No. 19-50982

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of: Annette Marie Diaz,
Debtor

ANNETTE MARIE DIAZ,
Appellant

v.

MARY K. VIEGELAHN,
Appellee

On Appeal from the U.S. District Court for the Western District of Texas,
Case No. 18-798

**BRIEF OF AMICI CURIAE NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER AND NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF APPELLANT AND SEEKING REVERSAL OF THE BANKRUPTCY COURT'S DECISION**

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January 21, 2020

# RULE 26.1 CORPORATE DISCLOSURE STATEMENT

*Diaz v. Viegelahn,* No. 19-50982.

Pursuant to Fed. R. App. P. 26.1, Amici Curiae, the National Consumer Bankruptcy Rights Center and the National Association of Consumer Bankruptcy Attorneys, make the following disclosure:

1) For non-governmental corporate parties please list all parent corporations. **NONE.**

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock. **NONE.**

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. **NONE.**

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by the appellant. **NOT APPLICABLE.**

This day of January 21, 2020.

*s/ Tara Twomey*
Tara Twomey, Esq.
Attorney for Amici Curiae

**SUPPLEMENTAL CERTIFICATE OF INTERESTED PERSONS**

*Diaz v. Viegelahn*, Case No. 19-50982.

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

Appellant: Annette Marie Diaz, Debtor

Appellee: Mary K. Viegelahn, Chapter 13 Trustee

Appellant's Counsel: J. Todd Malaise, Malaise Law Firm, Suite 300, 909 N.E. Loop 410, San Antonio, TX 78209-0000.

Appellee's Counsel: Vanessa DeLeon Guerrero, Office of the Chapter 13 Trustee Suite 201, 10500 Heritage Boulevard, San Antonio, TX 78216.

Other: Various consumer bankruptcy debtors and their counsel nationally and in the Fifth Circuit, including the membership of the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center.

This 21st day of January, 2020.

*s/ Tara Twomey*
Tara Twomey, Esq.
Attorney for Amici Curiae

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## INTEREST OF AMICI CURIAE

The National Consumer Bankruptcy Rights Center (NCBRC) is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

The National Association of Consumer Bankruptcy Attorneys (NACBA) is also a nonprofit organization of more than 2,000 consumer bankruptcy attorneys nationwide. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

*Amici* have a vital interest in the outcome of this case. The Bankruptcy Code sets out requirements for chapter 13 plans which, if met by the debtor’s proposed plan, mandate confirmation. The Code also specifies that so long as debtors meet the mandatory requirements, they may include other provisions not inconsistent with the Code. While districts are permitted to create rules and forms governing

practice and procedure in bankruptcy cases, such rules and forms may not conflict with the Bankruptcy Code or deprive debtors of substantive rights under the Code.

In this case, the Bankruptcy Court for the Western District of Texas promulgated a "form" plan with a one-size-fits-all treatment of tax refunds. Section 4.1 of the District Plan permits debtors to keep only $2,000 of their tax refund and precludes them from using anything above that amount for reasonable and necessary expenses. As a practical matter, the District Plan is likely to have a disproportionate negative impact on lower-income debtors because they are more likely to receive a refund as a result of tax credits. These tax credits, such as the Earned Income Tax Credit or Additional Child Care Credit, are designed to stabilize insufficient budgets for low income families and on average exceed the threshold set in the District Plan of $2,000. Even though a debtor's entire tax refund would be used to pay for reasonable and necessary expenses, under the District Plan any amount in excess of $2,000 goes to the Trustee and unsecured creditors instead. The Bankruptcy Code, through the proper calculation of "projected disposable income," would allow low-income debtors to keep some or all of their tax refund to the extent it was needed to pay necessary and reasonable expenses.

Conversely, higher-income taxpayers typically receive a tax refund due to over-withholding of payroll taxes. Many high-income debtors do not need additional funds to cover their permitted expenses. Nevertheless, the District Plan permits these higher-income borrowers to retain $2,000 even if it is not needed to cover

reasonable and necessary expenses. In either case, the result is inconsistent with the Bankruptcy Code and the projected disposable income test.

Of particular concern to *Amici* is that the District Plan deprives low-income debtors of the substantive right to formulate a treatment of their tax refunds in accordance with the Code and in response to their circumstances. Many lower-income debtors wait for and rely on tax refunds to pay for much-needed goods and services such as transportation, medical treatments, and non-emergency expenses. Section 4.1 of the District Plan sweeps away much needed funds that these debtors would otherwise be entitled to under the Bankruptcy Code.

*Amici* believe the issue presented to this Court is of fundamental importance to bankruptcy system and seek to provide the Court with additional background on the principles of law at stake in this case.

## STATEMENT UNDER FED. R. APP. P. 29(c)(5)

No party's counsel authored this Amicus Curiae Brief in whole or in part; no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and no person, other than the amicus curiae, it members, or its counsel, contributed money that was intended to fund preparing or submitting this brief.

## SUMMARY OF ARGUMENT

The Bankruptcy Code enumerates mandatory and permissive provisions for chapter 13 plan confirmation. In addition, section 1322(b)(11) permits a debtor's plan to "include any other appropriate provision not inconsistent with [the Code]." Over an objection to confirmation by the trustee or a creditor, the plan may be confirmed only if the debtor commits all of her projected disposable income to the plan. Though "projected disposable income" is not defined in the Code, disposable income is based on current monthly income, which is defined as average monthly income from all sources, minus reasonable and necessary expenses. That amount is then projected into the future, taking into account known or virtually certain changes, to determine the "projected disposable income."

In accordance with the statutory right to include appropriate provisions consistent with the Code, and in compliance with the projected disposable income test, debtors have crafted a variety of treatments for tax refunds in their plans. In fact, bankruptcy's Official Form 113 allows debtors to specify treatment of such refunds, permitting retention of the refund, turnover during the plan, or proposing some other treatment depending upon the type of tax refund, and the debtor's needs. All of these treatments are permissible under the Code and are within the debtor's authority to propose under section 1322(b)(11). A debtor expecting a refund based on an Earned Income Tax Credit aimed at benefiting low-income taxpayers, may require the refund for the payment of reasonable and necessary expenses. A

debtor expecting a refund based on over-withholding by an employer, may not need the refund for expenses and will provide for the refund to be distributed to creditors.

Against this background, Federal Rule of Bankruptcy Procedure 3015.1 permits districts to adopt a form of plan, so long as that form does not contravene the provisions of the Bankruptcy Code or "abridge, enlarge, or modify any substantive right." 28 U.S.C. § 2075.

In the present case, the Western District of Texas, promulgated its District Plan that restricts debtors to only one method of treating their tax refunds. Under this one-size-fits-all treatment of tax refunds, the debtor may retain $2,000 of the refund and turn over to the Trustee the amount that exceeds $2,000. The rule does not take into consideration the type of refund or whether the refund is needed to pay debtor's reasonable and necessary expenses. As a result, lower-income debtors, may be required to devote more income to the plan than the Code requires. Ironically, the district rule may unfairly benefit some higher-income debtors by permitting them to retain income that is not necessary for expenses.

In either case, however, section 4.1 of the District Plan contravenes the Bankruptcy Code and deprives debtors of the substantive right to formulate a treatment of their refunds. The section is therefore invalid.

## STATUTORY FRAMEWORK

*Chapter 13 and Chapter 13 Plans*

Individuals seeking bankruptcy relief generally seek liquidation under chapter 7 of the Bankruptcy Code or propose a plan for repayment of a portion of their debt under chapter 13. Chapter 13 permits an individual debtor with a source of regular income to receive a discharge of certain debts after completing a bankruptcy plan that meets the Code's requirements. Section 1321 directs debtors to file a debt adjustment plan, also known as a chapter 13 plan. 11 U.S.C. § 1321. Chapter 13 plans that meet the requirements set forth in the Code must be confirmed by the bankruptcy court. 11 U.S.C. §§ 1322, 1325. Debtors make payments under confirmed plans for the benefit of the debtors' secured and/or unsecured creditors. Upon completion of payments under the plan debtors receive a discharge of all debts provided for by the plan, with limited exceptions. 11 U.S.C. § 1328(a).

Subchapter II of chapter 13 contains the statutory provision applicable to chapter 13 plans. Two critical sections of this subchapter are sections 1322 and 1325. Section 1322(a) delineates the mandatory provisions for chapter 13 plans. Section 1322(b) describes the permissive provisions that a debtor may incorporate into his or her chapter 13 plan. Section 1325 lists additional standards for confirmation of a chapter 13 plan. Section 1325(a) identifies nine substantive conditions that must be met to obtain plan confirmation. These include requirements such as: the plan must be proposed in the good faith; the plan must pay unsecured creditors at least as much as they would receive under a chapter 7;

the plan must be feasible; and the debtor must debtor must have filed various required tax returns. Section 1325(b) permits the trustee or holder of an allowed unsecured claim to object to confirmation if the debtor does not propose to pay a sufficient amount of her income to unsecured creditors. If the debtor's plan satisfies the mandatory provisions of 1322(a) and the requirements of 1325, then the bankruptcy court must confirm the plan. 11 U.S.C. § 1325(a) ("[T]he court *shall* confirm if—") (emphasis added).

In addition, to the enumerated permissive and mandatory elements, a plan may "include any other appropriate provision not inconsistent with [the Code]." 11 U.S.C. § 1322(b)(11). This catch-all provisions allows chapter 13 plans "to serve as a flexible vehicle for the repayment of part or all of the allowed claims by the debtor." S. REP. 95-989, at 141, 95TH Cong., 2ND Sess. 1978, 1978 U.S.C.C.A.N. 5787, 1978 WL 8531; *see HSBC Bank, USA, N.A., v. Blendheim* (*In re Blendheim*), 803 F.3d 477, 485 (9th Cir. 2015) ("A Chapter 13 debtor formulating a proposed plan of reorganization must include certain mandatory provisions, but also has at his disposal various discretionary provisions—the "tools" in the reorganization toolbox.").

As a leading treatise has observed:

> "There are few limits in the Code on other possible plan provisions. For example, the debtor's payments into the plan may be varied to take into consideration seasonal income, as long as the plan is feasible. The plan may provide for a temporary moratorium on certain types of payments; or it may delay the vesting of property until some time after confirmation. [It may even] include a provision providing for injunctive or equitable relief."

8 Collier on Bankruptcy ¶ 1322.14[4] (Richard Levin & Henry J. Sommer, eds., 16th ed.). Under section 1322(b)(11), courts have permitted debtors to, among other things, (1) redeem real property from a tax purchaser, *In re Washington*, 551 B.R. 664 (Bankr. M.D. Ala. 2016) (2) provide for enhanced creditor account reporting requirements, *In re Sperry*, 562 B.R. 1 (Bankr. D. Mass. 2016), (3) use a trustee's avoidance powers, *In re Hearn*, 337 B.R. 603 (Bankr. E.D. Mich. 2006), (4) establish reserve funds to pay utilities in the event of default, *In re Epling*, 255 B.R. 549 (Bankr. S.D. Ohio 2000), and (5) pay taxes in a particular order, *In re Klaska*, 152 B.R. 248 (Bankr. C.D. Ill. 1993).

The statutory construct and Congressional purpose behind chapter 13 offers chapter 13 debtors the ability to craft a plan that satisfies the debtor's obligations to creditors while also meeting the needs and circumstances of the debtor.

## ARGUMENT

### I. The Treatment of Tax Refunds in Chapter 13

Under the Bankruptcy Code, debtors typically have a variety of approaches to treating tax refunds in proposing a chapter 13 plan. The most common question that arises with respect to tax refunds is whether the debtor's proposed approach satisfies the projected disposable income test.

Confirmation of a chapter 13 plan over an objection requires that "the plan provide[] all of the debtor's projected disposable income to be received in the applicable commitment period…will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b). The term "projected disposable

income" is not defined in the Code. However, "disposable income" is defined as "current monthly income…less amounts reasonably necessary to be expended…for the maintenance or support of the debtor or a dependent of the debtor." In simplified terms disposable income is:

*Disposable income = CMI – reasonable and necessary expenses*

"Current monthly income" is essentially the debtor's average gross monthly income over the six months prior to the bankruptcy. 11 U.S.C. § 101(10A). For debtors with lower than average income, expenses are those that are reasonable and necessary for the support of the debtor and her dependents. For debtors with higher than average income, expenses are limited to those provided for in the Code. 11 U.S.C. §§ 707(b)(2), 1325(b)(3)(A). "Projected disposable income" is the amount the must be paid to unsecured creditors in a chapter 13 plan. It is determined by projecting disposable income into the future, taking into account any known or virtual certain changes in income and expenses. *Hamilton v. Lanning*, 560 U.S. 505, 513 (2010).

Debtors have a number of different ways to treat tax refunds and still satisfy the projected disposable income requirements of the Code. The approach used by debtors depends, in part, on the nature of the refund. Tax refunds typically arise as a result of either over-withholding or tax credits, such as the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC).

*Over-withholding:* Current monthly income includes income prior to tax withholdings. *In re Curcio*, 387 B.R. 278, 283 (Bankr. N.D. Fla. 2008) (CMI consists of "pre-tax income from all sources, similar to 'gross income' under the Internal

Revenue Code."). Therefore, tax refunds from over-withholding result, not from a failure to properly calculate current monthly income, but from an overstatement of the income tax expense. That is, disposable income is potentially too low, because the income tax expenses are too high.

*CMI – reasonable and necessary expenses (too high) = Disposable income (too low)*

Debtors are permitted to deduct amounts for taxes, Medicare, and social security contributions, as reasonable and necessary expenses. *In re Balcerowski*, 353 B.R. 581, 587-88 (Bankr. E.D. Wis. 2006) (federal, FICS, Medicare, state and local taxes are necessary expenses), *citing* Internal Revenue Manual § 5.15.1. Debtors must estimate to the best of their ability their actual tax liability for purposes of determining projected disposable income. *Id.* In a perfect world, a debtor's actual tax withholdings would exactly match the anticipated tax withholdings used in calculating a chapter 13 plan payment. In the real world, actual tax withholding may be greater than or less than the anticipated amounts. To address over-withholding when calculating projected disposable income:

> Courts frequently permit debtors to use their withholding tax amounts in determining their monthly payments if the debtor agrees to turn over their tax refund, which by definition is the difference between their withholding tax payments and their actual tax liability. *In re Spraggins*, 386 B.R. 221, 226-27 (Bankr. E.D. Wis. 2008). Essentially, a debtor can: (1) deduct their tax withholdings from their CMI and turn over their over-withheld tax refund to the Trustee or (2) calculate their disposable income using their actual tax liability in their expenses and keep that portion of their refund when they receive it. Absent unusual circumstances, the projected monthly amount of actual tax withholding would be one-twelfth of the debtor's prior year's tax liability. *Id.* at 227-28.

*In re Blake*, 565 B.R. 871, 876 (Bankr. N.D. Ill. 2017), *aff'd sub nom Marshall v. Blake*, 885 F.3d 1065 (7th Cir. 2018)

*Tax credits:* Unlike tax withholding amounts, future tax credits[1] are not necessarily included in current monthly income. When refunds resulting from tax credits are not included in CMI, there are two methods for addressing the refund in a chapter 13 plan. First, if the amount of the anticipated tax credit is "known or virtually certain," under *Hamilton*, the amount should be included in the debtor's current monthly income. 560 U.S. at 513. Because such tax refunds are payable annually, not monthly, the amount is pro-rated over a 12-month period. *See* Instructions—Bankruptcy Forms for Individuals, R.1066-69 (amounts not paid on a monthly basis should be annualized and then divided by 12 to obtain a monthly figure). Alternatively, if the amount of the tax refund is unknown or uncertain, then the amount of the refund when received, less reasonable and necessary expenses, is turned over the chapter 13 trustee for distribution to unsecured creditors. *See In re Styerwalt*, -- B.R. --, 2019 WL 6873636 (Bankr. D. Colo. Dec. 16, 2019) (using this methodology to account for uncertain future bonus payments). In any event, *Hamilton* requires debtors and courts to account for all reasonably known income and expenses when determining projected disposable income. 560 U.S. at 512-13. When debtors account for expected tax refunds in their projected

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[1] The most common programs with refundable tax credits are the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC). 26 U.S.C. § 32(f); 26 U.S.C. § 24(d). Both programs were a deliberate attempt to provide benefits to lower income families in the form of tax "refunds" to taxpayers with little or no income tax liability.

disposable income, as Ms. Diaz did, at the time of confirmation, those refunds do not need to be paid as additional plan payments. Requiring the turnover of tax refunds, when the amounts have already been included in the projected disposable income calculation results in a double-counting of the funds and overpayment to unsecured creditors.

The Advisory Committee on Bankruptcy Rules recognized the varied treatment that debtors could afford to tax refunds and still comply with the confirmation requirements for chapter 13. As such, Official Bankruptcy Form 113, allows debtors to specify the treatment of tax refunds under the plan. It permits the debtors to retain income tax refunds during the plan, turnover tax refunds during the plan, or specify some other treatment of the tax refunds. *See* Official Bankruptcy Form 113, § 2.3. As the Bankruptcy Court properly noted, Official Form 113 provides debtors with the ability to determine how debtor's tax refunds will be treated under the plan. Op. at 11.

Notwithstanding, the variety of ways tax refunds may be appropriately treated under the Bankruptcy Code, the Western District of Texas, in section 4.1 of its District Plan, has impermissibly mandated one method, and prohibited all others.

## II. The Tax Refund Provision in the District Plan is Impermissible Because It Abridges Debtors' Substantive Rights and Conflicts With the Bankruptcy Code.

Bankruptcy courts have been delegated authority to adopt local rules governing practice and procedure. Fed. R. Bankr. Pro. 9029(a) (permitting district

courts to adopt local bankruptcy rules "governing practice and procedure in all cases and proceedings within the district court's bankruptcy jurisdiction). The Federal Rules of Bankruptcy Procedure also permit courts to create a local form for plans. Fed. R. Bankr. P. 3015.1. As this Court has previously stated, courts are empowered to promulgate "housekeeping" rules. *Matter of Adams*, 734 F.2d 1094, 1098 (5th Cir. 1984). Notwithstanding this grant of authority, neither the local rules nor the local form plan may "may abridge, enlarge, or modify any substantive right." 28 U.S.C. § 2075; *see In re Washington*, 602 B.R. 710, 716 (B.A.P. 9th Cir. 2019) (rules and forms must be consistent with the Code and not abridge, enlarge or modify substantive rights.)

"The test of whether a rule exceeds the congressional mandate embodied in the enabling act is 'whether the rule really regulates procedure—the judicial process for enforcing rights and duties recognized by substantive law…'" *Adams,* 724 F.2d at 1101*., quoting Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941). If the rule operates to abridge, enlarge, or modify the rules of decision by which the court will adjudicate the parties' rights then the rule is invalid. *Id.* at 1102, *quoting Mississippi Publishing Corp. v. Murphree*, 326 U.S. 438, 445-46 (1946). Applied in the context of the local plan, the Federal Rules of Bankruptcy Procedure give courts the ability to adopt a *form* of a chapter 13 plan, but that *form* cannot override the debtor's substantive rights.

Here, the District Plan for the Western District of Texas, in particular section 4.1, crosses the line between facilitating chapter 13 administration and dictating

the substantive terms of the debtor's chapter 13 plan. The District Plan abridges and modifies the substantive rights of debtors because it requires one method of treating tax refunds, to the exclusion of all others. Additionally, it fails to properly account for a debtors' projected disposable income in contravention to the Bankruptcy Code because it is both under-inclusive and over-inclusive—in some instances it will not require the payment of all of debtors' projected income and in other circumstances it requires debtors to pay more than their projected disposable income.

### A. Ms. Diaz' Proposed Plan Satisfied the Confirmation Requirements of the Code, Including the Projected Disposable Income Test.

Because the Trustee objected to confirmation of Ms. Diaz' Second Amended Chapter 13 Plan,[2] the Bankruptcy Court could not confirm the Plan unless it found that it "provide[d] that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." 11 U.S.C. § 1325(b)(1)(B). The applicable commitment period is the time period during which a chapter 13 debtor must make payments to the trustee to be eligible for a discharge of her debts. 11 U.S.C. § 1325(a)(4). If the debtor's current monthly income is less than the median household income for her state, the applicable commitment period is three years. *Id.*, § 1325(b)(4)(A).

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[2] A similar analysis and conclusion is reached if one evaluates Ms. Diaz's First Amended Plan instead of the Second Amended Plan.

The phrase "disposable income" is defined in relevant part as "current monthly income received by the debtor ... less amounts reasonably necessary to be expended ... for the maintenance or support of the debtor or a dependent of the debtor." *Id.,* § 1325(b)(4)(A). "Current monthly income" is calculated by averaging the debtor's monthly income during the six full months preceding the filing of the bankruptcy petition. *Id.,* § 101(10A)(A)(i). And "amounts reasonably necessary" refers to the full amount needed for "maintenance or support," § 1325(b)(2)(A)(i), unless the debtor's income exceeds the state median—then expenses must be calculated using a means test formula set forth in the statute. *Id.*, §§ 707(b)(2), 1325(b)(3)(A). While "disposable income" is defined as current monthly income less reasonably necessary expenses, it is "projected disposable income" that must be committed to the plan. 11 U.S.C. § 1325(b)(1)(B).

In *Hamilton*, the U.S. Supreme Court considered whether determining "projected disposable income" required a mechanical use of the "current monthly income" (based on the six months preceding the filing of the bankruptcy petition), or whether the court could take a "forward-looking approach," which permitted consideration of "known or virtually certain" future income. *See Hamilton*, 560 U.S. at 513. The debtor in *Hamilton* had received a one-time, lump-sum payout from an employer in the six months preceding her bankruptcy, a payment which made her "current monthly income" as calculated under the Code much higher than the income she actually expected during her commitment period. *See id*. at 511-12. The Court affirmed the bankruptcy court's approach, which essentially allowed her to

use the difference between her actual income, as reported on her Schedule I, and her reasonable expenses, reported on her schedule J, as her monthly plan payment. *See id*. at 512-13. In upholding this approach, the Court made clear that where significant changes in the debtor's financial circumstances, occurring between the six months used to calculate "current monthly income" and the time of confirmation, are known or virtually certain, the debtor may make appropriate adjustments. *Id.* at 513.

In this case, likewise, it was known or virtually certain that Ms. Diaz would be entitled to a tax refund at the end of the year. Accordingly, she incorporated the anticipated tax refund into her income and offset that income with reasonably necessary expenses. *See Marshall v. Blake*, 885 F.3d 1065, 1075 (7th Cir. 2018) ("Just because tax credits are included in CMI, however, does not mean the debtor must pay the entire tax credit to the trustee as disposable income. After all, disposable income equals CMI minus the 'amounts reasonably necessary to be expended … for the maintenance or support of the debtor or a dependent of the debtor."). Ms. Diaz not only calculated her projected disposable income as required by the Code and *Hamilton*, she was also permitted to propose such treatment of her tax refund under section 1322(b)(11).

Ms. Diaz' Chapter 13 Statement of Current Monthly Income and Calculation of Commitment Period listed average monthly income of $3,097.72, which annualized to $37,172.64, placing her well below the median family income for a family of three in Texas ($67,849.00). R.117, 118. As a below-median Debtor, the

applicable commitment period for Ms. Diaz was 36 months (though she proposed a 60-month plan), and her disposable income was not determined under 11 U.S.C. § 1325(b)(3). Ms. Diaz' Schedules I and J (Income and Expenses, respectively) show gross monthly wages of $2,644.16. R.923. Ms. Diaz also included a monthly family contribution of $523.00, and a prorated share of her future estimated tax refund of $272.00, in her monthly income. R.933. After payroll deductions, her net monthly income was $2,681.44. R.933. Schedule J showed monthly expenses of $1,071.44, leaving a disposable monthly income amount of $1,610.00. R.234. Though Ms. Diaz could have proposed a 36-month plan, she instead proposed to pay all of her disposable monthly income to the Trustee for 60 months, for a total of $95,920.00. R.220. The Plan provided that creditors with general unsecured claims would receive no less than 17% of their allowed amounts. R.221.

All of these calculations demonstrate that Ms. Diaz' Second Amended Plan satisfied the requirements of the projected disposable income test as defined in the Bankruptcy Code. *See* 11 U.S.C. § 1325(b).

Ms. Diaz' Plan was also feasible. Some trustees object to the proration of anticipated tax refunds on the basis that it makes a plan infeasible.[3] The argument goes something like: the prorated income over twelve months is illusory and the debtor will not have the actual cash flow each month to make plan payments. The

[3] The Trustee's written objection does not raise this issue. R.263-266. However, the Bankruptcy Court noted that the Trustee argued that the Plan would be infeasible without inclusion of the Debtor's tax refund. There is no further discussion of this point in the decision.

lack of feasibility argument fails for two reasons: 1) the income is real, not illusory, and 2) expenses, like income, do not always fall neatly into the monthly framework. *See In re Morales*, 563 B.R. 867, 874 (Bankr. N.D. Ill. 2017). There are many types of income that are not paid consistently on a monthly basis, including bonuses and seasonal employment wages. Similarly, annual tax refunds constitute a substantial portion of yearly income for many people. Here, Ms. Diaz' estimated tax refund makes up nearly 10% of her annual income. The Bankruptcy Code's focus on monthly income means that types of income that are not received monthly must nevertheless be converted to a monthly amount. This is typically done by estimating the amount of income the borrower will receive in a year and dividing by 12. Instructions—Bankruptcy Forms for Individuals, R.1066-69.

Just an income does not always fit squarely into monthly periods, expenses can also be lumpy. Realistically, debtors do not spend the same amount every month on home or auto maintenance, insurance, medical bills or even utilities (particularly in places where high heating costs during the winter or high air-conditioning costs during the summer produce a significant seasonal difference in utility costs). Instead, Schedule J directs the debtor to divide the estimated annual spending by 12 to achieve a monthly budget figure. Low-income debtors, in particular, often must budget in a way that defers expenses for medical visits, new clothes, property taxes, or car or home repairs until the tax refund is received. Notwithstanding a low-income debtors' ability to defer expenses, the District Plan

deprives debtors of the funds to pay for such expenses, by sweeping away the tax refund and turning the funds over to unsecured creditors.

In sum, Ms. Diaz' Second Amended Plan provided for the payment of all projected disposable income for the applicable commitment period, and beyond. The Plan was feasible and otherwise appeared to satisfy all the requirements for confirmation in the Bankruptcy Code. Therefore, the Bankruptcy Court should have confirmed her Second Amended Plan.

The Bankruptcy Court, however, denied confirmation of the Plan because the Debtor opted for a different, albeit statutorily permissible, treatment of her tax refunds, than required by the District Plan.

### B. The District Plan Abridges the Debtors' Substantive Rights to Propose a Plan That Satisfies the Mandates of the Code And Does Not Accurately Account for Projected Disposable Income.

A chapter 13 debtor has the exclusive right to file a plan. 11 U.S.C. § 1321. A proposed chapter 13 plan must meet the requirements of the Bankruptcy Code in order to be confirmed. But, chapter 13 debtors should be afforded flexibility in crafting their plans. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 117–18 (1977). This flexibility is embodied in section 1322(b)(11), which permits debtor's plan to "include any other appropriate provision not inconsistent with [the Code]."

As discussed above, there are various ways to treat tax refunds in chapter 13 plans, depending on the type of tax refund (as a result of over-withholding or tax credits) and based on the needs of the debtor. However, in the Western District of Texas, the District Plan mandates that every debtor treat their tax refund

identically (regardless of source) and every debtor must pay that tax refund, less $2,000, into the plan as additional disposable income regardless of whether the entire refund was needed to meet the reasonable and necessary expenses of the debtors and their dependents.

Section 4.1 of the District Plan allows debtors to retain only the first $2,000 of their tax refunds and requires the remainder to be turned over to the Trustee to be paid to unsecured creditors. This is true regardless of the nature of the tax refund, and regardless of whether excess refund amounts are needed by the debtor to pay for reasonable and necessary expenses. The tax refund provision has a substantive effect on debtors by requiring them to treat tax refunds in a less favorable manner than the Bankruptcy Code otherwise permits. For many debtors, particularly those with lower incomes, the District Plan puts more money in the pockets of unsecured creditors than the Code requires. As an example, for the 2018 tax year, the average Earned Income Tax Credit for a family with children was $3,191.[4] The EITC was enacted as a mechanism for providing relief to low income families hurt by rising food and energy prices and to provide an incentive to work instead of relying on other forms of government assistance. It is a vital part of the budget of low-income families that receive it. "Research indicates that most families use the EITC to pay for necessities, repair homes, maintain vehicles that are needed to commute to work, and in some cases, obtain additional education or

[4] "Policy Basics: The Earned Income Tax Credit," Center on Budget and Policy Priorities, December 10, 2019, available at https://www.cbpp.org/research/federal-tax/policy-basics-the-earned-income-tax-credit.

training to boost their employability and earning power."[5] Under the projected disposable income test, to the extent that the debtor had reasonable and necessary expenses that equaled the amount of the tax refund, she should be able to keep the entire amount. However, for the average family receiving earned income tax credits about 30% of that amount will be redirected to unsecured creditors under the District Plan for the Western District of Texas.

Conversely, for a smaller subset of debtors, the District Plan provides less to unsecured creditors than they would otherwise receive. Take for example, a high-income debtor whose income already exceeds his reasonable and necessary expenses. The debtor's employer overwithholds taxes, but the debtor does not need any portion of his tax refund to cover permitted expenses. This debtor will nevertheless receive the first $2,000 of his tax refund, even if those funds more properly should have been distributed to unsecured creditors.

Here, under Ms. Diaz' Second Amended Plan, which complied in every respect with the Bankruptcy Code, she would have been able to use her entire tax refund to cover uncontested reasonable and necessary expenses. *See* 11.U.S.C. §§ 1322(b)(11); 1325(a); 1325(b). Pursuant to the District Plan, she will only be able to keep $2000, and she will be required to turn over the remaining $1200 for payment to unsecured creditors. The District Plan has a significant substantive effect on the amounts available to Ms. Diaz to pay her necessary expenses.

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[5] *Id., supra* n.4.

**CONCLUSION**

A *form* plan that forces debtors, like Ms. Diaz, to pay more to unsecured creditors than they would otherwise be required to under the Code, crosses the line from one that is procedural to one that is substantive. Because section 4.1 of the District Plan in this case abridges and modifies Ms. Diaz' rights, while expanding the rights of unsecured creditors, the provision violates the Bankruptcy Rules Enabling Act and is invalid. The Bankruptcy Court erred in denying confirmation of Ms. Diaz' Second Amended Plan, solely because the treatment of her tax refunds did not comply with section 4.1 of the District Plan.

Therefore, the decision of the Bankruptcy Court below should be reversed and the Bankruptcy Court should be directed to confirm Ms. Diaz' Second Amended Plan or permit Ms. Diaz to submit a Fourth Amended Plan consistent with this Court's decision.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit by using the appellate CM/ECF system on January 21, 2020. All participants that are registered as CM/ECF users will receive service via appellate CM/ECF system.

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## CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 5th Cir. R. 29.3 because this brief contains 5,453 words, excluding parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This filing complies with Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Century Schoolbook 14-point type.

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