

In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:)
)
LAURA M. BUTLER)
(Chapter 13 Case 96-40658))
)
Debtor)

Adversary Proceeding
Number 96-4041

LAURA M. BUTLER)
)
Plaintiff)

FILED
at 11 O'clock & 39 min AM
Date 8-12-96
MARY C. BECTON, CLERK
United States Bankruptcy Court
Savannah, Georgia

v.)
)
THE UNITED STATES OF AMERICA)
AND THE UNITED STATES)
DEPARTMENT OF EDUCATION)
)
Defendant)

MEMORANDUM AND ORDER ON MOTION FOR SUMMARY JUDGMENT

Plaintiff, Laura M. Butler (hereinafter "Plaintiff"), brings this adversary proceeding against the United States of America, et al. (hereinafter "Defendant") to recover an alleged preferential transfer pursuant to Section 547. Plaintiff also claims

that Defendant wilfully violated the automatic stay and requests attorney's fees and other appropriate relief under Section 362. Defendant contends that its actions were permissible pursuant to Section 553 and now has moved for summary judgment regarding the merits of the underlying adversary pursuant to Bankruptcy Rule 7056. Because Defendant's motion arises in a proceeding to recover a preferential transfer, the matters involved herein constitute a core proceeding over which this Court has jurisdiction. *See* 28 U.S.C. § 157(b)(2)(F). After considering the evidence submitted, as well as the applicable authorities, I make the following Findings of Fact and Conclusions of Law pursuant to Bankruptcy Rule 7052.

FINDINGS OF FACT

The following facts are not in dispute. Plaintiff, Laura M. Butler, executed promissory notes to secure a Guaranteed Student Loan ("GSL") (currently termed a "Federal Family Education Loan Program" loan), authorized by Title IV, Part B of the Higher Education Act of 1965, as amended (20 U.S.C § 1070 et seq.), totaling \$2,625.00 from Florida Federal Savings and Loan ("FFSL"). The GSL was guaranteed by the Higher Education Assistance Foundation ("HEAF").

The terms of the promissory notes executed by Plaintiff required repayment beginning six months after she ceased to carry at least one-half of the

normal full-time academic workload at an eligible institution. On or before May 31, 1989, Plaintiff ceased carrying at least one-half the normal full-time academic workload. On April 4, 1991, Plaintiff defaulted on her repayment obligations. On or about December 31, 1991, FFSL assigned all rights and title to the loan to HEAF.

Under a contract for reinsurance between HEAF and the Department of Education (hereinafter "Education), Education agreed to reimburse HEAF for its losses in making payments to lenders in the event of default, death, or disability. See 20 U.S.C. § 1078(c). On July 26, 1993, Education received assignment of the GSL pursuant to its right to take assignment of a defaulted GSL of which it pays reinsurance claims. See 20 U.S.C. § 1078(c)(8).

Since the assignment of the GSL, Plaintiff has failed to make any voluntary payments to satisfy her loan obligations. Thus, on March 11, 1996, Education, in cooperation with the IRS, setoff Plaintiff's 1995 tax refund in the amount of \$2,443.00, pursuant to Section 2653 of the Deficit Reduction Act of 1984, now codified at 31 U.S.C. Section 3720A and 26 U.S.C. Section 6402(d).

Following the offset of Plaintiff's tax refund, Plaintiff filed a petition under Chapter 13 of the Bankruptcy Code on March 13, 1996. On or about March

15, 1996, Plaintiff filed this complaint against the United States Department of Education (Education) and Internal Revenue Service (IRS) seeking return of her 1995 tax refund under 11 U.S.C. Section 547.

Defendant, United States, contends that its actions were permissible pursuant to the setoff provisions of 11 U.S.C. Section 553. In the alternative, Defendant asserts that its actions may not be avoided pursuant to 11 U.S.C. Section 547 because it possessed an unavoidable statutory lien pursuant to 11 U.S.C. Section 6402(d). Defendant, therefore, moves this Court for summary judgment pursuant to Bankruptcy Rule 7056.

CONCLUSIONS OF LAW

In accordance with Federal Rule of Civil Procedure (applicable to bankruptcy under Fed.R.Bankr.P. 7056), this Court will grant summary judgment only if "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). A fact is material if it might affect the outcome of a proceeding under the governing substantive law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). The moving party has the burden of establishing the right of summary judgment, See Clark v. Coats & Clark, Inc., 929 F.2d 604, 608 (11th Cir.1991); See Clark v. Union

Mut. Life Ins. Co., 692 F.2d 1370, 1372 (11th Cir.1982), and the court will read the opposing party's pleadings liberally. See Anderson, 477 U.S. at 249, 106 S.Ct. at 2510-11.

In determining whether there is a genuine issue of material fact, the Court must view the evidence in the light most favorable to the party opposing the motion. See Addickes v. S.H. Kress & Co., 398 U.S. 144, 157, 90 S.Ct. 1598, 1608, 26 L.Ed.2d 142 (1970); See Rosen v. Biscayne Yacht and Country Club, Inc., 766 F.2d 482, 484 (11 Cir.1985). Once a motion is supported by a *prima facie* showing that the moving party is entitled to judgment as a matter of law, the party opposing the motion must go beyond the pleadings and demonstrate that there is a material issue of fact which precludes summary judgment. See Martin v. Commercial Union Ins. Co., 935 F.2d 235, 238 (11th Cir.1991).

This Court will first decide whether the Defendant has met its burden pursuant to the setoff requirements of 11 U.S.C. Section 553. Section 553 preserves a creditor's setoff rights in bankruptcy that are available under other applicable state or federal law. However, Section 553 does not create an independent right to setoff; to utilize Section 553, a creditor first must demonstrate that this right exists under other applicable law. After meeting this burden, a creditor must satisfy the additional

requirements of Section 553. Only if those requirements are met will the setoff be permissible. Here, it is undisputed that the IRS has the statutory authority to exercise a setoff. *See* 31 U.S.C. § 3720A(c) and 26 U.S.C. § 6402(d); *see also* Bosarge v. United States Department of Education, 5 F.3d 1414, 1417-1418 (11th Cir.1993) ("[w]e hold that 26 U.S.C. § 6402(d) and 31 U.S.C. § 3720A establish 'statutory rights of setoff'"); In re Orlinski, 140 B.R. 600, 602 (Bankr.S.D.Ga. 1991) (recognizing tax offset authority). Thus, Defendant must only meet the requirements of 11 U.S.C. Section 553 to prevail on its Motion.

11 U.S.C. Section 553, in pertinent part, provides as follows,

(a) . . . this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that . . .

(1) the claim of such creditor against the debtor is disallowed;

(2) such claim was transferred, by an entity other than the debtor, to such creditor--

(A) after the commencement of the case; or

(B)(i) after 90 days before the date of the filing of the petition; and

(ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor--

(A) after 90 days before the filing of the petition

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

(b)(1) . . . if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of--

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) . . . "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

For the Defendant to prevail, it must demonstrate that there is no genuine issue as to any material fact and that it is entitled to judgment as a matter of law. *See* Fed.R.Bankr.P. 7056(c).

1. Whether The Debts Are Mutual

The parties contest this first issue. Defendant, United States, contends that mutuality exists between a claim arising from a federal agency other than the IRS and a debtor's claim to a tax refund. In support of this position, Defendant cites In re Sound Emporium, 43 B.R. 1, 2-3 (Bankr.W.D.Tex. 1984) (finding that claim against contractor for unpaid federal taxes and a debt owed by the United States Army under a contract are mutual); U.S. v. Luther, 225 F.2d 495, 498 (10th Cir.1954) (finding that debts to Commodity Credit Corporation and a claim for an income tax refund are mutual). To the contrary, Plaintiff asserts that the obligations are not mutual. Plaintiff contends that each government agency is separate and distinct and should be treated as such. Moreover, Plaintiff notes that Section 553 setoff should be interpreted narrowly in light of Section 547. See In re Turner, 59 F.3d 1041, 1045 (10th Cir.1995) (holding that setoff between SBA and ASCS was impermissible); In re Ionosphere Clubs, Inc., 164 B.R. 839 (Bankr.S.D.N.Y. 1994) (holding that federal government units are to be treated as distinguishable for setoff purposes); In re Lakeside Community Hosp., Inc., 139 B.R. 886 (Bankr.N.D.Ill. 1992) (holding that state revenue and education agencies were separate entities for purposes of setoff); In re Howard, 1988 WL 96197 (Bankr.E.D.Pa.) (holding that no mutuality exists between debt owed to Dept of Education and IRS refund obligation). Although both parties present persuasive arguments, the language of 31 U.S.C. Section 3720A(c) clearly

contemplates permitting setoff between government agencies and treating the individual agencies as branches of one governmental unit. *See* 31 U.S.C. § 3720A(c) ("[i]f the Secretary of Treasury finds that any such amount is payable, he shall reduce such refunds by an amount equal to the amount of such debt, pay the amount to such agency, and notify such agency . . . "); *see also* Bosarge v. United States Department of Education, 5 F.3d at 1419 (holding that 3720A treats Federal agencies as if they were one agency); In re Reed, 179 B.R. 353, 354 (S.D.Ga. 1995) (holding that the government may setoff funds owed by one agency in order to collect debts owed to other agencies). In light of the above, Defendant has satisfied the requirement of mutuality of debts.

II. Whether The Debts Arose Pre-Petition

There is no dispute over this requirement. Clearly, Plaintiff's obligation arose pre-petition. Plaintiff enrolled in less than a full academic workload on May 31, 1989 and commenced debt payments shortly thereafter. Plaintiff defaulted on her obligation on April 4, 1991; the debt was assigned to Education on July 26, 1993. In regard to the 1995 tax refund owed by the IRS, that obligation arose on one of three possible dates: December 31, 1995, the date Plaintiff filed her tax refund, or the date on which the IRS formally acknowledged pursuant to 26 U.S.C. Section 6407 that the taxpayer is owed a refund. Although there may be some debate as to which one of

these dates constitutes the actual date on which a tax obligation accrues, there is no dispute that all three of these dates occurred pre-petition.

III. 553(a) Limitations

Section 553(a) contains three limitations to a creditor's right to setoff. First, under Section 553(a)(1), an existing right to setoff may not be exercised to the extent that the claim is disallowed. As far as this Court is aware, this provision is inapplicable to the current matter. Plaintiff defaulted on her loan obligation and the Department of Education has a right to collect its loan in the full amount. Second, Section 553(a)(2) denies a creditor the right to setoff when the claim was transferred by an entity other than the debtor to a creditor after the debtor filed for relief under the Code or within the 90 days prior to filing. Here, there is no evidence of a transfer of this debt to the government during the ninety days prior to filing. Defendant has held this obligation for at least three years and has not assumed the debts of other creditors. Defendant has satisfied its burden pursuant to Section 553(a)(2). Finally, Section 553(a)(3) limits the right to setoff when a debt owed to the debtor was incurred by a creditor within ninety days prior to the filing of the petition for the purpose of exercising a right to setoff. This limitation is not applicable because the debt that the IRS owes although created within ninety days of filing was not incurred for the purposes of obtaining a right to setoff. Therefore, Defendant has met all three

requirements of 553(a).

IV. Section 553(b)

Section 553(b) contains the final limitation on a creditor's right to setoff. This limitation, commonly referred to as the "Improvement in Position Test," expressly prevents any creditor from improving its position within the ninety days prior to bankruptcy. Essentially, Section 553(b) limits the exercise of pre-petition setoff. It examines the amount owed to a creditor ninety days prior to bankruptcy and on the date of filing; any difference in the insufficiencies on the two dates amounts to a preference and an impermissible setoff. Here, ninety days prior to the filing of the petition, on or about December 13, 1995, the amount of the insufficiency was \$2,625.00.¹ On the date of filing, the amount of the insufficiency, after the \$2,443.00 offset on March 11, 1995, amounted to \$182 (\$2,625.00 - \$2,443.00). Thus, Defendant, United States improved its position within the ninety days prior to filing by the amount of the tax-refund setoff.

Within its brief, Defendant asserts that the purpose of this provision

¹ This amount represents the amount which the Plaintiff owed to the Department of Education. Note, in other proceedings, the contention has been raised that before an insufficiency arises there must be debts and credits running in both directions; however, the majority of case law rejects that assertion. See, e.g. Matter of Lawndale Steel Co., 155 B.R. 990, 995 (Bankr.N.D.Ill. 1993); Hankerson v. United States Department of Education, 133 B.R. 711 (Bankr.E.D.Pa. 1991), *rev'd on other grounds*; In re Schmidt, 26 B.R. 89 (Bankr.D.Minn. 1982); In re Keystone Foods, 145 B.R. 502, 507 (Bankr.W.D.Pa. 1992).

is to prevent commercial creditors, primarily banks, from securing a better position for themselves by demanding additional collateral during the period immediately before the bankruptcy. See Matter of Moses, 91 B.R. 994, 997 (Bankr.M.D.Fla. 1988). Implicit within this statement and throughout the Defendant's brief is the contention that because no further sums were demanded by the IRS this provision is inapplicable and that pursuant to 11 U.S.C. Section 553(b)(2) no insufficiency existed.² However, the test is an objective one. It only requires a court to determine whether the amount of the any insufficiency ninety days before the filing has decreased by the date of filing. It does not require a Court to consider the intent of the parties or their ability to demand payment. Moreover, considering the purpose of this statute, Congress enacted Section 553(b) to prevent creditors from improving their position and forcing an individual into bankruptcy. Clearly, Plaintiff, who filed for bankruptcy only two days after the IRS setoff her tax refund, was forced into bankruptcy by this final act.

Defendant contends that the case law also supports this modified analysis and cites Lee v. Schwejker, 739 F.2d 877 (3rd Cir.1984). In Lee, the Third Circuit Court of Appeals held that Social Security benefits actually accrued before the

² See Government's Memorandum of Law, p. 9-11 ("no further security was demanded by the government ... case law is clear that the principles applicable to offsets in commercial settings (in which the creditor has the discretion to require additional security from the debtor) do not apply to offsets by the United States ... [t]he United States cannot obtain additional security for student loans by requiring debtors to overpay their taxes").

ninety-day period even though they were not payable until sometime during the preference period. Thus, the Court determined that because the obligation of the Social Security Administration accrued outside of the preference period the insufficiency between the parties was unchanged during the ninety days prior to filing and, therefore, the setoff was permissible under Section 553. In this instance, Defendant acknowledges within its brief that the tax refund claim accrued on one of three possible dates, the earliest of which being December 31, 1995. See Government's Memorandum of Law, p. 7. Because Plaintiff filed for bankruptcy on March 13, 1995, all three dates are within the preference period and, therefore, the obligation accrued and the insufficiency correspondingly decreased within ninety days of the bankruptcy filing.³

In further support of its position, Defendant also cites Matter of Moses, 91 B.R. at 997-98, although under those facts, this Court would also find Section 553(b) inapplicable. In Moses, similar to the present case, the debtor owed the Department of Education and the IRS setoff Debtor's tax refund. The order of events were as follows: on December 31, 1985, Debtor's tax refund accrued; on September

³ As noted in the Defendant's brief, the obligation accrued on one of three dates. At this point in time, the majority of case law seems to hold that a tax refund accrues to an individual on the last day of the taxable year. See In re Thorvund-Statland, 158 B.R. 837 (Bankr.D.Idaho 1993); but see Hankerson v. U.S. Department of Education, 133 B.R. at 717, rev'd on other grounds; In re Glenn, 1996 WL 387656 (Bankr.E.D.Pa.). Because all three possible dates fall within the 90-day preference period, for purposes of this discussion only, this Court will adopt the majority position.

1, 1986, the IRS setoff the tax refund; on October 27, 1986, Debtor filed for bankruptcy. Again, Section 553(b) requires a Court to view the amount of the insufficiency on the date of filing and ninety days prior to the petition. Because that Debtor's tax refund accrued outside of the ninety-day period, the insufficiency remained unchanged during the preference period when the IRS properly exercised its right to setoff. Again, Section 553(b) prohibits the setoff of obligations which accrue during the ninety days prior to the filing of the petition. Since, in the present case, the tax refund accrued during the ninety-day period before filing, any attempt to exercise a setoff is impermissible.⁴ The end result is that the Court must deny Defendant's Motion for Summary Judgment.

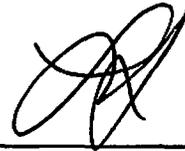
In the alternative, Defendant also asserts that the relevant offset provisions, 31 U.S.C. Section 3720A and 26 U.S.C. Section 6202(d), create an unavoidable statutory lien. This Court has reviewed the language of both provisions and is unpersuaded by this contention. The statutes provide the manner in which an agency shall exercise a setoff and is silent regarding statutory liens. Without an express provision granting a lien in favor of the Defendant, this Court is not inclined to imply such a lien.

⁴ Similarly, this Court also agrees with the outcome of In re Stall, 125 B.R. 754 (S.D. Ohio 1991), where the income tax obligation accrued outside of the Section 553(b) ninety-day preference period.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the Motion for Summary Judgment of Defendant, The United States of America and the United States Department of Education,, is hereby DENIED.

The Clerk shall set this case for trial as soon as possible.



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 9th day of August, 1996.