

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
LARRY REYNOLDS,) CASE NO. BK96-82786
)
DEBTOR.) CH. 13

MEMORANDUM

Hearing was held on October 13, 2000, on Motion for an Order to Compel Payment of Post Petition Taxes or in the Alternative to Dismiss or to Convert Chapter 13 Case to Chapter 7 filed by the United States of America on behalf of the Internal Revenue Service ("IRS"). Appearances: Howard Duncan for the debtor and Henry Carriger for the IRS. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

Introduction

This matter is before the court on a motion by the United States of America on behalf of the Internal Revenue Service ("IRS") to dismiss the debtor's Chapter 13 case or in the alternative to convert the case to Chapter 7. The IRS argues that a "material default" has occurred because the debtor failed to pay post-petition income taxes during the pendency of the Chapter 13 case. According to the IRS, the debtor should, therefore, be denied the benefit of a Chapter 13 discharge. Conversely, the debtor argues that no material default exists because, although he did fail to pay some of his post-petition income tax obligations during the course of his plan, he has made all payments under the Chapter 13 plan and, therefore, should receive a discharge of all pre-petition debts.

Decision

In this case, the debtor's failure to completely pay post-petition income taxes is not a "material default" by the debtor with respect to a confirmed plan. The motion of the IRS is denied and the debtor shall receive a Chapter 13 discharge.

Facts

The debtor filed a Chapter 13 petition in 1996 and an amended plan was confirmed in June of 1997. All payments under the plan were to be used by the trustee to pay pre-petition state and federal priority tax claims. By a consent order entered August 25, 1998, Filing No. 37, the debtor agreed to pay to the trustee \$24,224.05 to assure complete payment of obligations dealt with by the plan. The debtor has made all plan payments. However, the debtor failed to pay his post-petition federal income taxes for the years 1997, 1998, and 1999.

Concerning the post-petition federal income taxes, the debtor owes, including penalties and interest to April 27, 2000, \$260.66 for the tax year 1997; \$7,970.24 for the tax year 1998; and \$2,565.28 for the tax year 1999. The debtor made one payment of \$1,000.00 to the IRS on May 18, 1999. This amount has been deducted and is reflected in the above totals. Although there is no dispute that the debtor failed to pay his tax obligations post petition, until this motion was filed at the end of the case, the IRS had not filed any motion or pleading which would have made the court aware that the debtor had failed to meet his income tax obligations. On April 27, 2000, the IRS filed the present motion.

Law and Discussion

The Bankruptcy Code, at 11 U.S.C. § 1307(c)(6), states that a court may convert a Chapter 13 case to a Chapter 7 case or dismiss a case if there has been a "material default by the debtor with respect to a term of a confirmed plan." 11 U.S.C. § 1307(c)(6). The IRS urges this court to adopt a rule that failure to pay post-petition income taxes is per se a "material default" according to Section 1307(c)(6). The term "material default" is not defined in the Bankruptcy Code. Cases dealing with the failure to pay post-petition taxes have found that such failure may be deemed a "material default", but only after considering all of the circumstances of the case.

In *In re Jenkins*, a Chapter 11 case, the court held that although failure to pay over \$34,000.00 in interest on post-petition taxes could be considered a material default under a Chapter 11 plan, a dismissal is not appropriate where the debtors fully complied with the other terms of the plan.

Additionally, the court noted that the IRS waited five years to file the motion to dismiss even though it had knowledge of the default before the debtor completed plan payments. *In re Jankins*, 184 B.R. 488, 494 (Bankr. E.D. Va. 1995).

On the other hand, in a Chapter 13 case decided in 1998, the court in *In re King* allowed a post-petition tax claim filed by the IRS under 11 U.S.C. § 1305(a). The court held that a priority claim, if allowed, had to be paid in full. The court then dismissed the case because the debtor did not have enough time left to pay the claim in the statutorily allowed sixty-month period. The court also based the dismissal on the fact that the debtor had failed to make trustee payments for several months. *In re King*, 217 B.R. 623, 626 (Bankr. S.D. Cal. 1998). In the *King* case, the debtor had paid \$30,130.56 into the plan, but failed to pay \$33,534.14 in post-petition taxes.

In *In re Bennett*, the bankruptcy court held that a debtor's Chapter 13 case should be dismissed where the debtor fails to pay post-petition taxes. In *In re Bennett*, the IRS filed a claim for approximately \$84,000.00 pursuant to 11 U.S.C. § 1305(a) and also requested that the debtor amend the reorganization plan to include the post-petition taxes. The debtor failed to amend his plan to include payment of these taxes and the IRS subsequently filed for a dismissal of the bankruptcy case based on 11 U.S.C. § 1307(c)(1). The IRS argued that both the failure to pay post-petition taxes and the failure to amend the plan to provide plan payment amounted to an "unreasonable delay by the debtor that is prejudicial to creditors." *In re Bennett*, 200 B.R. at 254. The court agreed with the IRS, holding that the debtor's failure to pay post-petition taxes and the utilization of these taxes to fund his Chapter 13 plan showed a lack of good faith as well as unreasonable delay that is prejudicial to creditors. Neither the IRS nor the court suggested that the failure to pay post-petition taxes was a "material default with respect to a confirmed plan."

The case before this court is similar to the factual situation in *Jankins* and quite different from the factual situation in *King* and *Bennett*. In *Jankins*, and in this case, the IRS waited until the debtor had completed all or substantially all of the plan payments before requesting a dismissal or a conversion. No other action was taken by the

IRS prior to the end of the case. In contrast, in both *King* and *Bennett*, the IRS filed a post-petition claim under 11 U.S.C. § 1305(a). Only when it was clear that the debtors could not pay such claim in full (*King*) or would not pay the claim through an amended plan (*Bennett*) was it determined that the debtors had "materially defaulted", prejudicially delayed the creditors or had acted in bad faith, resulting in dismissal.

Although a creditor is not required to file a Section 1305 claim in order to collect a debt incurred post-petition, the IRS could have filed such a claim and still can. Upon allowance of such claim in this case, the claim could have been, and still can be, extended, perhaps using all of the sixty months to pay the claim on a priority basis. The plan in this case was confirmed on June 4, 1997, leaving approximately eighteen months from this date for the debtor to complete such payments.

In this case, although the IRS, as mentioned, could have, and still can, file such a post-petition claim, it has intentionally declined to do so. Instead, the IRS has waited until all of the plan payments have been made; the only thing remaining to be done is the granting of a discharge. The remedy requested by the IRS, dismissal or conversion, seems especially harsh considering the fact that no attempt was made by the IRS to have the debtor amend his plan or begin regular payments on the post-petition tax obligation, which, after all, and in contrast to the amount due in the above-cited cases, is less than \$12,000.00 plus accruing penalties and interest.

Although the IRS, by virtue of this decision, does not obtain the remedy it requests, it is not left without a remedy. The post-petition taxes, penalty and interest will not be discharged at the end of this Chapter 13 case. Upon discharge, the IRS is free to pursue collection of any post-petition taxes which are due and owing.

Conclusion

The debtor's behavior cannot be condoned. However, failure to pay post-petition tax obligations is not, per se, a "material default" under a confirmed plan. In this case, such failure is not found to be a "material default", because the

debtor did pay all payments due under the terms of the plan; entered into a consent order increasing the payments to be paid from approximately \$18,000.00 to approximately \$24,000.00; paid a relatively large payment of \$1,000.00 in 1999, and owes, on post-petition tax obligations, less than half of the amount actually paid through the Chapter 13 plan.

The motion to dismiss or convert the case to Chapter 7 is denied.

DATED: December 5, 2000

BY THE COURT:

/s/Timothy J. Mahoney

Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

20 DUNCAN, HOWARD T.

Copies mailed by the Court to:

Henry Carriger, Esq.
United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
LARRY REYNOLDS,) CASE NO. BK96-82786
) A
DEBTOR(S))
) CH. 13
) Filing No.
Plaintiff(s))
vs.) JOURNAL ENTRY
)
) DATE: December 5, 2000
Defendant(s)) HEARING DATE: October 13, 2000

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion for an Order to Compel Payment of Post Petition Taxes or in the Alternative to Dismiss or to Convert Chapter 13 Case to Chapter 7 filed by United States of America on behalf of the Internal Revenue Service.

APPEARANCES

Howard Duncan, Attorney for debtor
Henry Carriger, Attorney for ITS

IT IS ORDERED:

The motion to dismiss or convert the case to Chapter 7 is denied. See Memorandum entered this date.

BY THE COURT:

/s/Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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