



SO ORDERED.

SIGNED this 17 day of October, 2005.

Janice Miller Karlin

JANICE MILLER KARLIN
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:)
)
JACK LEE ROOKARD and)
BRENDA LUCETTE ROOKARD,) **Case No. 03-42320-13**
)
Debtors.)
_____)

**ORDER GRANTING DEBTORS' MOTION FOR TURNOVER
OF 2002 INCOME TAX REFUNDS**

This matter is before the Court on Debtors' Motion for Turnover of 2002 Income Tax Refunds.¹ Debtors and the Chapter 13 Trustee (Trustee) have stipulated to all the relevant facts and have filed briefs, which this Court has fully considered. This matter constitutes a core proceeding,² and the Court has jurisdiction to decide it.³

¹Doc. 66.

²28 U.S.C. § 157(b)(2)(J).

³28 U.S.C. § 1334.

I. FINDINGS OF FACT

Debtors filed their Chapter 13 bankruptcy petition and plan on August 18, 2003. As of that date, Debtors were entitled to receive, but had not yet received, their 2002 federal and state income tax refunds in the total amount of \$17,752.29. These refunds were properly disclosed as an asset on Schedule B.

Debtors' Plan contains the following provisions relating to the 2002, and projected 2003, income tax refunds:

LIQUIDATION ANALYSIS and BEST INTEREST OF CREDITORS: The debtors' payments under the plan as proposed total \$72,000. Leaving aside the potential proceeds of Brenda Rookard's unliquidated civil rights claim against the Department of Transportation, this amount exceeds the liquidation value of the bankruptcy estate, if the estate were liquidated under Chapter 7.

Therefore, except for the civil rights claim, the debtors shall retain all of their exempt and non-exempt property, including but not limited to their 2002 federal and state income tax refunds, and a portion of the debtors' 2003 federal and state income tax refunds representing the pro-rata share of the refunds earned prior to the filing of the bankruptcy petition. [Footnote: The remaining portion of the 2003 refunds, and all refunds received thereafter during the first 36 months of the plan, shall be deemed "disposable income" and paid to the Chapter 13 trustee for distribution under the plan.] Upon confirmation of the plan, all such property shall vest in the debtors, free and clear of any claim or interest of any creditor provided for in the plan, except as provided in the plan. (emphasis added).

On October 27, 2003, the Trustee filed a timely objection to confirmation of Debtor's Plan,⁴ stating that "[w]hile the general concept of the Debtors being able to buy back the income tax refund and to generally satisfy the best interest of creditors test is not objectionable to the Trustee, the Trustee is concerned that the estate needs to be fully protected with respect to this issue."⁵

⁴Doc. 28.

⁵*Id.* at ¶ 2.

To protect the estate, the Trustee proposed that the refund money be segregated and preserved until such time as the “best interest of creditors” requirement under 11 U.S.C. § 1325 (a)(4) had been actually satisfied by way of payments made to the Trustee under the Plan. The Trustee further proposed that Debtors not receive a discharge until the “best interest of creditors” test was satisfied, and that the amount to be paid under the Plan to meet the test should not be subject to modification.⁶

On November 21, 2003, the Court entered an agreed Order Resolving Chapter 13 Trustee’s Objection to Debtors’ Plan.⁷ The Order provided that the Trustee should receive and retain the proceeds of the tax refunds in his trust account until further order of the Court. The order also provided that Debtors reserved the right to “raise additional issues or to negotiate specific language in a supplementary order.” Finally, the order provided that the Trustee’s objection to confirmation was resolved without prejudice to the rights of either party.

Debtors’ Chapter 13 Plan was confirmed by the entry of an Order of Confirmation⁸ on December 15, 2003. On December 29, 2003, Debtors turned over their 2002 income tax refunds checks to the Trustee, who has since held the proceeds from those refund checks in his trust account. The unsecured creditors have now received total dividends from Debtors’ payments under the Plan in excess of the Chapter 7 liquidation value of the bankruptcy estate (leaving aside potential proceeds of Brenda Rookard’s unliquidated civil rights claim, which remains property of the estate subject to administration by the Trustee).

⁶*Id.* at ¶¶ 2-3.

⁷Doc. 38.

⁸Doc. 40.

II. CONCLUSIONS OF LAW

Debtors filed this motion for turnover of \$17,752.29, representing the proceeds from their pre-petition 2002 tax refunds. Debtors contend that they have now paid in sufficient money to satisfy the best interest of the creditor's test under 11 U.S.C. § 1325(a)(4),⁹ and that the estate no longer needs to preserve the funds for that purpose.

The "best interest of the creditors test" under § 1325(a)(4) requires that the Chapter 13 plan provide distributions to each allowed unsecured creditor that are not less than what the unsecured creditor would have received if the debtor's estate were liquidated under a Chapter 7 proceeding. This provision essentially allows Chapter 13 debtors to "buy-out" non-exempt, pre-petition assets by paying their value to unsecured creditors, by increased payments to the Trustee over at least 36 months.

The Trustee admits that Debtors have now met the best interest of the creditors test, because they have now paid in funds well in excess of \$17,752 to unsecured creditors. Nevertheless, he contests turnover of the proceeds of the pre-petition tax refund, at least for approximately another year. His argument is that if he returns those funds to Debtors during the first 36 months of the plan, those funds will constitute "disposable income." He contends Debtors would then need to immediately return the money to the estate so he can pay the funds to their creditors pursuant to the § 1325(b)(1)(B) "disposable income test." The "disposable income test" under § 1325(b)(1)(B) requires a debtor to pay all of their projected disposable income into the plan for the first three years.

⁹All future statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (2004), unless otherwise specified.

Although there is no Interim Report in the case file to indicate when Debtors commenced making plan payments, as the only Interim Report on file covers the period commencing in August 2004, the Court assumes payments commenced before confirmation in November 2003. This would mean that the 36 month period would expire approximately October/November 2006. As the Court understands the Trustee's argument, the Trustee would agree to turn over the funds then, but cannot turn them over now, approximately 12 months before the completion of that 36-month period, because of his interpretation of the disposal income requirement.

For the reasons explained below, the Court finds that the proceeds from Debtors' 2002 income tax refunds would not constitute disposable income if returned to them now, prior to the completion of the first 36 months of the plan. In addition, the Court finds that even if these proceeds were otherwise considered disposable income, Debtors' Chapter 13 Plan, coupled with this Court's Order Resolving Chapter 13 Trustee's Objection, mandates a holding that the proceeds from the 2002 tax refunds were expressly not to be considered disposable income.

A. Proceeds from Debtors' 2002 income tax refund are not disposable income in this case.

The Trustee objects to the turnover of the proceeds of Debtors' 2002 income tax refunds on the basis that their receipt of those funds at this point in time would necessarily constitute disposable income that must be paid to creditors under § 1325(b)(1)(B). The income tax refunds in question resulted because of Debtors' decision to over-withhold (or over-pay estimated) taxes from their 2002 wages. At the time Debtors filed their petition in 1993, their entitlement to these over-withheld funds, which would ultimately

become the tax refunds, was fixed. These refunds, as well as a pro-rata portion of any 2003 refunds, were undisputedly a pre-petition asset.¹⁰

The Court finds that the Trustee's return of the proceeds constituting the 2002 income tax refunds during the first 36 months of Debtors' plan will not turn these funds into disposable income. That is because, by definition, "[P]ostpetition disposable income does not include prepetition property or its proceeds. This is the chapter 13 debtor's bargain. Creditors of a chapter 13 debtor have no claim to any of these assets."¹¹ "In exchange for satisfying the best interest of creditors' test §1325(a)(4), the debtor keeps [the prepetition] assets free from any claim of creditors."¹²

This treatment of the tax refund that Debtors were entitled to receive prior to the filing of bankruptcy, but did not actually receive until after the petition was filed, is consistent with existing case law in this circuit. In *In re Midkiff*,¹³ the Tenth Circuit Bankruptcy Appellate Panel addressed the issue of whether a tax refund that the debtors were entitled to receive during the first 36 months of their Chapter 13 plan, but which was not actually received until after the plan was completed, constituted disposable income that should have been paid into the estate for distribution to creditors.

¹⁰*In re Midkiff*, 271 B.R. 383 (10th Cir.BAP 2002) (holding that a debtor's right to a federal income tax refund arises at the end of the tax year, not on the day of the filing of the tax return).

¹¹*In re Burgie*, 239 B.R. 406, 410 (9th Cir. BAP 1999).

¹²*In re Euler*, 251 B.R. 740, 748 (Bankr. M.D. Fla. 2000). See also *See Hagel v. Drummond (In re Hagel)*, 184 B.R. 793, 796, 798 (9th Cir. BAP 1995); *In re Ash'shadi*, 2005 WL 1105039, *1 (Bankr. E.D. Mich. 2005); *In re Golek*, 308 B.R. 332, 338 (Bankr. N.D. Ill. 2004).

¹³271 B.R. 383.

The *Midkiff* court found that the date the debtors became entitled to receive the tax refund, not the date they actually received the refund, was the critical date for determining whether the refund was disposable income. Because the debtors in *Midkiff* first became entitled to the refund during the first thirty-six months of the Chapter 13, they were ultimately required to turn it over.¹⁴ The rationale, in part, for this decision was that had the debtors not overpaid their taxes during the pendency of their Chapter 13 plan, the excess income would have been available to creditors for distribution prior to the expiration of the 36 month plan.

In this case, of course, the refunds were earned prior to the filing date. The Court thus finds that the *Midkiff* holding must apply similarly in both situations. If a debtor “earns” a tax refund within the first thirty-six months after the filing of the Chapter 13, and it is considered post-petition disposable income, then it only follows that a tax refund that is due, but not received, prior to the filing of the Chapter 13 petition is not post-petition disposable income. Further, had the debtors spent, instead of over-withheld, the excess income that constitutes the tax refunds for 2002 (and the pre-petition portion of 2003), it is not money that would have been available for payment of creditors in this bankruptcy proceeding.

The Court thus finds that the proceeds from Debtors’ 2002 income tax refunds presently held by the Trustee constitutes a pre-petition asset, and if returned to them by the Trustee would not constitute post-petition disposable income.

B. Debtors’ Chapter 13 Plan also provides that the 2002 income tax refund is not disposable income.

¹⁴*Id.* at 388 (“The right to the Debtors’ income tax refund arose during the first 36 months of the plan and therefore is included as disposable income.”)

Even if the Court had held the pre-petition tax refund constituted disposable income, Debtors' treatment of that refund in their confirmed Chapter 13 plan excludes it from the definition of "disposable income" in this case. The Chapter 13 plan expressly and specifically provided that "debtors shall retain all of their exempt and non-exempt property, including but not limited to their 2002 federal and state income tax refunds, and a portion of the debtors' 2003 federal and state income tax refunds representing the pro-rata share of the refunds earned prior to the filing of the bankruptcy petition." A related footnote in the plan also states "Note: The remaining portion of the 2003 refunds, and all refunds received thereafter during the 36 month term of the plan, shall be deemed 'disposable income' and paid to the Chapter 13 trustee for distribution under the Plan."

It is absolutely clear from the plan language that Debtors intended to retain the 2002 income tax refund, and the pro-rata share of their 2003 refund (for the portion of the tax year to the date of filing bankruptcy), and, conversely, the post-petition portion of the 2003 refunds, and future years refunds, if any would constitute disposable income. Although, the Trustee did object to confirmation of the plan, his objection did not dispute this pre-petition/post-petition dichotomy. In fact, he expressly agree with this treatment of Debtors' tax refunds. Instead, his objection was framed as "[w]hile the general concept of the Debtors being able to buy back the income tax refund and to generally satisfy the best interest of the creditors test is not objectionable to the Trustee, the Trustee is concerned that the estate needs to be fully protected with respect to this issue."¹⁵

¹⁵See Chapter 13 Trustee's Objection to Confirmation, Doc. 28. The Trustee raised no objections to the Debtors' proposal to exclude their 2002 income tax refund from disposable income.

In order to resolve this objection, the Trustee proposed “that the income tax refund received by the Debtors be escrowed in either their attorney’s interest bearing trust account or in the trust account of the Chapter 13 Trustee **pending satisfaction of the best interest of the creditors test**, ultimately.”¹⁶ The Court eventually entered an agreed order resolving this dispute, whereby the Court ordered the tax refund to be paid over to the Trustee for retention in his trust account until further order of the Court. Following resolution of the Trustee’s objection, the Court entered an order confirming the Chapter 13 plan on December 15, 2003.

The provisions of a confirmed plan bind the debtor and each creditor to the terms contained in the plan.¹⁷ “Upon becoming final, the order confirming a chapter 13 plan represents a binding determination of the rights and liabilities of the parties as ordained by the plan. Absent timely appeal, the confirmed plan is res judicata and its terms are not subject to collateral attack.”¹⁸ “The purpose of section 1327(a) is the same as the purpose served by the general doctrine of res judicata. There must be finality to a confirmation order so that all parties may rely upon it without concern that actions which they may thereafter take could be upset because of a later change or revocation of the order.”¹⁹

In this case, the plan language clearly indicates that the 2002 income tax refunds, along with a pro-rata portion of the 2003 income tax refunds for the pre-petition period prior to the filing of bankruptcy, were not to be considered disposable income. In addition, the Court’s order resolving the Trustee’s

¹⁶*Id.* (emphasis added).

¹⁷11 U.S.C. § 1327(a).

¹⁸*Andersen v. Unipac-NEBHELP (In re Andersen)*, 179 F.3d 1253, 1258-59 (10th Cir. 1999) (quoting *United States v. Richman*, 124 F.3d 1201, 1209 (10th Cir. 1997)).

¹⁹*Id.* at 1259 (quoting 5 Collier on Bankruptcy ¶ 1327.01 [1] (15th ed. 1996)).

objection to confirmation, which the Trustee approved, clearly states that the Trustee was to hold the tax refund only until Debtors had met the best interest of the creditor's test, which the Trustee has now stipulated they have done. The plan was confirmed following the resolution of the Trustee's objection and that confirmation order is now binding. Therefore, even if the 2002 tax refund could otherwise have constituted disposable income, a theory with which this Court disagrees, Debtors' confirmed plan language stating that the applicable income tax refunds would not be constitute disposable income is binding.

C. The Trustee's need to hold the tax refund no longer exists.

The Court agreed, when it signed the Order Resolving the Trustee's Objection to Debtors' Plan, that protections needed to be in place to ensure Debtors' intent to "buy-out" these refunds was effectuated before Debtors could have access to this estate property. That order required the Trustee to retain the funds until Debtors' intent — to buy-out the refunds by monthly payment of periodic sums to the Trustee — was completed. The Trustee's valid concern about protecting the unsecured creditors in case Debtors' case was dismissed or converted prior to completion of the buy-out, has now been satisfied. Although it was a very prudent action by the Trustee to ensure that the tax refund could not be spent until Debtors had fulfilled their bargain relating to meeting the best interest of the creditors test, the fact is the test has been met and the security is no longer necessary.

III. CONCLUSION

For the above reasons, the Court finds that Debtors' Motion for Turnover of 2002 Income Tax Refunds should be granted. Debtors have satisfied the best interest of the creditors' test, and the return of the proceeds from the tax refunds, which were pre-petition assets, would not constitute additional disposable income to Debtors. In addition, Debtors' confirmed plan, which states that the pre-petition

income tax refunds would not be considered disposable income, binds the parties to that treatment of the tax refunds. That fact, combined with the Court's order that the Trustee was to only hold the refunds until the best interest of the creditors' test was met, provides a separate basis for requiring the prompt turnover of the 2002 income tax refunds proceeds.

IT IS, THEREFORE, BY THIS COURT ORDERED that the Debtors' Motion for Turnover of 2002 Income Tax Refunds is granted. The Trustee is ordered to turn over the proceeds of the 2002 tax refunds as soon as practical.

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