

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION**

**In re: Jeffery T. Patterson and
Sora L. Patterson, Debtors**

**No. 5:09-bk-75683
Ch. 13**

ORDER

Before the Court is the Trustee's Objection to Confirmation of the debtors' chapter 13 plan, in part, filed by the chapter 13 trustee on February 16, 2010; a Motion for Refund filed by the debtors on March 1, 2010; and the Trustee's Response to Debtors' Motion for Refund filed on March 22, 2010. On May 12, 2010, the Court held a hearing on the motion, response, and objection. The debtors are seeking a "refund" of their income tax refund in the amount of \$7567.05 [the Funds] that the chapter 13 trustee currently holds in order to pay for their daughters' college tuition. The trustee objects to the motion for refund because she argues that the college tuition expenses are not reasonably necessary for the debtors' daughters' maintenance or support under § 1325(b)(2)(A)(i). The trustee objects to confirmation of the debtors' plan on several grounds, including that payments to unsecured creditors are inconsistent with disposable income; however, the trustee's entire objection is not before the Court. At the hearing, the trustee announced that her objection was sustained, except to the extent the debtors claim their daughters' college tuition as an expense that can be deducted from the Funds. The trustee argued that this deduction is not permissible because the tax refund is "disposable income" under § 1325(b)(2) and must be applied to payments to unsecured creditors. At the conclusion of the hearing, the Court took the matter under advisement. For the reasons stated below, the Court grants the debtors' motion and overrules the trustee's objection.

Jurisdiction

This Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (L). The following order constitutes findings of fact and conclusions of law in accordance with Federal Rule of

Bankruptcy Procedure 7052, made applicable to this proceeding under Federal Rule of Bankruptcy Procedure 9014.

Issues

Based on the pleadings before the Court, the May 12 hearing, and the parties' partial settlement of the trustee's objection to confirmation, two issues are before the Court: (1) whether the Funds must be "refunded" to the debtors, and (2) whether the Funds are disposable income under § 1325(b). The Court will address each issue in turn.

Whether the Funds Must Be Refunded to the Debtors

At the May 12 hearing, the parties stipulated to the following facts, summarized in relevant part:

- (1) The plan proposed or the debtors intend to propose that if the debtors receive an income tax refund, they will pay the trustee the amount they receive in excess of \$2000.00.
- (2) The debtors received a tax refund for 2010 that was \$9996.00.¹
- (3) The trustee received a check for \$7567.05 on February 16, 2010.²
- (4) The debtors' chapter 13 plan is not confirmed.
- (5) Based on the debtors' proposed plan, the trustee estimates an 11% distribution to unsecured creditors.

The first stipulation listed above relates to the trustee's policy regarding chapter 13 debtors' income tax refunds. The trustee's position is that debtors' income tax refunds should be committed to the plan; however, if debtors provide in their plans to pay the amount of income tax refund received in excess of \$2000.00 to the trustee, the trustee

¹ The Court notes that the debtors' Exhibit A reflects that the tax refund was on account of withholdings in tax year 2009, not 2010.

² The Court presumes from the context of the stipulation that the check was from the debtors.

typically will not object to the confirmation of debtors' plans based on the refund, or otherwise demand the entire amount of the refund. At the hearing, the trustee explained that this practice is a "rule of thumb . . . that has been used over the years" to allow debtors to pay for certain expenses that they had planned on paying with their tax refund without having to request a refund from the Court. There is no written statement regarding this policy. The trustee stated that \$2000.00 is an arbitrary amount that was in place when she became trustee. In this case, the debtors' proposed plan does not mention the treatment of income tax refunds; therefore, according to the stipulation, the debtors intend to propose to pay the amount of income tax refund received in excess of \$2000.00 to the trustee. Regardless, the debtors have already acted in accordance with the refund policy by sending the Funds to the trustee's office even though their current plan does not address tax refunds.³

Determining whether the debtors are entitled to possession of the Funds already paid to the trustee requires an analysis of several bankruptcy code sections. Under 11 U.S.C. § 541, the commencement of a bankruptcy case creates an estate that is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "A tax refund that is received post-petition is property of the estate if it is attributable to wages earned and withholding payments made during pre-petition years." *Carlson v. Moratzka (In re Carlson)*, 394 B.R. 491, 493 (B.A.P. 8th Cir. 2008) (citing *Benn v. Cole (In re Benn)*, 491 F.3d 811, 813 (8th Cir. 2007)) ("A debtor's anticipated tax refund, to the extent it is attributable to events occurring prior to the filing of the petition for bankruptcy, is part of the bankruptcy estate."). Additionally, in chapter 13 cases, "[p]roperty of the estate includes . . . earnings from services performed by the debtor *after* the commencement of the case . . ." 11 U.S.C. § 1306(a)(2) (emphasis

³ The trustee noted at the hearing that the debtors actually kept slightly more than the \$2000.00 amount. However, Mr. Patterson explained that the difference was on account of the tax preparation fee, and the debtors only retained \$2000.00. The trustee is not requesting that the \$2000.00 be returned to the trustee's office, so the Court will not consider or change the fate of the \$2000.00.

added). A tax refund on account of wages earned post-petition by a chapter 13 debtor is “unquestionably property of the bankruptcy estate.” *In re Halverson*, 2009 WL 2171095, at *2 (Bankr. D.Mass. July 20, 2009); *see also In re Rodger*, 423 B.R. 591, 594 (Bankr. D.N.H. 2010) (stating that in a chapter 13 case, an income tax refund due to the debtors on account of income that was earned post-petition is property of the estate). Therefore, the Funds, whether due to the debtors on account of wages earned pre-petition or post-petition, are property of the debtors’ bankruptcy estate.

According to § 1306, the debtor is entitled to remain in possession of all property of the estate, “[e]xcept as provided in a confirmed plan or order confirming a plan.” 11 U.S.C. § 1306(b). Section 1302, which sets forth the duties of chapter 13 trustees by incorporating certain duties of chapter 7 trustees, does not include the duty under § 704(1) to “collect and reduce to money the property of the estate for which such trustee serves.” 11 U.S.C. §§ 1302(b)(1), 704(a)(1). Unlike a chapter 7 trustee, the chapter 13 trustee “is appointed to act in a limited fashion. He or she serves an administrative function The debtor remains in control of the assets.” *In re Lee*, 35 B.R. 452, 457 (Bankr. N.D. Ga. 1983) (quoting *In re Ciavarella*, 28 B.R. 823, 825 (Bankr. S.D.N.Y. 1983) (finding a violation of the automatic stay where a bank closed the debtors’ accounts and transferred the debtors’ funds to the chapter 13 trustee). The trustee “acts as an adviser and administrator to facilitate the repayment of debts according to the plan,” but does not maintain possession of property of the estate, unless otherwise ordered by the plan. *Cable v. Ivy Tech State Coll. (In re Cable)*, 200 F.3d 467, 472 (7th Cir. 1999). Based on the above-stated law, and because of the absence of a confirmed plan or order confirming a plan to the contrary, the debtors are entitled to remain in possession of the Funds.

The Funds or a portion thereof might also be disposable income under § 1325(b). However, this does not change the fact that the debtors remain in possession of property of the estate pending confirmation. If the Funds are adjudicated to be “disposable income,” this adjudication would only require the debtors to provide in their plan that the

Funds would be applied to make payments to unsecured creditors under the plan,⁴ beginning on the date that the first plan payment is due. 11 U.S.C. § 1325(b). It would not require the debtors to pay the Funds to the trustee *before* a plan was confirmed. In sum, the possibility that the Funds are projected disposable income does not defeat the debtors' entitlement to possession of the Funds pre-confirmation.

Because the debtors already paid the Funds to the trustee in accordance with the trustee's income tax refund policy also does not change this result. The refund policy is not based on an analysis of the characterization of tax refund income under the bankruptcy code. Rather, it is a policy that the parties in this jurisdiction have simply followed, perhaps to avoid litigation or for other reasons. Regardless, the Court cannot allow the trustee to continue to hold the Funds because the bankruptcy code does not permit chapter 13 trustees control over the Funds pre-confirmation in this context. For these reasons, the Court finds that the debtors are entitled to possession of the Funds, and grants the debtors' motion for refund, pending confirmation of the debtors' plan.

Whether the Funds are Disposable Income

Because the chapter 13 trustee has objected to the debtors' plan and the plan does not provide for the full repayment of unsecured debts, the plan must apply "all of the debtor's projected disposable income to be received" over the life of the plan "to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1). The debtors' current plan states that the debtors will pay all disposable income into the plan, and proposes monthly payments to the trustee's office in the amount of \$3355.00. The plan also provides for a pro-rata distribution to unsecured creditors, and, according to the trustee, unsecured creditors will receive an 11% distribution under the current proposed plan.

⁴ This presumes no unusual circumstances exist that warrant final adjustments to the debtors' plan payment when considering the debtors' *projected* disposable income. See *Hamilton v. Lanning*, 2010 WL 2243704, at *9, *12 (U.S. June 7, 2010).

However, the trustee argues that the debtors should also apply the Funds to payments made to unsecured creditors because the Funds are disposable income.

Disposable income is defined, in relevant part, as, “current monthly income received by the debtor . . . less amounts reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor . . .” 11 U.S.C. § 1325(b)(2).

“Current monthly income” is “calculated by averaging the debtor's monthly income during what the parties refer to as the 6-month look-back period, which generally consists of the six full months preceding the filing of the bankruptcy petition.” *Hamilton v.*

Lanning, 2010 WL 2243704, at *4 (U.S. June 7, 2010) (citing 11 U.S.C.

§ 101(10A)(A)(I)). Current monthly income is gross income and should be calculated before withholding for taxes. *In re Forbish*, 414 B.R. 400, 402–03 (Bankr. N.D. Ill. 2009); 11 U.S.C. § 101(10A). The debtors in this case are above-median income debtors, and, as such, they may include only certain specified expenses as “amounts reasonably necessary to be expended.” *Hamilton*, 2010 WL 2243704, at *4 (citing §§ 707(b)(2), 1325(b)(3)(A)). These expenses are specified in § 707(b)(2), and for chapter 13 debtors, the expenses are calculated, along with the debtors’ currently monthly income, using Official Form 22C, also known as “the means test.” *Id.*

In this instance, the debtors’ means test states that the debtors’ current monthly income is \$8061.01. This amount includes the debtors’ “gross wages, salary, tips, bonuses, overtime, [and] commissions,” which is listed on line 2 of the debtors’ means test. The debtors state on line 30 that the total average monthly expense that they actually incurred on account of taxes, including income taxes, was \$897.25. However, because the debtors received an income tax refund, it is possible that some portion of the amount withheld from their wages for income taxes was an overpayment; in other words, the amount was more than the amount necessary to pay their income taxes. Although the debtors did not receive the tax refund until 2010, withheld wages owed to the debtors are income at the debtors at the time they are withheld. *Forbish*, 414 B.R. at 402–03. It follows then that the Funds should be included in the debtors’ current monthly income to the extent the

Funds are on account of an overpayment of income taxes that were earned but withheld during the six months prior to the filing of the bankruptcy petition. The resulting current monthly income figure, minus expenses *as allowed under § 707(b)(2)*, is the debtors' "disposable income." 11 U.S.C. § 1325(b).

The Court cannot determine this amount from the record before it. First, the Court does not know how much of the Funds are on account of income earned but withheld during the six months prior to the bankruptcy filing, and, therefore, cannot determine how much of the Funds should be included in the debtors' current monthly income. Second, although the trustee has objected to the debtors' college tuition expense and argues the expense should not be deducted from the debtors' disposable income figure, the debtors have not done so. Because the debtors are above-median income filers, the debtors' means test reflects the debtors' expenses as allowed under § 707(b)(2), and the college tuition expenses are not included. While Schedule J does account for the college tuition expense, the purpose of Schedule J is not to determine the debtors' "disposable income"; rather, Schedule J is a list of the debtors' current expenditures. 11 U.S.C. § 521(a)(B)(ii). Schedule J may be taken into consideration when making the final determination as to whether the debtors have applied all of their *projected* disposable income to the plan, to the extent it reflects changes in the debtors' income or expenses that are known or virtually certain at the time of confirmation. *Hamilton v. Lanning*, 2010 WL 2243704, at *9, *12 (stating that "a court taking the forward-looking approach should begin by calculating disposable income, and in most cases, nothing more is required. It is only in unusual cases that a court may go further and take into account other known or virtually certain information about the debtor's future income or expenses"). Finally, based on the debtors' stipulation at the May 12 hearing and the partial settlement of the trustee's objection, the debtors will be filing at least one additional plan. Because the Court is not privy to the parties' settlement or the resulting adjustments to the plan payment, the Court cannot determine from the current plan whether the debtors have applied all of their disposable income, projected or not, to payments to unsecured creditors.

Conclusion

For the reasons stated above, the Court grants the debtors' motion for refund and finds that the debtors are entitled to possession of the Funds, pending confirmation of the debtors' plan. Additionally, while some portion of the Funds may need to be included in the debtors' current monthly income calculation, the Court cannot determine what portion of the Funds are current monthly income, and, ergo, disposable income, from the record before it. Therefore, the Court overrules the portion of the trustee's objection to confirmation that is before the Court. The trustee is not prejudiced from seeking a determination as to whether the debtors are applying all of their "projected disposable income" to the plan once the debtors have filed an amended plan in accordance with this Order and the parties' stipulation.

IT IS SO ORDERED.

July 14, 2010

DATE



BEN T. BARRY
UNITED STATES BANKRUPTCY JUDGE

cc: Joseph Cornell, attorney for debtors
Joyce Bradley Babin, chapter 13 trustee