Res Judicata
Setoff
Chapter 13 confirmed plan

In re Jan Vanderspek and Barbara Gleasman 696-63082-fra13

11/23/97 FRA Unpublished

The Debtors had not yet filed their 1995 federal income tax return when they filed for bankruptcy on 6/25/96. The IRS objected to confirmation of the Chapter 13 Plan because of the missing tax return; the court confirmed the Plan on 9/25/96 subject to the continuing objection of the IRS. The Plan provided for full payment of secured and priority unsecured tax debt. On 7/22/97, the IRS withdrew its objection upon the filing of the tax return and almost immediately moved for relief from stay to set off the refund from the 1995 return against priority unsecured taxes. Debtors objected, arguing that the confirmed plan provided that the tax refund be paid over to the Trustee. In the event that setoff were allowed, Debtors asked that the IRS be required to allocate the refund against secured tax debt. The IRS argued that its setoff rights were not affected by confirmation of the Plan, citing In re DeLaurentiis Entertainment Group, Inc..

The court did not address the issue of the priority of setoff rights over provisions of a confirmed plan, holding instead that confirmation of the Plan in this case could not have any res judicata effect with respect to the tax refund in question. The tax return had not been filed at the time of confirmation and the refund had not been scheduled. Because neither the court nor interested parties, including the IRS, were on notice of the refund at the time of confirmation, the IRS could not be bound to the terms of the Plan with regard to the refund and the IRS's setoff rights could not be affected. Because the Debtors failed to explain how the feasibility of their plan depended on the allocation of the IRS's setoff, the IRS's general right to allocate as it sees fit was also not affected.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF OREGON

IN RE	)	
	)	Case No. 696-63082-fra13
JAN VANDERSPEK and BARBARA GLEASMAN,	)	
	)	MEMORANDUM OPINION
Debtors.	)	

The Internal Revenue Service (IRS) has filed a motion for relief from the automatic stay to allow it to set off a tax refund which is owing to the Debtors for a pre-petition tax year against the Debtors' pre-petition tax liability, specifically against a priority tax penalty. The Debtors object on the grounds that their confirmed Chapter 13 Plan of Reorganization directs that tax refunds be paid over to the Trustee and that the IRS will be paid in full for priority and secured tax debts. In the alternative the Debtors request that, should the court rule that the IRS is entitled to a setoff, the IRS be ordered to set off the refund against secured tax liability.

Because I find that the doctrine of res judicata is not applicable with respect to the tax refund, I will allow the Government's motion.

BACKGROUND

The Debtors filed a bankruptcy petition on June 25, 1996 and a Chapter 13 Plan which requires that the Debtors turn over to the Trustee all tax refunds received; it also states that all property described in 11 U.S.C. § 1306(a)(1) and (2) shall remain property of the estate.[1] It provides for payment in full over the term of the Plan the IRS's secured and priority tax claims of $16,556.07 and $20,302.96, respectively. Neither the schedules of assets filed with the petition nor any subsequent amendments disclose any right to a tax refund.

The IRS objected to confirmation of the Plan when it found that it had no record of the Debtors having filed a 1995 federal income tax return. The Plan was confirmed on September 25, 1996

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[1] 11 U.S.C. § 1306(a) reads as follows:

(a) Property of the estate includes, in addition to the property specified in section 541 of this title—

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.

subject to further objection by the IRS. On July 22, 1997, the IRS withdrew its objection to confirmation, presumably upon the Debtors' filing of their 1995 federal income tax return. On September 26, 1997, the IRS filed the present motion for relief, asking the court to allow it to set off the overpayment of $8,265 from the recently filed 1995 tax return against a pre-petition priority civil tax penalty.

Debtors argue that the provisions of their confirmed Plan require that the tax refund be paid over to the Trustee and, further, that the IRS be paid over the term of the Plan. Confirmation of the plan is *res judicata*, and the IRS cannot now seek different treatment of the tax refund. In re Ground Systems ____ BR _____ (BAP 9th Cir. 1997), Trullis v. Barton, 107 F.3d 685 (9th Cir. 1995). If a setoff is allowed, the Debtors urge the court to direct that the refund set off against secured, rather than priority, debt, pursuant to In re Moore, 200 B.R. 687 (Bankr. D. Or. 1996).

Relying on Carolco Television, Inc. v. National Broadcasting Co. (In re DeLaurentiis Entertainment Group, Inc.), 963 F.2d 1269 (9th Cir. 1992), cert denied, 506 U.S. 918 (1992), the government asserts that the terms of a confirmed plan do not affect the rights of a creditor to setoff under Bankruptcy Code §553. Moreover, the Internal Revenue Code, at 26 U.S.C. §6402, confers on the IRS the right to designate the account or tax against which any setoff is to be applied. The government acknowledges, however, Moore's holding that the right of allocation is subject

to a showing that another application is required to preserve the feasibility of a plan of reorganization.

DISCUSSION

1. Effect of Confirmation

It is well established that "Once a bankruptcy plan is confirmed, it is binding on all parties and all questions that could have been raised pertaining to the plan are entitled to res judicata effect." Trullis v. Barton, et al. 107 F.3d 685, 691 (9th Cir. 1995). Res judicata bars a party from bringing a claim if a court of competent jurisdiction has rendered final judgment on the merits in a previous action involving the same parties and claims. *Id.*,; In re Int'l Nutronics, Inc., 28 F.3d 965, 969 (9th Cir.), cert. denied, 513 U.S. 1016 (1994).

The question here is whether confirmation of the plan in this case constituted an adjudication of the parties' rights regarding the tax refund. Clearly it did not. As noted, the Debtors did not disclose the existence of the refund in their schedules.[2] Since Debtors had not filed a return for the tax year in question, the Government cannot be said to have had notice of the potential refund. The Government cannot be bound by the plan's disposition of the refund when the refund's existence was not disclosed. More to the point, the plan cannot

[2]It appears that the Debtors filed their return for the tax year after confirmation. The Government's motion was made after the return was filed, and the right to a refund became known to it. However, there is nothing in the record to suggest that Debtors were aware of the potential refund when they filed their petition and schedules.

conclusively dispose of an asset if neither the parties nor the court is aware of its existence.

Debtors rely on the following language in their plan:

> 1. Property described in 11 USC §1306(a)(1) & (2) shall remain property of the estate after confirmation and is submitted to the supervision and control of the Court. The debtor shall pay to the trustee (a) a periodic payment of **$1,250** every **month;** (b)all proceeds from avoided transfers; (c) all tax refunds received by the debtor; (d) a lump sum payment of ----- on -----; and (e) **for 36 months; $2,000 per month and continuing until all 507 claims are paid.**

The quoted language is from a form chapter 13 plan promulgated by the Court. The form plan is used almost universally in chapter 13 cases in Oregon. The bold portions are the "variables" filled in by the debtors. The reference to "property described in 11 U.S.C. §1306(a)(1) & (2)" would include the tax refund, since the right to it existed at the time the case was filed. However, since the Debtors presumably did not know about the refund at the time, the language was either intended to apply to other assets, or left in simply as boilerplate. Superfluous language in form plans should not be given preclusive effect when it appears that the language does not reflect an actual adjudication, and when it is not sufficient to put a creditor on notice that its interests are to be affected. See Cen-Pen Corporation v. Hanson, 58 F.3d 89 (4th cir. 1995).

Since the plan does not adjudicate the disposition of the Debtors' tax refund, it remains subject to the Government's

setoff rights under 26 U.S.C. §6402 and 11 U.S.C. §553.

2. Application of proceeds

Ordinarily the Government may allocate funds subject to setoff however its interests may dictate. 26 U.S.C. §6402 In re Moore, 200 B.R. 687 (Bankr. D. Or. 1996) recognizes this right, but holds further that the court has the discretion to direct the manner of the allocation if failure to do so would render a confirmed plan unfeasible. Moore at 690.

The Debtors' plan provides for payment in full of both the secured and unsecured priority claims of the Government.[3] The IRS proposes to allocate the $8,265 refund to the unsecured priority portion; Debtors seek an order allocating the refund (if setoff is allowed) to the secured debt. Debtors do not explain how the government's proposed allocation diminishes their ability to reorganize. Since the proposed allocation would not affect the Debtor's ability to reorganize under Chapter 13, the government's right to allocate is not subject to limitation under Moore.

CONCLUSION

1. Provisions of a confirmed plan purporting to control the

[3]It could not have been confirmed otherwise, since secured and priority claims must be paid in full. 11 U.S.C. §1325.

use or allocation of an asset are not binding if the asset was not scheduled, and affected parties had no knowledge of the assets' existence.

2. Where a plan's feasibility is not diminished by a proposed allocation, the Government may allocate funds acquired under its setoff rights.

This Memorandum Opinion constitutes the court's findings of fact and conclusions of law, which will not be separately stated. Counsel for the United States shall submit an order consistent herewith.

FRANK R. ALLEY, III
Bankruptcy Judge