation, funds held by the trustee are disbursed first to pay administrative expense claims, including attorney fees, and then returned to the debtor; funds held by trustee for adequate protection payments were treated the same as other funds on hand since secured creditor did not make a request for adequate protection under §1326(a)(3)); *In re Ulmer*, 2015 WL 3955258, at *1 (Bankr. W.D. La. June 26, 2015)(debtor's motion to authorize the Chapter 13 trustee to distribute funds on hand to debtor's counsel in the event of conversion or dismissal was inconsistent with *Harris* and premature. In the context of dismissal of a case, *Harris* does not apply and 11 U.S.C. §1326(a)(2) still applies).

debtor. [2] Other courts have ruled that funds on hand, post confirmation, at the time of dismissal are to be distributed to the creditors as required by the confirmed plan. [3]

In *In re Bateson*, Case No. 13-55057-PJS (June 23, 2016), the Court was presented with the issue of whether, in the post-confirmation context, a Chapter 13 trustee can disburse funds on hand to creditors following the voluntary dismissal of the case by the debtor. The debtor filed bankruptcy in August of 2013 and the plan was confirmed in March of 2014. Debtor made plan payments periodically throughout the case with the last payment posting on the trustee's records on January 12, 2016. On January 19, 2016, debtor filed a motion to voluntarily dismiss her case. On January 20, 2016, the Court entered an order dismissing the case. At the time of dismissal, the trustee had $16,614.96 funds on hand. As part of the trustee's process of closing out the case, the trustee paid four of the debtor's unsecured creditors with the funds on hand.

On April 14, 2016, the debtor filed a motion to compel the trustee to recoup the funds paid to the debtor's unsecured creditors and instead pay them to the debtor. The debtor argued in her motion and brief, that the post petition funds in the trustee's possession upon dismissal revested in the debtor under 11 U.S.C. § 349(b)(3) and the trustee should not have disbursed the funds to creditors. The debtor relied on a majority of cases that have held that Section 349(b)

[2] *See In re Edwards,* 538 B.R. 536, 539-42 (Bankr. S.D. Ill. Sept. 22, 2015)(*Harris* does not apply; instead §349(b) is applicable and requires funds to be disbursed to the debtor); *In re Hamilton*, 493 B.R. 31, 37-46 (Bankr. M.D. Tenn. 2013)(Upon post confirmation dismissal, §349(b) controls and undistributed funds held by the trustee must be returned to the debtor); *In re Williams*, 488 B.R. 380, 386-87 (Bankr. N.D. Ill. 2013)(Post confirmation plan payments remitted to trustee must be returned to the debtor upon dismissal of the case pursuant to §349(b)); *See also In re Dubose,* 2016 Bankr. LEXIS 2793 at*12-13 (Bankr. M.D. Ala. Aug. 2, 2016)(§1326(a)(2) only applies to pre confirmation cases; in the post confirmation dismissal context, funds returned by a creditor are to be distributed to the debtor; funds returned by creditor after discharge are to be disbursed to creditors per the confirmed plan unless all claims have been paid in full; creditors retain a claim against the estate for full payment and returned funds do not constitute "unclaimed funds.")

[3] *See In re Darden*, 474 B.R. 1, 13-14 (Bankr. D. Mass. 2012)(Court found "cause" existed under §349(b) to allow trustee to disburse settlement proceeds to creditors upon dismissal of the case); *In re Hufford*, 460 B.R. 172, 178 (Bankr. N.D. Ohio 2011)(After a year of settlement negotiations, funds on hand with the trustee would not revest in the debtor but would be disbursed to creditors)

requires the trustee to return the funds to the debtor since dismissal "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case." (Debtor's brief, docket #116-3, p. 8).

The debtor also relied on the "instruction" provided by the United States Supreme Court in *Harris v. Viegelahn*, 135 S.Ct 1829 (2015), in asking the Bankruptcy Court to extend the holding in *Harris* to dismissed cases. In response to the debtor's motion, the trustee filed a response in opposition. The trustee relied on Section 1326 as dispositive of the issue as to the trustee's authority to distribute funds on dismissal. The trustee argued that Section 1326(a)(2) required the trustee to distribute the funds "in accordance with the plan as soon as is practicable," i.e., to creditors as required by the confirmed plan. In the alternative, if the plan was not confirmed, then the funds were to be disbursed to the debtor after payment of unpaid allowed claims under Section 503(b).

The trustee further distinguished the cases cited by the debtor in support of the position that the funds on hand had to be returned to the debtor under Section 349(b)(3). The trustee asserted that the debtor's reliance on this section providing for revesting of property "in the entity in whom the property was vested immediately prior to the commencement of the case" was nonsensical because the debtor's post petition plan payments were not in existence as of the petition date. (Trustee's brief, docket #123, p. 16). The trustee therefore concluded that debtor's reliance on Section 349 was misplaced.

The trustee made a distinction between Section 348 and Section 349 and the Supreme Court's decision in *Harris* asserting that Section 348 applies to converted cases but not dismissed cases. The trustee argued that the termination of the trustee language in Section 348 is not

present in Section 349, reflecting clear evidence of Congressional intent to treat these situations differently. As a result, the trustee contended that the trustee continues to serve as the trustee and is required to fulfill his duties required by statute. (Trustee brief, docket #123, p. 19).

Finally, the trustee argued that Section 349 allowed the court to "vest" the funds on hand in the creditors for "cause" as provided for in Section 349(b), since the debtor had had the benefit of the automatic stay for almost 30 months without fulfilling her obligations under the plan. Debtor had failed to remit $115,000 in plan payments, payments that were due to be paid to creditors under the confirmed plan. The debtor never made an attempt to modify her plan to rectify the delinquency in plan payments but instead, with her actions, deprived the creditors of the funds on hand with the trustee. Therefore, the trustee asserted, cause existed to "vest" the funds in the creditors rather than the debtor. (Trustee brief, docket #123, pgs. 20-25)

The Court held a hearing and took the matter under advisement. In the Court's written opinion dated June 23, 2016, the Court rejected both the debtor's and the trustee's reliance on the split of cases around the country regarding who is entitled to the funds once a case is dismissed. Instead, the Court relied on the Supreme Court's decision in *Harris* as determinative of the outcome of the case.

The Court found that the Supreme Court's statement that "when a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance and no Chapter 13 provision holds sway," was equally applicable in dismissed cases. (Opinion p. 6, citing *Harris* at 1838.) The Court reasoned that "if no Chapter 13 provision holds sway" then the effect of the Order Confirming Plan is not somehow more effective in a converted case rather than a dismissed case because the net result is the same- the case is over.

The Court found the Supreme Court's reasoning in *Harris* to be "even more compelling" in a dismissed case because no "provision of the Bankruptcy Code remains in effect" other than the provisions of Section 349. (Opinion p. 7) In rejecting the trustee's distinction between dismissed cases and cases that have been converted, the Court reasoned that there was no need for such a provision in Section 349 as found in Section 348 because the case is over and no new trustee is appointed. The Court further reasoned that the debtor's duties under Section 1326(a)(1) and the trustee's duties under Section 1326(a)(2) are only in effect if a case is pending. The Court held that, "once the Chapter 13 case is over-whether by conversion to Chapter 7 or by dismissal- *Harris* makes clear that a Chapter 13 trustee's authority and responsibility under §1326(a)2) terminates." (Opinion p. 7)

The Court also found persuasive the Supreme Court's rejection in *Harris* of the notion that a debtor's creditors somehow have a vested right in the funds on hand with the Trustee since there is no Code section that provides for an ownership interest for creditors in the funds, including the debtor's post petition wages. The Bankruptcy Court stated that, "there is no logical reason why this statement of law should be any less true in a dismissed Chapter 13 case than it is in a converted Chapter 13 case. If creditors have no vested rights in the funds held by a Chapter 13 trustee in a converted case post-confirmation, it necessarily follows that those creditors have no vested rights in funds held by a Chapter 13 trustee in a dismissed case post-confirmation." (Opinion, p. 8) The Court relied on the "intention" of §349(b) to essentially restore the positions of the parties as if the case never occurred with the end result being that any funds on hand with the trustee once the case is dismissed must be returned to the debtor pursuant to §349(b)(3). (Opinion p. 9)

The Court rejected the Trustee's arguments in support of a finding of "cause" under §349(b)(3) for the Court to "order otherwise." The Court stated that while the facts asserted by the Trustee were accurate, they were not sufficient facts for the Court to find "cause." The Court noted that the facts were "typical of unsuccessful Chapter 13 cases." (Court opinion p. 10) The Court seemed to reason that to find cause, allegations of dishonesty or bad faith needed to be alleged. *Id.*

The Bankruptcy Court acknowledged that the impact of the holding to return all funds on hand to the debtor upon dismissal represented a departure of the normal practice in the Eastern District of Michigan, however, the Court ultimately found that the holding in *Harris* was binding and must be followed.

The Impact of Bateson

The *Bateson* decision has greatly impacted not only debtor attorneys who are seeking to be paid, but also the internal procedures for the Chapter 13 Trustees. Many questions have arisen as to the applicability of the *Bateson* decision. For instance, does the *Bateson* decision apply in pre-confirmation dismissed cases? What is required to show "cause" such that a Court can "order otherwise" as provided for in Section 349(b)(3)? Is a motion required or can a debtor's attorney merely include a statement in the fee application and proposed order granting attorney's fees? [4]

In an effort to assist the Bar in dealing with these issues, the Chapter 13 Trustees in the Eastern District of Michigan issued a joint statement via email (see attached) on August 19,

[4] *See In re Follo*, Case No. 15-32672 (Bankr. E.D. Mich. 2016) (Court permitted counsel to establish "cause" on the record to allow payment of attorney fees, but suggested language be included in future fee applications as to why cause exists to allow payment of attorney fees.); *In re Myricks*, Case No. 14-49606 (Bankr. E.D. Mich. 2016)(Post *Bateson,* Court granted an award of fees in conjunction with the filing of a motion for "cause." Court required more than a mere assertion that "cause" existed, requiring a factual determination for the court to "order otherwise" as found in 11 U.S.C. §349(b).)

2016. The Trustees informed the Bar that they would continue to process cases dismissed pre-confirmation as they had prior to the decision in *Bateson*, subject to further guidance from the Judges. The Trustees also indicated that in the post-confirmation dismissal context following *Bateson*, the Trustees would return all funds on hand upon dismissal to the debtor, absent a showing of "cause" as discussed by the Court in *Bateson.* The Trustees further indicated that they would hold funds for fourteen (14) days after the date of dismissal to comply with the time periods for appeals or re-hearings and, if a pleading was filed within that 14 day period of time, the Trustees would continue to hold the funds pending Court review. While the Trustees expressed no opinion as to the vehicle in which to get the matter before the Court, the trustees suggested that counsel may want to consider making such a request via motion, order, fee application or any other method decided upon by counsel. (Trustees email August 19, 2016).

Conclusion

While the ultimate solution in how to deal with the impact of the *Bateson* decision remains to be seen, it is likely that the once these matters are presented to the Court, a preferred pattern of practice will be developed and instituted once the Court provides direction on these matters.

TO: Chapter 13 attorneys in the Eastern District of Michigan

FROM: The chapter 13 trustees in Eastern Michigan

RE: Impact of the Bateson decision

DATE: August 19, 2016

Many of you may be aware of Judge Shefferly's recent opinion In re Bateson regarding disposition of funds on hand with trustees at the time of a post-confirmation dismissal. Several lawyers have raised questions as to how this opinion may impact their ability to collect attorney fees via the trustee.

The Chapter 13 Trustees in the Eastern District have conferred and offer the following statement to assist the Bar:

1. PRE-confirmation dismissals will continue to be processed as before the Bateson opinion was issued. This is, of course, subject to further guidance by our Judges.

2. POST-confirmation dismissals will now, due to Bateson, be treated as follows:

    a. Funds on hand at the time of POST-confirmation dismissal will be returned to the debtor

    b. However, as outlined in Bateson, funds may be re-directed to someone else but it requires a showing of "cause" as per Section 349(b)(3)

    c. We will hold funds for 14 days from date of dismissal due to time periods for appeals or re-hearings

    d. During that 14 day period, the Trustee will continue to hold funds to be re-directed IF a pleading is filed within that 14 day period requesting the Court to find such "cause".

3. We express no opinion as to what procedure counsel should use. Until the Court advises otherwise, we will place a hold on the requested funds should any pleading requesting that relief be filed. Counsel may consider filing such a request by motion, order, fee application, or whatever method counsel finds appropriate, subject of course, to Court review.

We hope this helps you in understanding and implementing Bateson in your practice. Please feel free to contact any of the Chapter 13 Trustees should you have questions.

David Wm. Ruskin

Chapter 13 Trustee – Detroit

Voluntary Retirement Contributions: Disposable Income Or Not?

Explanation:

Debtors are required to pay creditors their best effort or disposable income during the term of the Plan. Disposable income, defined generally under Section 1325, is the current monthly income the debtor receives less amounts "reasonable necessary" to be to be expended for the maintenance and support of the debtor's household. Voluntary retirement contributions and the the debtor's ability to exclude those contributions from disposable income has been garnering recent attention. The attention in the Southern Division of the Eastern District of Michigan has led to debtors being prohibited from continuing voluntary retirement contributions. Conversely, debtors with mandatory retirement contributions may continue to exclude retirement contributions from their disposable income.

The Bankruptcy Appellate Panel of the 6th Circuit (6th Cir BAP) determined that a debtor could not resume their voluntary retirement deductions in the midst of Chapter 13 Plan after retirement loan payments ceased, Burden v. Seafort, 437, BR 204 (6th Cir. BAP 2010) (Seafort 1). The issue presented to the 6th Cir BAP was whether debtors could increase their voluntary retirement contributions post-petition after repaying a retirement loan. The result was that debtors could confirm their Plan *and* exclude existing voluntary retirement contributions from their disposable income.

The 6th Cir BAP concluded that "[O]nly 401(k) contributions which are being made at the commencement of the case are excluded from property of the estate under § 541(b)(7)" Seafort 1 at 209. The Panel further explained, "[I]ncome which becomes available after 401(k) loans are repaid is projected disposable income which must be committed to the

repayment of unsecured creditors," Seafort 1 at 211. Therefore, Chapter 13 Debtors were allowed to continue contributions to their retirement accounts while repaying unsecured creditors less than 100%. However, after the retirement loan was paid in full, debtor had to increase their Plan payments accordingly to their unsecured creditors.

The 6th Cir BAP reasoned, "[Its] construction of § 541(a) and (b) and § 1325 is also consistent with the stated objection of BAPCPA. A primary objective of BAPCPA . . . was to ensure that debtors repay the maximum they can afford", Seafort 1 at 210. The 6th Cir BAP continued that, "This balance is best achieved by permitting debtors who are making contributions to a Qualified Plan at the time their case is filed to continue making contributions, while requiring debtors who are not making contributions at the time a case is filed to commit post-petition income which becomes available to the repayment of creditors rather than their own retirement plan." Seafort 1 at 210.

The case was appealed to the 6th Circuit where it was affirmed. While affirming Seafort 1, the 6th Circuit went even further (in dicta) stating that it would not only prohibit debtors from resuming voluntary contributions after retirement loans were paid off, but that it would not permit voluntary retirement contributions in effect at the time of filing from being excluded from disposable income, Burden v. Seafort, 669 F.3d 662 (6th Cir. 2012) (Seafort 2). Because the Code does not contain an exclusion for voluntary retirement contributions, Congress meant to require debtors to contribute *all* disposable income, including amounts previously paid toward voluntary retirement accounts, to their creditors.

The 6th Circuit is the only circuit court at this time to make a ruling on this issue. Judge Opperman noted that "Although the Sixth Circuit Court of Appeals made it clear that its

holding in (Seafort 2) would not be binding . . . it gave very clear direction and guidance on this issue," In re Rogers, Case No. 12-32558, (Bankr. E.D. Mi., 2015, Opperman).

The 6th Circuit's decision leaned heavily on a decision from the United States Bankruptcy Court for the District of Montana that denied confirmation to a debtor seeking to exclude 401(k) contributions from his disposable income, In re Prigge, 441 B.R. 667 (Bankr. D. Mont. 2010). For support, Prigge cited Section 1322(f) "A plan may not materially alter the terms of a loan described in section 362(b)(19) and any amounts required to repay such loan shall not constitute 'disposable income' under section 1325," Id at 677 Further, the Court reasoned, "If Congress had intended to exclude voluntary 401(k) contributions from disposable income it could have drafted § 1322(f) to provide for such an exclusion, or provided one elsewhere, Id at 677.

The 6th Circuit's *primary* ruling was to affirm that after payment in full of the retirement loan debtor's disposable income was increased accordingly and the funds formerly contributed to the retirement loan must be paid to creditors. If Seafort 1 was the middle ground and represented a balancing act, Seafort 2 has simply had a negative impact on the debtor's' ability to continue *any* voluntary retirement contributions. The impact to the 6th Circuit is that debtors could not rely upon 541 to exclude voluntary retirement contributions from being remitted to creditors.

In July, a Virginia Bankruptcy Court determined that voluntary retirement contributions, like mandatory contributions, may be excluded from disposable income, In re Cantu, 2016 WL 3982881 (Bankr. E.D. Va.). Cantu reasoned that "Section 541 [(b)(7)] of the Bankruptcy Code defines property of the estate for all Chapters. In addition, under Chapter 13

unlike in Chapter 7, the Debtor's post-petition wages and compensation are included in property of the estate. U.S.C. § 1306(a)(2)", Id at 3.

Cantu found additional support from the US Court of Appeals, Fourth Circuit. "Congress has harmonized these two statutes for us. With Section 541, Congress established a general definition for bankruptcy estates. With Section 1306, it then expanded on that definition specifically for purposes of Chapter 13 cases. Thus, 'Section 1306 broadens the definition of property of the estate for Chapter 13 purposes to include all property acquired and all earnings from services performed by the debtor after the commencement of the case.' S. Rep. NO. 95-989, at 140-41 (1978)." Carroll v. Logan, 735 F.3d 147, 150 (4th Cir. 2013)

Cantu discussed both of the Seafort decisions. The Bankruptcy Court reasoned that presently the Seafort decisions represented 2 different minority views regarding voluntary retirement deductions. Interestingly, the Chapter 13 Trustee, in Cantu, argued that the Court should follow the holding of Seafort 1. Cantu adopted what it referred to as the majority view permitting debtors to contribute to their voluntary retirement accounts and exclude those contributions from their disposable income. The ability of the debtor to continue voluntary retirement contributions is subject to *good faith*.

The Chapter 13 Trustee has filed a notice of intent to appeal the decision. Assuming Cantu progresses further, it may provide an opportunity for a higher court to directly address this matter.

Practice Tips and Discussion:

In pre-confirmation matters, Seafort 2 has meant that a debtor's Plan is not proposed in good faith, if the debtor seeks to exclude from their disposable income, the voluntary

retirement contributions. In re Reyes, Case No. 15-45618, (Bankr. E.D. Mi. 2015, Shefferly) In post-confirmation matters, Seafort 2 has meant that a debtor's best effort pursuant to a Plan Modification will need to include voluntary retirement contributions in their disposable income. In re Curran, Case No. 12-44197, (Bankr. E.D. Mi. 2015, McIvor)

Seafort 1 controlled the way the Southern Division of the Eastern District of Michigan handled retirement contributions for the better part of the last 4 years. The debtor could continue voluntary retirement contributions in the the approximate amount he or she contributed at the time of filing for the duration of the Plan term. When retirement loans ended during the Plan term, the debtor was not able to increase their voluntary contribution by the amount of the expiring retirement loan. Debtors were required to increase their Plan payments by the amount of the expired retirement loan.

Debtor-counsel can simply cease all voluntary contributions - even where those debtors are giving up the matching funds offered by employers. Conversely, a debtor could continue a "small" ongoing retirement contribution even though their Schedule I is prepared without deducting voluntary retirement contributions. This approach would "short" the debtor's household budget. The impact is that the debtor cuts into an otherwise approved budget to continue "small" retirement contributions.

Another approach is to disclose the "small" voluntary retirement contribution in Schedule I under the detailed analysis (specifically 5. C.) of debtor's income. Then, debtor-counsel adds the total of those periodic withholdings to Schedule I under "other monthly income" (specifically 8. H.). This has an impact of "shorting" debtor's net household budget, but also fully discloses the ongoing contributions.

Pursuant to LBR 3015-2(b)(1)(E)(4) debtors are required to file Amended Schedules I & J when filing post confirmation Plan Modifications. Therefore, debtor-counsel needs to be mindful of the *total* impact to their clients when discussing Plan Modifications and explore the impact of Seafort 2 on the debtor's budget. The Trustee is not barred from objecting to the debtor's best effort by a previous order confirming plan pursuant to a Plan Modification, (In re Curran, McIvor) Expect the Trustee to object to your debtor's amended budget to the extent it continues to exclude voluntary retirement deductions from the debtor's best effort in post confirmation Plan Modifications.

Debtors in active Plans, who were able to exclude voluntary retirement contributions from their disposable income at confirmation, may be better served making up the payment delinquencies on their own or simply remitting the tax refund they otherwise would have preferred to excuse. Essentially, a debtor in month twenty-four (24) of a sixty (60) month Plan may not *really* benefit by excusing $1000 in federal tax refunds if the Trustee objects to the Amended Schedule I on the basis that debtor should not be excluding $250 per month from their disposable income.

BANKRUPTCY PRACTICE TIPS & REMINDERS

I. STALE CLAIMS

A. SECTION 11 USC 101(5)(A) DEFINES "CLAIM"

"Right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."

B. STATUTE OF LIMITATIONS

A statute of limitations is a period of time within which a lawsuit must be brought on a claim. The limitations period for a specific type of lawsuit (i.e. personal injury; non-payment) may vary from state to state. Moreover, it may be unclear if the claim is barred by the statute of limitations, as the time period may turn on pivotal dates not readily apparent.

If a creditor is barred by a statute of limitations from pursuing the debtor for payment on a claim, the creditor may also be barred from filing a Proof of Claim within the debtor's bankruptcy. Even if the claim is listed in the debtor's schedules, some courts have held that the schedules are intended for informational purposes only, and not necessarily a promise to pay. See Crawford v. LVNV Funding LLC (758 F.3d 1254 (11th Cir. 2014). See also Patrick v. Pyod, LLC, 39 F.Supp.3d. 1032 (S.D. Ind. August 20, 2014) which held that allowing the creditor to file a Proof of Claim for an out of statute debt is an attempt to collect a debt because the least sophisticated consumer may presume that the debt is legally enforceable. The court In re Avalos, 531 B.R. 748 (N.D. Ill. 2015) rejected the creditor's defense that the bankruptcy code does not prohibit the filing of the proof of claim on a stale debt. The court explained that a time-barred debt gives rise to "at most a moral obligation to pay. Without more, a moral obligation is not a claim under 101(5)." Id. at 754. Conversely, other districts have held that filing a Proof of Claim

on an out of statute debt does not rise to the level of false, deceptive or misleading representations prohibited under the FDCPA. See In re Martel, 539 B.R. 192 (D. Maine 2015); Claudio v. LVNV, 463 B.R. at 193 (Bankr.D.Mass.2012); LaGrone v. LVNV Funding, LLC, 525 B.R. 419 (Bankr. N.D.Ill 2015).

C. **STALE CLAIMS AND THE FAIR DEBT COLLECTION PRACTICES ACT**

If a creditor files a Proof of Claim on an out of statute debt, has the creditor violated the Fair Debt Collection Practices Act (FDCPA)? Again, there is a split of authority. The 11th Circuit has held that doing so violates the FDCPA, see Crawford v. LVNV Funding, LLC, 758 F.3d 1254 (11th Cir.2014); In re Avalos, 531 B.R. 748 (Bankr.N.D.Ill 2015). Others, however, hold that creditors who file Proofs of Claim within the confines of the applicable Federal Rules of Bankruptcy Procedure and Bankruptcy Code sections, are not misleading or harassing debtors, nor are they abusing the bankruptcy process. See In re Gatewood, 533 B.R. 905 (B.A.P. 8th Cir. 2015).

D. **SUBJECT MATTER JURISDICTION**

Can the U.S. Bankruptcy Court hear arguments related to the FDCPA? While some courts have held that the Bankruptcy Code and the FDCPA cannot co-exist, most maintain that the statutes do not attempt to repeal one another. The U.S. Bankruptcy Court's jurisdiction is limited by 28 USC 157 to those proceedings "arising under", "arising in" or "related to" a bankruptcy case under Title 11. A claim involving a potential violation of the FDCPA may affect the amount of money available for distribution or the allocation of property amount creditors. See In re Avalos, 531 B.R. 748 (2015).

Also see Judge Gregg's opinion and analysis in In re Perkins, 533 B.R. 242 (W.D. Mich. 2015), where he held that the bankruptcy court lacked subject matter jurisdiction to hear the

dispute. Judge Gregg gave a thorough analysis of the competing issues between creditor and debtor and found that a Proof of Claim does not equate to the coercive nature of a demand letter and/or a lawsuit. Especially when, as in Perkins, the debtor listed the debt in his schedules.

II. CONFLICTING PLAN PROVISIONS INVOLVING CREDITOR CLAIMS

A.REGULAR MONTHLY DISBURSEMENTS

1. **11 USC 1322(b)(5) PROVIDES:**

"…notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any …secured claim on which the last payment is due after the date on which the final payment under the plan is due."

2. **11 USC 1325(5)(B)(iii) PROVIDES**:

"… if property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts."

3. PRACTICE TIPS:

Turning first to secured creditors whose collateral is an item of debtor's personal property, notwithstanding the language of 11 USC 1325(5)(B)(iii), note the interplay of Section 5.1, Section V.F. Order of Payment of Claims, and the payment of debtor's counsel's fees. In most Chapter 13 Plans, Section 5.1 reads, "Creditors to be paid Equal Monthly Payments, 11 USC 1325(a)(5)(B)". Compared to Section 5.2, which also provides that the secured claim will be paid during the term of the Plan, but the respective claims will **not** to be paid equal monthly payments, 11 USC 1325(a)(5)(A).

Next, review the language of Section V.F., Order of Payment of Claims. This section of the Plan instructs the Chapter 13 Trustee to pay creditors in a certain order, irrespective of the language found in Section 5.1/5.2. To give meaning to the intent found in Section 5.1 and 11 USC 1325(a)(5)(B), the claims should be paid as follows:

Level 1: Class 1
Level 2: Class 5.1 and 6.1
Level 3: Class 2.1 and 2.3
Level 4: Class 2.2 and 2.4
Level 5: Classes 4.1
Level 6: Classes 4.2, 5.2 and 6.2
Level 7: Class 7
Level 8: Classes 3, 8 and 9

However, the debtor may alter the above-referenced order. The most common change in the order involves advancing Class 2 claims (attorney fees) to Level 2 status, ahead of Class 5.1 (and 6.1).

Mortgage creditors may also experience conflicting treatment in connection with the payment of a continuing claim. Despite the language of 11 USC 1322, unless the Order of Payment of Claims allows the Chapter 13 Trustee to disburse "maintenance" payments, the mortgage creditor will not receive regular monthly disbursements on its continuing claim. The payment structure may also result in a longer time to cure any pre-petition defaults.

Next, review Class 2 and the payment of the debtor's attorney's fees and costs. Look to see if debtor's counsel has requested that the Chapter 13 Trustee escrow funds for the payment of his/her pre-confirmation fees. In certain instances, the creation of a fee escrow, may supersede

disbursements to creditors in 5.1 and/or 4.1 and the overall implementation of the Order of Payment of Claims.

Finally, keep in mind that the Order Confirming Plan does not necessarily control the payment of claims, especially a secured, Class 5.1, claim. All the aforementioned sections need to provide the same intent to ensure regular monthly disbursements.

B.DEFICIENCY CLAIMS SUBSEQUENT TO STAY RELIEF

1. ISSUE:

Once the automatic stay is lifted on a secured debt, the creditor may liquidate the asset. If the deficiency balance can be paid through the Chapter 13 Trustee, be aware of any time limits to file the amended Proof of Claim and be sure your client can liquidate the collateral accordingly.

2. PRACTICE TIPS:

See Sections V.P. and V.V. which discuss how a secured creditor's claim will be paid once the automatic stay provision of 11 USC 362(d) is terminated. Note that any deadlines set forth in these sections are independent from the time lines set forth in FRBP 3002.

III. PREPARING AND FILING PROTECTIVE PROOFS OF CLAIMS

A.SECTION 11 USC 501, FRBP 3002, FILING OF PROOFS OF CLAIM

Subsection(c) states that "if a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim."

B. **PRACTICE TIP:**

Be watchful that secured creditors file timely proofs of claim. If they fail to do so, debtor's counsel may want to file one on behalf of the creditor. It advances your client's position and his/her ability to obtain a fresh start. Home Owners Associations (HOA) regularly fail to

appear and/or participate in the confirmation process. Inasmuch as debts owed to a HOA follow the debtor, it is imperative that you verify the balance due and make provisions for the payment of said amount.

IV. VESTING TITLE OF PROPERTY IN THE CREDITOR

A.SURRENDERING AN INTEREST CANNOT INCLUDE TRANSFER OF TITLE

A Massachusetts court held that the debtor could not, upon surrender of his house to the creditor, further vest title of the property in the creditor. Upon confirmation, the Chapter 13 Plan usually provides that all property of the estate vests back into the debtor. In the case In re Weller, 2016 WL 164645 (Bankr.D.Mass. January 13, 2016), the debtors surrendered their residence in the Plan. Three years post-confirmation, the debtors had vacated the property, but the creditor had not foreclosed its security interest in the property. As a result, the debtors were still the legal owners of the property. In an attempt to rectify that, they amended the Plan to state that the property would vest in the creditor. The court denied the modification because vesting of ownership requires consent and the creditor must be free to either accept or decline ownership.

V. HOW TO ENFORCE TIMELY SURRENDER OF COLLATERAL

A. ISSUE:

If a secured creditor obtains relief from the automatic stay, more often than not, the creditor intends to foreclose its security interest in the subject collateral. In certain circumstances, however, the secured creditor has difficulty locating its collateral. The frustrated secured creditor may want to seek the court's assistance to compel the debtor's cooperation. It is common to seek redress from the court when a party fails to comply with that court's order. However, courts follow a different line of thinking. Inasmuch as the automatic stay is lifted, the

property is no longer property of the estate. As a result, the Bankruptcy Court no longer has subject matter jurisdiction. See In re Foster, 2016 WL1105594 (Bankr.W.D.Okla. March 2016).

C. PRACTICE TIPS:

When the debtor is not cooperating, secured creditors may turn to state courts for assistance. The creditor may file a replevin action, seeking a judgment of possession only. Upon entry, the creditor may enlist the services of the sheriff's department to locate the vehicle and can further request the Secretary of State to flag the vehicle to prevent transfer of title.

V. CREDIT REPORTING

In order to challenge information disclosed on a credit report, debtors must follow the protocol set forth in the Fair Credit Reporting Act. They must be mindful that credit reporting agencies do not work for creditors and often, these agencies fail to report the information accurately. That aside, "a creditor's failure to correct or update such information, standing alone, is not a violation of the discharge injunction. This is because the mere failure to update or remove information posted prepetition does not constitute an act in violation of the discharge injunction." In Small v University of Kentucky Federal Credit Union, 2011 WL 1868839 (Bkrtcy.E.D.Ky.).

Debtors must show egregious collection activity on the part of the creditor to coerce payment (i.e. repeated phone calls and written demands for payment). Debtor must also show actual damages and prove that creditor's misreporting caused the harm.

VI. EXPANSION OF ACTUAL FRAUD

11 USC 523(a)(2)(A) exempts from discharge obligations incurred by a debtor under false pretenses, false representation and/or actual fraud. False pretenses is a series of events, activities or communications that when considered as a whole, create a false and misleading set of circumstances or misunderstanding. Actual fraud encompasses any deceit, artifice, trick or design used to circumvent and cheat another. Actual fraud may exist wherever a creditor shows a debtor obtained funds without a subjective intent to repay the creditor. However, can actual fraud exist in a transaction involving a fraudulent conveyance, but no fraudulent misrepresentation?

In the case, Husky International Electronics, Inc. v. Ritz (May 16, 2016), the U.S. Supreme Court unequivocally expanded "actual fraud" to encompass acts of fraud committed with wrongful intent. Looking back to the Elizabethan Era and the first statutes defining fraudulent conveyances, the Court reasoned that actual fraud can include a series of fraudulent transactions and does not need the specific element of fraudulent representation to be exempt the debt from discharge.

The defendant in Ritz argued that the underlying debt was not incurred through actual fraud. Meaning, he did not misrepresent information to obtain an extension of credit from the Plaintiff. Therefore, he reasoned, the debt could not be exempted from discharge under 11 USC 523(a)(2)(A) because he did not act dishonestly to induce the creditor in the extension of credit.

The Court rejected his argument. The Court explained that "actual fraud" has two distinct elements, actual and fraud, and can encompass any act done with wrongful intent. The Court acknowledged that the debt at issue in Ritz was one obtained through a series of fraudulent conveyances where the debtor shifted assets from one company to another and not an

inducement to obtain credit. Nevertheless, the defendant's overall intent was wrought with fraud as he intentionally transferred assets to evade his creditors. Although there was no debt at the end of a fraudulent conveyance traceable to the fraud, the Court focused on how the defendant's actions impaired the plaintiff's ability to collect payment.

Deceased Debtors-

What happens when a debtor dies during the case?

Relevant Authority:

a. F.R.Bankr.P. 1016 provides:

> Death or incompetency of the debtor shall not abate a liquidation case under Chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred. If a reorganization, family farmer's debt adjustment, or individual debt adjustment case is pending under chapter 11, chapter 12, or chapter 13, the case may be dismissed; or if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetence had not occurred.

b. Section 1307-conversion and dismissal;

c. Section 1328(b)-hardship discharge;

d. Section 1329-modification of the plan.

Case law:

1. Can a deceased debtor convert a case?

a. *In re Spiser*, 232 B.R. 669 (Bankr. N.D. Tx. 1999)-Both debtors died post 341 hearing but prior to confirmation. Debtor's attorney converted the case to a Chapter 7. The Chapter 7 trustee moved to vacate the order of conversion and dismiss the case. The Court held that under Section 1307(a), a "probate" estate is not a debtor eligible to convert a case. Conversion was vacated and since the debtors were unable to fund a plan, the case was dismissed.

b. *In re Estrada,* 224 B.R. 132 (Bankr. S.D. Cal. 1998)- In a joint filing where one debtor dies, remaining debtor may seek to convert the case to chapter 13. Joint consolidation of the case was never requested resulting in two separate estates.

c. *In re Evans*, Case No. 08-71076-S (Bankr. E.D. Mich. 2011)- Order converting debtor spouse and deceased debtor's case to a chapter 7 case set aside as Rule 1016 does not permit conversion of a deceased' debtor's estate. Case dismissed as to deceased debtor but surviving spouse permitted to convert her case to chapter 7.

2. Can a deceased debtor file a plan modification?

a. *In re Martinez,* 2013 WL 6051203 (Bankr. W.D. Tx. 2013). Deceased chapter 13 debtor may not propose and confirm a Chapter 13 plan. The benefits of Chapter 13 are only available to the debtor and not to the debtor's estate.

b. *In re Guentert*, 206 B.R. 958 (Bankr. W.D. MO. 1997)-Joint debtor sought permission to use her deceased husband's life insurance proceeds to pay off her case in less than 36 months and with a dividend of less than 100%. Court denied her request and ordered that a plan modification to include the life insurance proceeds and its distribution must be filed.

3. Can a deceased debtor request and be granted a hardship discharge?

a. *In re Miller*, 526 B.R. 857 (D. Colo. 2014)-Debtor's non-filing surviving spouse not entitled to a hardship discharge in her husband's case as she was not a party to the case and further administration of the case is not possible under F.R.Bankr.P. 2016.

b. *In re Inyard,* 532 B.R. 364 (Bankr. D. Kan. 2015)- Upon request by the administrator of the deceased debtor's probate estate for a hardship discharge, the court held that since creditors had been paid the required dividend and all priority claims had been paid, a hardship discharge was in the best interests of

creditors. The court also waived the personal financial management course requirement under 11 U.S.C. §1328(g)(1) due to the death of the debtor.

c. *In re Shorter,* 544 B.R. 654 (Bankr. E.D. Ark. 2015)-Widow of chapter 13 debtor had standing to request a hardship discharge. Court's decision to grant the hardship discharge was based on the fact that the debtor had paid all secured creditors and most of his unsecured creditors before passing away. Decision must be made on a case-by-case basis.

d. *In re Hennessey,* 2013 WL 3939886 (Bankr. N.D. Cal. 2013)- When a debtor dies while in confirmed chapter 13 plan, case can either be dismissed or can continue as if debtor was still alive. However, Rule 1016 does not provide for hardship discharge based on death of debtor. Further, hardship discharge would not benefit debtor but would only benefit debtor's heirs at expense of unsecured creditors. Plan provided for full payment of unsecured debts, and if hardship discharge was entered, creditors would be precluded from asserting claims against probate estate.

e. *In re Murray,* Case No. 07-41134 (Bankr. E.D. Mich. 2011) – Motion for Hardship Discharge denied without prejudice for lack of standing. Debtor passed away and attorney filed Motion. Upon death of debtor, attorney's authority to act for debtor terminated automatically. Motion could be filed only by personal representative duly appointed by the probate court.

4. Is further administration of the case possible and in the best interest of the parties?

a. *In re Querner,* 7 F.3d 1199(5th Cir. 1993)- Bankruptcy court abused its discretion in retaining jurisdiction over the debtor's probate estate.

b. *In re Levy,* 2014 WL 1323165 (Bankr. N.D. Ohio 2014)-Court required person seeking to execute the DSO certification to file a motion and affidavit setting forth facts regarding the existence of a probate estate, the identification of the party seeking to act and the foundation for the person's personal

knowledge of the debtor's circumstances before the court would make a determination.

c. *In re Fogel,* 507 B.R. 734 (Bankr. D. CO. 2014)- Case where the sole debtor dies, the case must be dismissed under F.R.Bankr.P. 1016. Nondebtor spouse cannot continue to make payments and obtain a discharge without filing her own case.

d. *In re Langley*, 2009 WL 5227665 (Bankr. S.D. Ga. 2009)-Further administration of the case is not "in the best interest of the parties." The purpose of a bankruptcy case is to give the debtors a fresh start. Since the debtors were both deceased, there is no fresh start. The mere fact that the debtor's daughter would benefit was not sufficient to allow the case to proceed.

e. *In re Seitz,* 430 B.R. 761 (Bankr. N.D. Tx. 2010)-Joint debtor died after the filing but before attendance at a 341 First Meeting of Creditors. Joint debtor spouse sought court approval to attend the hearing on her own behalf and as personal representative of joint deceased debtor's estate. Court granted the motion and permitted the case to continue under F.R.Bankr.P. 1016.

f. *In re Digiantomasso,* Case No. 12-46397 (Bankr. E.D. Mich. 2012) – Chapter 13 Case must be dismissed where debtor died after filing petition but prior to confirmation. Rule 1016 allows a chapter 13 to continue after death of debtor if further administration is possible and in the best interest of the parties. However, Section 1325(a)(6) requires that the "debtor" shall make payments under the plan. Death of debtor appears to preclude confirmation as debtor will not make payments under the Plan. Rule 1016 permits cases to continue post confirmation but does not allow a pre-confirmation case to proceed where the debtor dies before confirmation.

g. *In re Raffone,* Case No. 13-61907 (Bankr. E.D. Mich. 2015) – Death of debtor post-confirmation does not require dismissal of case. However, case can proceed only if debtor's personal representative appears in case or otherwise takes actions consistent with Rule 1016. Where personal

representative failed to make appearance in response to Court's Order to Show Cause, Chapter 13 proceeding dismissed as to decedent.

h. *In re Uren,* Case No. 13-90369 (Bankr. W.D. Mich. 2014) – Death of one co-debtor in joint Chapter 13 is not basis to disallow claims. Rule 1016 provides that upon death of debtor, case proceeds as though death had not occurred.

i. *In re Ingram,* Case No. 11-68905 (Bankr. E.D. Mich. 2015) – Following debtor's death, only Personal Representative duly appointed according to state law is empowered to make decisions on behalf of estate. On death of debtor, attorney loses authority to act on behalf of estate unless attorney is later retained by personal representative. Motion for Hardship Discharge denied without prejudice where there was no evidence that person directing filing of Motion was duly appointed personal representative.

Income Tax Liabilities Beyond Chapter 13 Discharge: Fresh Start ... Not so Fast

Explanation:

Debtors receiving their discharge in a completed Chapter 13 Plan may not be aware that certain income tax liabilities survived discharge and the surviving liabilities accrued interest. BAPCPA limited the scope of the Chapter 13 Discharge. Prior to the passage of BAPCPA, the Chapter 13 Discharge was regularly referred to as a "Super Discharge". Because certain tax liabilities are now excepted from discharge, any unpaid interest on those non dischargeable claims, after Plan completion, remains due and owing to the Internal Revenue Service. The net result is that some debtors looking forward to their Fresh Start post Discharge may be met with collection notices from the Internal Revenue Service.

The Supreme Court held that where Congress intended an income tax debt to survive the Bankruptcy discharge the post-petition interest for that claim was just as collectible as the underlying debt against the debtor. The Supreme Court reasoned, "[I]nterest is considered to be the cost of the use of the amounts owing a creditor and an incentive to prompt repayment and, thus, an integral part of a continuing debt. Interest on a tax debt would seem to fit that description. Thus, logic and reason indicate that post-petition interest on a tax claim excepted from discharge . . . should be recoverable in a later action against the debtor personally," Bruning v U.S., 376 U.S. 358, 360 (1964).

The debtor argued that the bankruptcy discharge was supposed to give the debtor a fresh start. In response, the Court stated, "As the Court of Appeals noted, . . . certain problems

-e.g., those of financing government - override the value of giving the debtor a wholly fresh start," Id at 361.

The United States Court of Appeals for the First Circuit reversed the holdings of lower courts that permitted Chapter 12 debtors to discharge post-petition interest on a non dischargeable pre-petition income tax liability. After the debtor's discharge, the IRS sought to collect on the post-petition interest - even though the balance of the actual tax liability was paid pursuant to the Chapter 12 Plan. The debtors brought an adversary against the IRS. The Court held, "Tax liabilities survive the bankruptcy proceeding's termination, and as *Bruning* held, so does the interest upon these liabilities," IRS v. Cousins, 209 F.3d 38, 42 (1st Circuit, 2000).

Similarly, the 6th Circuit held reclamation fees owed and paid in full to the IRS by way of Debtor's Chapter 11 accrued post petition interest. And, the debtor was required to pay that accrued interest after the Chapter 11 Plan was completed. The 6th Circuit determined, "[T]he reclamation fee has the essential characteristics of a tax, and we conclude it is a 'tax'," United States v. River Coal Co., 748 F.2d 1103, 1106 (6th Circuit, 1984). After determining the reclamation fee was a tax, the Court further held, "[T]he government may recover post petition interest on nondischarged debts for taxes regardless of whether the underlying debt has been paid or not," Id at 1107.

United States v. Monahan, 497 B.R. 642 (1st Cir. BAP, 2013) is another case where the IRS was permitted to collect post petition interest after debtor's' discharge. In Monahan, the 1st Circuit BAP determined that the Bankruptcy Court erred when it granted the debtor's motion to prevent further collection. The 1st Circuit BAP held that because the underlying tax debt was specifically non dischargeable under Section 1328(a), the IRS was

entitled to the unpaid interest on the tax debt even though the underlying (non dischargeable) claim was paid in full.

Debtor's recognizing the non dischargeable nature of certain tax debts generally are not permitted to pay the anticipated interest in the Plan unless they are paying all claims in full. Section 502(b)(2) of the Bankruptcy Code specifically bars claims for unmatured interest. Section 1322(b)(10), however, permits the payment of interest on non dischargeable unsecured claims pursuant to debtor's Plan, but only to the extent the debtor is paying all allowed claims in full.

The 1st Circuit BAP explained that there are two reasons most Chapter 13 Plans do not provide interest on unsecured claims. "First, a chapter 13 plan can only provide for allowed claims . . . § 502(b)(2) prohibits a claim from including unmatured interest. Thus, an allowed unsecured claim does not include unmatured post-petition interest, and the Chapter 13 plan may not provide for payments outside of the allowed claim." Id at 648 (2013). The 1st Circuit BAP continued, "Second, § 1322(b)(10) provides the lone exception in which a plan may provide for the payment of interest accruing after the petition date on unsecured claims. Section 1322(b)(10) allows for the payment of post petition interest . . . only when 'the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims,'" Id at 648.

Similarly, a Kansas debtor's Chapter 13 Plan was denied confirmation because the proposed Plan sought to pay a non dischargeable student loan liability in full and with interest where the proposed Plan did not provide for payment in full to other unsecured claim. As such, the Bankruptcy Court held, "The Code expressly forbids the payment of interest on an

unsecured nondischargeable claim unless all of the other allowed claims are paid in full," In re Stull, 489 B.R. 217, 218 (Bankr. D. Kan., 2013). Referring to Section 1322(b)(10) the Bankruptcy Court further noted that, "This language is plain: in the absence of "full payment of all allowed claims," an unsecured non-dischargeable claim may not receive interest," Id at 223.

Income tax liabilities can be determined non dischargeable not simply by the passage of time since the return was due and filed, but also by whether or not the tax forms filed by the debtor reflect the debtor's honest and reasonable intent to comply with the tax laws. There are "[F]our requirements for a document to serve as a tax return: (1) it must purport to serve as a tax return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law," In Re Justice, 817 F.3d 738 (11th Circuit, 2016); citing the four requirements of the *Beard* test in Beard v. Comm'r of Internal Revenue, 82 T.C. 766, (Tax, 1984). In Justice, the debtor had filed several successive tax returns nearly 5 (five) years late. And, the debtor only filed after significant effort had already been made by the IRS to assess debtor's tax liability and collect those liabilities. Debtor argued that because the late-filed returns were filed more than 2 (two) years before his Chapter 7 Bankruptcy was filed, the underlying tax liabilities should be discharged.

The Court held that, "[W]here a taxpayer files many years late, without any justification at all, and only after the IRS has issued notices of deficiency and has assessed his tax liability, the taxpayer's behavior does not evince an honest and reasonable effort to satisfy the requirements the requirements of the tax law." Id at 746. The debtor could not convince the Court that he satisfied the fourth prong of the Beard Test. He was not able to offer sufficient proof or a good reason regarding the delay in filing and complying with the tax law.

The Court reasoned that "If, however, the Forms 1040 do not qualify as 'returns' at all, then Justice's tax debts are non-dischargeable under § 523(a)(1)(B)(i) -i.e., Justice is deemed to never have filed 'returns.' The issue in this is whether the Forms 1040 that Justice belatedly filed constitute 'returns' or purposes of § 523(a)(1)(B)(i)," Justice at 742. The Court explained that, "A significant factor in our decision to adopt the majority position espoused by the Fourth, Fifth, Seventh, and Ninth Circuits is the fact that our system of taxation relies on prompt and honest self-reporting by taxpayers, Id at 744. Therefore, the underlying income tax liabilities were non dischargeable.

Practice Tips:

Pursuant to BAPCPA, Section 1328 included new exceptions that prevents the discharge of certain taxes. Section 1328(a)(2) exceptions now include (1)(B), (1)(C), (2), (3), (4) of Section 523(a). By expanding the exceptions to a discharge, the amount of the non dischargeable claim can be paid during the Plan term, but the associated interest will continue to accrue post petition and can be collected by the IRS after Discharge.

Therefore, debtor counsel needs to review the filing dates of the debtor's income tax returns with the debtor before the filing of a Chapter 13. This is especially necessary where debtor counsel is aware that debtor has filed tax returns late and/or has not yet filed certain returns. Counsel should advise debtors that if they have the ability to fund a 100% plan to unsecured creditors, the debtor may also pay interest to the IRS on the non dischargeable tax liability.

If the debtor cannot afford to pay the unsecured claims in full, you may be able to develop strategies to prepare the debtor to address the post petition interest on the non dischargeable tax claims.

Applicable Statutes:

§ 502 - Allowance of claims or interests

(b) [I]f such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(2) such claim is for unmatured interest

11 U.S. Code § 507 - Priorities (*Trust Fund Taxes*)

(a)The following expenses and claims have priority in the following order

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

A trust fund tax is money withheld from an employee's wages (income tax, social security, and Medicare taxes) by an employer and held in trust until paid to the Treasury. (www.irs.gov/businesses/small-businesses-self-employed/trust-fund-taxes)

11 U.S. Code § 523 - Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(B) with respect to which a return, or equivalent report or notice, if required—

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(3) neither listed nor scheduled under section 521(a)(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a

nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

§ 1322 - Contents of plan

(b) Subject to subsections (a) and (c) of this section, the plan may—

(10) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims

§ 1328 - Discharge

(a) [T]he court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(2) of the kind specified in section 507(a)(8)(C) or in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a);