UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

JUDGMENT ENTERED ON JUL 17 1989

IN RE:	)	Case No. C-B-86-01029
	)	Chapter 13
EDWARD H. BURNETTE, and	)	
JANET M. BURNETTE,	)	
	)	
Debtors.	)	
	)	

ORDER SUSTAINING DEBTORS' OBJECTION TO CLAIM OF INTERNAL REVENUE SERVICE

This Chapter 13 case is before the court on the debtors' objection to the proof of claim filed by the Internal Revenue Service ("IRS"). Specifically, the debtors object to the IRS' claim of secured status on its entire claim; and the debtors assert the right to designate to which delinquent taxes their Chapter 13 plan payments will go, such that those payments will pay IRS' secured and priority claims and leave the bulk of IRS' unsecured claim to be discharged upon completion of the Chapter 13 plan. IRS contends that it, not the debtors, has the right to designate to which delinquent taxes, penalties and interest the Chapter 13 plan payments should be applied, which would maximize payments to IRS. The determinative issue is whether Chapter 13 plan payments are "voluntary" (in which case the debtors can designate their application) or "involuntary" (in which case the IRS designates application of payments). After a full consideration of all that has been submitted in this case, the court has concluded that Chapter 13 plan payments are "voluntary" payments, and, consequently, the debtors are entitled to designate to which of their delinquent taxes their payments are to be applied.

FACTS

The debtors filed their Chapter 13 petition in October 1986. The IRS filed a proof of claim for a total of $34,091.40. This claim was for income tax deficiencies as follows:

Kind of Tax	Tax Period	Date Tax Assessed	Tax Due	Penalty to Petition Date	Interest to Petition Date	Notice of Lien Filed Date	Notice of Lien Office Location
Income	12/31/77	5/13/85	56.05	320.17	2,054.68	6/25/85	Mecklenburg Co.
Income	12/31/78	5/13/85	726.25	292.72	1,684.34	6/25/85	Mecklenburg Co.
Income	12/31/79	5/20/85	2,265.87	394.65	2,232.28	6/25/85	Mecklenburg Co.
Income	12/31/80	5/20/85	2,464.78	422.10	2,045.21	6/25/85	Mecklenburg Co.
Income	12/31/81	5/20/85	560.00	100.80	385.38	6/25/85	Mecklenburg Co.
Income	12/31/82	4/15/85	2,521.24	346.13	1,080.18	6/25/85	Mecklenburg Co.
Income	12/31/83	5/13/85	7,291.54	695.12	2,182.61	6/25/85	Mecklenburg Co.
Income	12/31/85	6/09/86	3,692.00	110.52	166.78	6/25/85	Mecklenburg Co.

Total Tax Lien = $ 34,091.40

It is the IRS' position that all payments pursuant to a court order, such as a confirmed plan, are involuntary and therefore cannot be designated by the debtor in a confirmed plan of reorganization. Thus, the IRS has asserted that the full amount of its claim is a secured claim as a result of Notices of Federal Tax Liens that it has filed prior to the debtors' bankruptcy petition. Further, -- notwithstanding the secured or unsecured nature of its claim -- IRS asserts that income taxes for tax periods within three years of the filing of the bankruptcy petition constitute priority claims which must be paid through the Chapter 13 plan. 11 U.S.C. § 507(a)(7). Federal taxes due for years prior to the three-year pre-petition period are not entitled to priority treatment -- nor are the penalties and interest that accrue on those taxes. Rather, those taxes, penalties and interest are general unsecured claims which may be

discharged by the bankruptcy case. Consequently, the IRS' practice is to apply involuntary payments in the most beneficial manner for the United States -- here, to apply the payments first to the oldest, dischargeable taxes, penalties and interest. See, Rev. Rul. 73-305, 1973-2 Cum. Bull. at 43.

The debtors assert that the IRS has a secured claim of only $5,940.00 (the value of the debtors' property subject to the IRS lien); that because the Chapter 13 plan payments are "voluntary," that secured portion of the IRS claim should be designated to 1985 and 1983 taxes and paid through the Chapter 13 plan; and that the consequence of that designation should be that the IRS has a secured claim of $5,940.00, a priority claim of $7,392.93, and the balance would be unsecured claim.

DISCUSSION

Generally, when a taxpayer submits a voluntary payment to the IRS, he is entitled to designate the tax liability to which the payment will be applied. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983). See Rev. Rul. 73-30, 1973-2 Cum. Bull, 42, modified by Rev. Rul. 79-204, 1979-2 Cum. Bull, 83; Rev. Rul. 73-305, 1973-2 Cum. Bull. 43. This rule is in accord with the rule generally recognized between creditors and debtors, that the debtor may indicate which debt he intends to pay when he voluntarily submits a payment to his creditor, but may not dictate the application of funds that the creditor involuntarily collects from him. See National Bank of the Commonwealth v. Mechanics' National Bank, 94 U.S. 437 (1877); Datlof v. United States, 370 F.2d 655, 658-59 (3d Cir. 1966);

Muntwyler v. United States, supra, 703 F.2d at 1032; O'Dell v. United States, 326 F.2d 451, 456 (10th Cir. 1964). When the payment is involuntary, it is the policy of the Internal Revenue Service to apply the payment in the most beneficial fashion to the United States, taking into consideration alternative means for collecting other outstanding tax liabilities. Muntwyler v. United States, supra, 703 F.2d at 1032, United States v. DeBeradinis, 395 F. Supp. 944, 952 (D. Conn. 1975), aff'd., 538 F.2d 315 (2d Cir. 1976).

Thus, the determinative issue here is whether the debtors' payments to the IRS through their Chapter 13 plan are "voluntary" or "involuntary" payments.

There is no binding authority on this issue in the context of a Chapter 13 case.* Neither the Fourth Circuit nor the District Court for this district has addressed this issue. But, the issue has arisen numerous times in Chapter 11 cases where the courts have reached varying results: (1) The Third, Sixth and Ninth Circuits have held that Chapter 11 plan payments to the IRS are "involuntary;"** (2) Other courts have held such payments to

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* In re Frost, 47 B.R. 961 (D. Kan. 1985), is a Chapter 13 case where the District Court in Kansas held that Chapter 13 plan payments to the IRS were "involuntary." Of course, that decision is not binding on this court, nor does it deal with the analysis used here.

** See, e.g., In re Ribs-R-Us, 828 F.2d 199 (3d Cir. 1987); In re Ducharmes & Co., 852 F.2d 194 (6th Cir. 1988); and In re Technical Knockout Graphics, Inc., 833 F.2d 797 (9th Cir. 1987).

be "voluntary;"* and (3) the First and Eleventh Circuits have held that the issue should be decided on a case-by-case basis.**

The Chapter 11 Cases

The courts which have held that Chapter 11 plan payments to the IRS are "involuntary" have relied on the definition of that term in Amos v. Commissioner:

> An involuntary payment of Federal taxes means 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.

47 T.C. 65, 69 (1966); Quoted in Ribs-R-Us, 828 F.2d at 201; TKO Graphics, 833 F.2d at 802; and Ducharmes & Co., 852 F.2d at 196. These courts have also relied on dicta in Muntwyler v. United States which suggested that a Chapter 11 bankruptcy case was a "legal proceeding" which would render payments to the IRS involuntary. 703 F.2d at 1033 and 1034 n.2. Finally, the courts have relied upon the "realities of bankruptcy" and the constraints of a Chapter 11 proceeding to find that the plan payments are not wholly "voluntary," but coerced by financial circumstances and made only within the constraints imposed on a Chapter 11 debtor by the Bankruptcy Code, court orders and the plan. See, Ribs-R-Us, 828 F.2d at 203; TKO Graphics, 833 F.2d 802-03.

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* See, e.g., In re Professional Technical Services, Inc., 80 B.R. 157 (Bankr. E.D. Mo. 1987); In re Lifescape, Inc., 54 B.R. 526 (Bankr. D. Colo. 1985); and In re Tom Le Duc Ent., Inc., 47 B.R. 900 (W.D. Mo. 1984).

** See, e.g., In re Energy Resources, Inc., 871 F.2d 223, (1st Cir. 1989); In re A & B Heating & Air Conditioning Co., 823 F.2d 462 (11th Cir. 1987).

The courts which have held that Chapter 11 plan payments to the IRS are "voluntary" have also started with the definition contained in Amos v. Commissioner. But, based upon other language in Muntwyler, they conclude that it is only court action that results in an actual seizure of property or money as in a levy which amounts to an involuntary payment. So, the mere existence of the Chapter 11 bankruptcy case does not render payments pursuant to the plan involuntary. See, Professional Technical Services, 80 B.R. at 160-61. Further, these courts do not equate the restrictions of Chapter 11 with involuntariness, but focus on the options and flexibility offered by Chapter 11 as indications that plan payments are voluntary.

The courts which have adopted the position of discretionary case-by-case determination of the voluntary/involuntary issue have noted that plan payments to the IRS have aspects of both voluntary and involuntary actions. See, Energy Resources Co., 871 F.2d at 228-29; A & B Heating and Air Conditioning, 462 F.2d 464-65. In the latter case the Eleventh Circuit set out a number of factors to be used in determining whether Chapter 11 plan payments are voluntary or involuntary on a case-by-case basis. 462 F.2d 465-66. The First Circuit reached the same result in Energy Resources, but via different reasoning. It held that Chapter 11 payments to the IRS were "involuntary," but that the allocation question in a Chapter 11 case should be left to the discretion of the bankruptcy court on a case-by-case basis. 871 F.2d at 233.

Chapter 13 Cases

The reasoning of the cases dealing with Chapter 11 tax payments does not completely apply when dealing with a Chapter 13 case. The court is persuaded that Chapter 13 tax payments are "voluntary" because of (1) the nature of the term "voluntary;" (2) peculiarities of a Chapter 13 case; and (3) policies favoring repayment of debts and the collective proceeding.

(1) Definition of "voluntary" payment.

Virtually all of the courts that have wrestled with this issue have looked to Muntwyler for the definition of voluntary and involuntary payments. This court does not find persuasive the dicta that "payments made in bankruptcy are involuntary...because court action is involved." 703 F.2d 1033. Rather, other language in Muntwyler holds that something more than the mere existence of a court proceeding is required to render a payment involuntary:

> The distinction between a voluntary and involuntary payment in Amos and all the other cases is not made on the basis of the presence of administrative action alone, but rather the presence of court action or administrative action resulting in an actual seizure of property or money as in a levy. No authorities support the proposition that a payment is involuntary whenever an agency takes even the slightest action to collect taxes, such as filing a claim....
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> The strongest indication that our holding is correct is the language of the IRS policy statement on which the Government bases it claim in this case... "The taxpayer, of course, has no right of designation in the case of collections resulting from enforced collection measures." (Citation omitted). Use of the phrase "enforced collection measures" belies the Government's contention that any administrative action is enough to render payment made in response to that action involuntary...

> Furthermore, the cases uniformly define an involuntary payment as one made pursuant to judicial action or some form of administrative seizure, like a levy.
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> 703 F.2d at 1033.

Here, the IRS has merely filed its Notice of Federal Tax Lien prior to the debtors' bankruptcy and then filed its proof of claim in the bankruptcy case. The only "court order" affecting the debtors' payments to the IRS is the January 1987* Confirmation Order confirming the plan the debtors proposed. That does not seem to be sufficient coercion to render the debtors' payments to the IRS involuntary under the language of Muntwyler.

(2) Nature of a Chapter 13 case.

The terms "voluntary" and "involuntary" are absolute and describe polar extremes. As the courts in A & B Heating & Air Conditioning and Energy Resources noted, payments pursuant to a Chapter 11 plan have characteristics of both voluntary and involuntary acts and, thus, fall somewhere between these two extremes. Because of the nature of a Chapter 13 case, payments

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* The debtors' Objection to the IRS claim was filed in September 1987. By agreement of the parties, this matter was held in abeyance pending resolution of the same issue in another case that was then pending on appeal to the District Court. Unfortunately, that case was dismissed and the appeal mooted. Consequently, the parties have now brought this matter on for resolution after some justifiable delay.

to the IRS pursuant to the debtors' Chapter 13 plan are more demonstrably "voluntary" acts than such payments pursuant to a Chapter 11 plan.

A Chapter 13 bankruptcy is a purely voluntary proceeding. Unlike Chapter 11, there is no provision for an involuntary Chapter 13 filed by creditors. See, 11 U.S.C. § 303(a). A Chapter 13 case can be commenced only by the debtors' voluntary petition. 11 U.S.C. §§ 301 and 303(a). Although the debtors' filing of a Chapter 13 case will virtually always be precipitated by financial distress and the debtors' need for protection from creditors, that does not make the proceeding "involuntary." Those practical "realities" may reflect motivation, but they do not amount to a requirement as would equate to a involuntary act. Plus, what is always "voluntary" about a Chapter 13 case is the debtors' election to pay creditors more than they would receive if the debtors had exercised their right to liquidate in a Chapter 7 case.

Further, unlike a Chapter 11 debtor, Chapter 13 debtors can dismiss their cases at any time as a matter of right. 11 U.S.C. § 1307(b); compare 11 U.S.C. § 1112(a). This right is necessary in a Chapter 13 case solely to preserve its voluntary nature. It is of such importance that a waiver of the right is unenforceable. 11 U.S.C. § 1307(b).

Moreover, in a Chapter 13 case the plan that is confirmed is the debtors' plan. 11 U.S.C. § 1321; compare, 11 U.S.C. § 1121(b) and (c). So, the payments pursuant to the confirmed plan are those payments proposed by the debtor. Consequently, the "court order" requiring the payments is simply an order confirming what the debtor has voluntarily proposed. Of course, the debtors' plan must be consistent with requirements of the

Bankruptcy Code. But, given the debtors' right to stop making payments and dismiss their case at any time, it is hard to deem the Chapter 13 plan payments to be anything but voluntary.

In summary, there appears to be enough uncertainty about whether Chapter 11 payments are voluntary or involuntary to cause the courts to split in three directions. Chapter 13 has enough additional attributes of voluntary nature that the court concludes that the debtors' payments to the IRS pursuant to their Chapter 13 plan in this case are voluntary payments.

(3) Policy favoring repayment of debts and collective proceedings.

The court in Energy Resources noted the preference for rehabilitation over liquidation. 871 F.2d at 233. Specifically with respect to Chapter 13, Collier has stated:

> The legislative history of chapter 13 this unmistakably defines the nature and prescribes the relative priority of Congress' legislative goals. Congress intended to encourage, but not require, financially overextended individual debtors to make greater voluntary use of repayment plans commensurate with each debtor's abilities, as the most effective means of improving, first, debtor relief, and, second, creditor recoveries, by enacting a simplified, expanded, and more flexible chapter 13. The success of this most recent congressional attempt to displace grab law depends upon the administrative and judicial allegiance accorded its clear legislative purposes and priorities.

5 Collier on Bankruptcy Para. 1300.02 at p. 1300-20-21 (footnotes omitted). In furtherance of the policy favoring repayment, the scope of the debtors' discharge in a Chapter 13 case where creditors are repaid through plan payments is broader than in a Chapter 7 liquidation. Compare 11 U.S.C. §§ 1328 and 727. Similarly, treating the Chapter 13 debtors' plan payments to the

IRS as voluntary -- and thus designated by the debtor -- as an incentive to voluntary repayment plans is consistent with that policy.

Another policy (in fact, purpose) of the Bankruptcy Code is to prefer collective debt collection proceedings in a bankruptcy case to individual "grab" collection. See Jackson, The Logic and Limits of Bankruptcy law, Harvard Univ. Press 1986, at 5-19. The court noted in Energy Resources that:

> we can find no policy in any statute suggesting that Congress felt that bankruptcy courts must maximize the likelihood that the IRS will receive its entire tax debt, irrespective of all other goals,...

871 F.2d at 233. The IRS' characterization of a Chapter 13 payment as "involuntary" and its consequent application of the payments is an effort to maximize its recovery from the debtor (of funds that would otherwise be distributed to other creditors). As such, it is to a large extent a form of individualized "grab" that bankruptcy was designed to avoid. Treating the Chapter 13 payments as "voluntary" to be designated by the debtors seems more consistent with Bankruptcy Code's collective purpose.

Conclusion

For all of the foregoing reasons, the court has concluded that the debtors' Chapter 13 plan payments to the IRS are "voluntary" payments such that the debtors are entitled to designate to which tax debts the payments are to be applied.

It is therefore **ORDERED** that the debtors' objection to the claim of the United States/Internal Revenue Service is sustained.

This the 13th day of July, 1989.

George B. Hodges
United States Bankruptcy Judge