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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 94-12677
	)	
BERNHARD FISCHER, JR.	)	
MOYRA MARGARET FISCHER,	)	Chapter 13
	)	
Debtors.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**

This matter is before the Court on one issue raised in Debtors' Motion to Modify Confirmed Plan and the Objection of the Internal Revenue Service ("IRS") to the Motion. The issue to be addressed is whether the Court should permit Debtors to designate payments due to the IRS in a manner which minimizes the Debtors' liabilities and guarantees that certain secured taxes will not be paid. For the reasons stated below, the plan cannot be modified to include the requested provisions.

JURISDICTION

This Court has jurisdiction to hear this matter pursuant to 28 U.S.C. § 1334 and General Order No. 84 entered on July 16, 1984 by the United States District Court for the Northern District of Ohio. This is a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(L), (O).

FACTS

The undisputed facts as set forth in the briefs and file are as follows:

Debtors filed their petition under Chapter 13 of the United States Bankruptcy Code on June 24, 1994. An amended plan was filed on November 2, 1994 and confirmed by Order entered February 6, 1995. (Docket 21).

The IRS filed a secured claim setting forth total liabilities of $42,263.94 arising from income taxes owed for the years 1985, 1986, 1987, 1988, 1990 and 1992. The IRS filed liens to secure payment of all these taxes. Debtors objected to this claim and requested a determination regarding the value of the claim and the extent to which it is secured. (Docket 24). The IRS response asserted it has a secured claim in the amount of $16,779.91, the value of Debtors' equity in their assets, and a priority claim in the amount of $5,841.77, the amount of Debtors' 1992 tax liability plus interest to the date of the petition. The balance is general unsecured debt. (Docket 28).

Debtors filed another amended plan to which the IRS objected. (Docket 33, 34). Debtors responded with a Motion to Modify Plan under 11 U.S.C. §1329(a). (Docket 35). In the proposed plan, Debtors seek to pay the IRS as a secured creditor in the amount of $4,699.89 with interest at 7% (Amended Plan ¶ 4) and $1,141.88 as a priority claim under § 507 of the Bankruptcy Code. (Amended Plan ¶ 1). Paragraph 9 of the Amended Plan includes these provisions:

> The debtors' Amended Chapter 13 Plan provides for the debtors to pay off the secured interest of the Internal Revenue Service in the property of the debtors as provided in 26 U.S.C. §§ 6321 and 6334 and as set forth in paragraph 4 above, by paying $4,699.89 to the Internal Revenue Service inside the Plan. This amount is to be applied to the payment of the debtors' 1992 Federal Income Tax.

> The debtors' Amended Chapter 13 Plan provides that the balance of the 1992 Federal Income Taxes due to the Internal Revenue Service, $1,141.88, will be paid in full through the Chapter 13 Plan by the Chapter 13 Trustee as an unsecured priority claim.
>
> The balance of the claim of the Internal Revenue Service is a general unsecured claim against the bankruptcy estate, and will be treated as provided in paragraph 6 above.
>
> Upon completion of the Plan, all liens on the debtors' property held by the Internal Revenue Service for taxes for tax years ending on or before December 31, 1993 shall be discharged.

Unsecured claims are to be paid nothing under the proposed modification. (Amended Plan ¶ 6).

The IRS objects to these provisions in the proposed modification: (1) the valuation of its secured claim; and (2) the designation of payments to the IRS to specific tax years. As a result of this decision on designation, the valuation issue is moot with respect to plan modification.

DISCUSSION

Debtors ask the Court in the exercise of its equitable powers to treat the IRS claim in this fashion: (1) the payments under the plan for the IRS secured claim will be applied to the 1992 taxes; (2) Debtors will make an additional payment to pay the 1992 taxes in full; and (3) Debtors' remaining liabilities to the IRS will be treated as general unsecured claims which will be paid nothing under the plan. The unpaid taxes for years 1985 through 1989 will be discharged upon completion of the plan. The 1992 priority taxes will have been paid in full. Debtors' acknowledged purpose in proposing this modification is to emerge from the Chapter 13 proceedings with no tax liability for the years 1985 through 1992.

The IRS argues that Debtors may not designate payments or, if designation is potentially available, it should not apply to the facts of this case. Left to its own, the IRS would apply the

secured payments to the 1985, 1986 and 1987 liabilities. The liabilities for 1985 and 1986 are entirely secured, with the 1987 taxes secured in part. The IRS would require the 1992 tax liability plus interest to the petition date to be paid in full pursuant to 11 U.S.C. § 1322(a)(2). The remaining liabilities would be general unsecured and would be paid nothing under the plan. According to the IRS, this allocation would still leave in excess of $19,000 unpaid. An exact determination of this amount is impossible at this point in the proceedings based on the pending objection to Debtors' valuation of the IRS secured claim. Regardless of the valuation decision, the parties agree that the IRS will receive less money under Debtors' proposal than under the IRS proposal.

Under established and accepted IRS policy, taxpayers may designate the application of voluntary payments, but not involuntary payments. *In re DuCharmes & Co.*, 852 F.2d 194 (6th Cir. 1988). An involuntary payment is "any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor." *Amos v. Commissioner*, 47 T.C. 65, 69 (1966). Payments made pursuant to a plan of reorganization are involuntary. *In re DuCharmes & Co.* (payments made pursuant to a Chapter 11 plan of reorganization were involuntary). Debtors' plan payments in the context of this Chapter 13 are equally involuntary because the payments are made only after the bankruptcy court confirms the plan at a hearing, and a confirmation hearing is a "legal proceeding." *In re Burgess*, 171 B.R. 227 (Bankr. E.D. Tex. 1994). In the ordinary course, therefore, Debtors would not be permitted to designate their tax payments because they are involuntary payments.

Debtors' request for designation of payments to the IRS is premised on *United States v. Energy Resources, Inc.*, 495 U.S. 545 (1990). In that Chapter 11 case, the Supreme Court considered whether the bankruptcy court had the equitable power to direct application of payments to the IRS pursuant to a plan of reorganization. The bankruptcy court had ordered the IRS to apply plan payments first to trust fund taxes and then to non-trust fund taxes. Although the court directed the application of payments, ultimately the IRS would be paid in full for both categories of taxes and the designation did not violate any Code provision. The IRS appealed, arguing that the court had exceeded its equitable powers. The Supreme Court, noting the designation would not compromise the government's right to be paid in full, held that bankruptcy courts may order designation of payments if the designation is necessary to the success of the reorganization plan. The Court relied on Bankruptcy Code § 105 (Power of court) and §1123(b)(5) (Contents of plan) in reaching this conclusion. 11 U.S.C. §§ 105, 1123(b)(5), currently 1123(b)(6).

The statutory basis for the exercise of equitable designation relied on in *Energy Resources* is equally applicable to a Chapter 13 proceeding. Section 105 applies to Chapter 13 cases pursuant to § 103(a) of the Code. 11 U.S.C. § 103(a). Additionally, § 1322(b)(10) of Chapter 13 duplicates § 1123(b)(6) in the Chapter 13 context. *In re Klaska,* 152 B.R. 248 (Bankr. C.D. Ill. 1993). Moreover, as noted by the *Klaska* court, *Energy Resources* refers generally to reorganization plans and Chapter 13 cases, like those in Chapter 11, revolve around such plans. Based on these similarities between Chapter 11 and Chapter 13, the Court finds that the holding of *Energy Resources* applies to Chapter 13 cases. As a result, the bankruptcy court has the equitable power under appropriate circumstances to approve a Chapter 13 plan that designates the

application of tax payments. The question, then, is whether the facts of this case present an appropriate basis for such a designation.

Debtors characterize the issue as an equitable balancing of "the right of the Internal Revenue Service to collect taxes owed to it versus the debtors' right under the bankruptcy laws to receive a fresh start free from old debt." (Supplemental Response, p.12; Docket 40). While bankruptcy courts do have broad equitable powers, *Energy Resources* at 549, the starting point for analyzing the parties' positions must be the Code itself.

Chapter 13 of the Bankruptcy Code requires a debtor to submit a plan under which existing debts are paid from future income. Those debts are classified into three categories: secured, priority, and general unsecured. The Code provides that secured and priority debts are entitled to be treated in a specific manner: Secured debts must be paid to the extent of the value of the property securing the claim, 11 U.S.C. §§ 506 (a), 1325(a)(5); priority claims, including priority taxes, must be paid in full. 11 U.S.C. § 1322(a)(2); 11 U.S.C. § 507(a)(8).

The distinguishing factor in this case is that Debtors are not proposing to pay their entire secured and priority tax liability with the only issue being the timing of those payments. They are instead attempting to designate plan payments to that portion of their tax liability that is secured by collateral and to their priority taxes. This designation is done for purposes of obtaining a full discharge of their tax liability with the minimum of payments. Under these circumstances, Debtors are not seeking a designation of payments within the parameters of *Energy Resources*. "Rather, Debtors seek to change the classification of debts from one category, where full payment is required, to another category where less than full payment is required." *In re Bates,* 974 F.2d 1234, 1235 (10th Cir. 1992). The equitable considerations of *Energy Resources* are inapplicable

to this situation where an attempt is being made to reclassify debt to provide for less than full payment rather than seeking approval to pay one tax liability before another.

Other courts which have addressed *Energy Resources* in the Chapter 13 context have similarly limited its holding. *In re Klaska*, 152 B.R. 248 (Bankr. C.D. Ill. 1993), cited by Debtors in support of designation, permitted designation of payments to the IRS under a Chapter 13 plan to require application of payments to a debtor's income tax liability before payment of employee withholding taxes. The plan provided 100% payment, but designation was requested based on the possibility that a former partner's liability for the employee taxes would reduce the debtor's tax liability. In cases where 100% payment is not provided and debtors are attempting to rearrange tax claims in an effort to avoid paying taxes altogether, designation has been ruled inappropriate and denied. *In re Bates*, 974 F.2d 1234 (10th Cir. 1992) (plan designation of trust fund taxes as priority and balance of liability as unsecured rejected). *In re Burgess*, 171 B.R. 227 (Bankr. E.D. Tex. 1994) (debtor's objection to IRS claim based on how claim was apportioned to collateral overruled); *In re Divine*, 127 B.R. 625 (Bankr. D. Minn. 1991) (plan proposal to allocate tax liability for various years as secured, priority and general unsecured rejected). *In re Lambert*, 124 B.R. 345 (Bankr. W.D. Okla. 1991) (plan amendment request that court require IRS to apply plan payments in inverse chronological order denied).

As noted above, in the absence of equitable re-allocation, Debtors may not designate their tax payments in the manner proposed. *Energy Resources* did not eliminate the distinction between involuntary and voluntary payments: "The distinction is only abrogated when a court finds that the bankruptcy policy of favoring reorganization would be furthered if the court could use its equity powers to direct how the payments were to be applied by the IRS." *Burgess* at 229.

Therefore, absent this equitable determination to designate, plan payments are involuntary and may not be designated by Debtors.

CONCLUSION

Debtors' request to modify their confirmed plan to designate the manner in which their payments to the IRS will be applied is denied. A separate Judgment will be entered in accordance with this Memorandum of Opinion.

Date: 8 May 1996

Pat E Morgenstern-Clarren
Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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