

In the United States Bankruptcy Court

for the Northern District of Iowa

GLENN A. GRAWE
SHERI A. GRAWE
Debtor(s).

Bankruptcy No. 97-10342-C

Chapter 13

ORDER RE DEBTORS' OBJECTION TO PROOF OF CLAIM BY IRS

This matter came on for hearing before the undersigned on July 10, 1997 on Debtors' Objection to Proof of Claim by Internal Revenue Service. Present at the hearing were Debtors Glenn Grawe and Sheri Grawe with their attorney, Jon McCright. Martin McLaughlin appeared on behalf of the IRS. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), (K).

STATEMENT OF THE CASE

The IRS filed a proof of claim asserting a secured claim of \$16,700, a priority claim of \$47,509.37 and an unsecured, nonpriority claim of \$69,192.13. Debtors agree with the IRS regarding the amount of the priority claim. As to the remainder, however, Debtors assert that none of the IRS's claim is secured. They argue that they have no interest in property to which the IRS tax lien can attach and therefore the IRS claim is completely unsecured. In essence, Debtors assert that they have no equity in any real or personal property because of existing security interests.

FINDINGS OF FACT

At the hearing, the only person to testify was Debtor Glenn Grawe. The Court gave the IRS until July 18, 1997 to decide whether to present additional valuation evidence. The IRS chose not to present additional evidence. The record on this matter, therefore, consists of Mr. Grawe's testimony and exhibits presented by the parties at the hearing.

Debtors are purchasing their home under a real estate contract. The balance due on the contract is approximately \$102,200. Debtor Glenn Grawe is a real estate agent and appraiser. He testified that the fair market value of their homestead is between \$108,000 and \$112,000. Debtors' Exhibit 6, market analysis prepared by Mr. Grawe, states that there is no "real equity" in Debtors' home after deducting the costs of sale, i.e. commission, tax, abstracting, revenue stamps and termite inspection. Debtors purchased the home in 1993 for \$102,000. The Linn County Assessor's Office currently values the property at \$122,029 for tax purposes. The Court finds that the fair market value of the homestead is \$110,000.

Debtors' Schedule B lists the market value of Debtors' household goods and furnishing as \$5,000. Mr. Grawe testified that this constitutes the replacement cost. Smulekoffs' Proof of Claim asserts a \$3,903

security interest in furniture. Mr. Grawe testified Smulekoffs' interest attaches to the household goods and furnishings, including appliances and a 35" TV. Mrs. Grawe has property rights in her IPERS account of \$1,500. Significant taxes and penalties would arise if Debtors attempted to liquidate this account at this time.

At the time Debtors filed their bankruptcy petition, pending real estate commissions of approximately \$10,000 were owed to Mr. Grawe by RE/MAX Associates and Mr. Grawe owed RE/MAX \$13,568 under an Independent Contractor Agreement. Debtors' interest in the accrued commissions is completely offset by the amount owed by Mr. Grawe under his agreement with RE/MAX.

Mr. Grawe held an interest in a promissory note with an unpaid balance of \$2,367.78. On January 7, 1997, prepetition, Mr. Grawe sold his interest in this note to Steve Petersen for \$1,800. Mr. Petersen later loaned Mr. Grawe \$12,000. Neither Debtors nor the estate have any property interest in the note.

Debtors own three vehicles which have no value in excess of financing. Business equipment is valued at \$2,000. Approximately \$2,700 remains owing on a lease for a computer. Thus, Debtors' business equipment also has no value in excess of financing. Also listed as personal property is wearing apparel valued at \$500.

CONCLUSIONS OF LAW

In order for Debtors to achieve confirmation of their Chapter 13 plan, the IRS must either accept the plan or retain its lien and receive the allowed amount of its secured claim through the plan. 11 U.S.C. § 1325(a)(5). This is known as the "cram down" provision in Chapter 13. Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1884 (1997); Harmon v. United States, 101 F.3d 574, 579 (8th Cir. 1996) (considering cram down in Chapter 12); In re Hall, 118 B.R. 671, 673 (Bankr. S.D. Ind. 1990). It requires that Chapter 13 debtors pay the secured portion of a creditor's claim to the extent of the value of the property securing it. In re Bates, 974 F.2d 1234, 1235 (10th Cir. 1992).

Section 1325(a)(5) is the authority for the typical chapter 13 treatment of undersecured claims of paying the secured creditor the present value of its collateral . . . and stripping the lien from the portion of the claim that exceeds the value.

In re Young, 199 B.R. 643, 647-48 (Bankr. E.D. Tenn. 1996).

The amount of the IRS's allowed secured claim is determined by reference to bifurcation of claims in § 506(a). This section divides the claim into secured and unsecured portions. Harmon, 101 F.3d at 578. A claim is secured only to the extent of the value of the property securing it. Bates, 974 F.2d at 1236. The remainder of the claim is unsecured. 11 U.S.C. § 506(a).

Under § 1325(a)(5), the undersecured creditor retains its pre-bankruptcy lien only insofar as it secures repayment of the secured claim, not the portion of the debt that has through § 506(a) become an unsecured claim. Harmon, 101 F.3d at 583 (applying principle in context of chapter 12); Bates, 974 F.2d at 1236. The overwhelming majority of courts hold that such lien stripping is permissible in Chapter 13 when the collateral is not the debtor's residence. Bank One v. Flowers, 183 B.R. 509, 514 (N.D. Ill. 1995); see Nobelman v. American Sav. Bank, 113 S. Ct. 2106 (1993) (holding that debtors cannot strip down residential mortgage lien in Chapter 13); Harmon, 101 F.3d at 584. Thus, undersecured creditors only retain an enforceable lien in an amount equal to the value of the collateral. Bank One, 183 B.R. at 517. This lien is satisfied when all payments under the plan are completed, unless the plan provides otherwise. Harmon, 101 F.3d at 584.

Under § 506(d), the pre-bankruptcy lien is void to the extent it secures a claim that is not an allowed secured claim. That is, the lien may be voided in a Chapter 13 plan as to the unsecured portion of the claim. IRS v. Campbell, 180 B.R. 686, 687 (M.D. Fla. 1995). Nothing in § 506(d) excludes its application to tax claims or liens. In re Krahn, 124 B.R. 78, 82 (Bankr. D. Minn. 1990). To the extent tax liens exceed the amount of the allowed secured claim, such liens may be modified and avoided as to property of the estate and of the debtors in a Chapter 13 plan. In re Strong, 203 B.R. 105, 116 (Bankr. N.D. Ill. 1996).

The IRS holds a perfected federal tax lien against the Debtors' property interests under Notices of Tax Lien filed in the Linn County Recorder's Office. Under 26 U.S.C. § 6321, that perfected lien attaches to "all property and rights to property" belonging to the Debtors. Thomson v. United States, 66 F.3d 160, 162 (8th Cir. 1995). Bankruptcy exemptions have no effect on the determination of the extent of a federal tax lien. 11 U.S.C. § 522(c)(2)(B); In re Hendrix, 179 B.R. 519, 520 (Bankr. E.D. Ky. 1994). Exempt property may be included in valuing the IRS's secured claim. In re May, 194 B.R. 853, 857 (Bankr. D.S.D. 1996). The lien attaches to the debtor's exempt personal property even though the property may be exempt from levy for the lien. In re Voelker, 42 F.3d 1050, 1051-52 (7th Cir. 1994). In Chapter 13, the debtor retains possession of the property and the lien, valued under § 506(a), simply determines the amount the debtor must pay the IRS in the plan. Id. at 1052.

The IRS does not assert that its tax lien is senior to other security interests in Debtors' property. Therefore, the value of its allowed secured claim equals Debtors' equity in their real and personal property, both nonexempt and exempt. The Court has found that the fair market value of Debtors' real estate is \$110,000. The Debtors' interest in Mrs. Grawe's IPERS account equals \$1,500. The replacement value of Debtors' household goods and furnishings is \$5,000; Mr. Grawe testified that forced sale value is \$2,500. As to each of these assets, Debtors assert that the costs associated with liquidating the asset should be deducted to determine the amount of the IRS's allowed secured claim under § 506(a).

The U.S. Supreme Court has recently held that in a "cram down" case under § 1325(a)(5), "the value of the property (and thus the amount of the secured claim under § 506(a)) is the price a willing buyer in the debtor's trade, business or situation would pay to obtain like property from a willing seller." Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1884 (1997). This is known as the replacement-value standard, similar to that applied in In re Trimble, 50 F.3d 530, 531-32 (8th Cir. 1995). In other words, the value of the property in this situation is the cost the debtor would incur to obtain a like asset for the same proposed use. Rash, 117 S. Ct. at 1886. The Court rejected the foreclosure value standard which deducts the costs of sale in determining value under § 506(a). Id. at 1885.

In this case, the fair market value of the real estate of \$110,000 constitutes its replacement value under Rash. The Court will not deduct the costs of sale from the value of the property. As the real estate is subject to a contract balance of \$102,200, Debtors' equity equals \$7,800. Likewise, the Court values the IPERS account at \$1,500 without deducting the taxes and penalties associated with liquidation of the account. The replacement value of Debtors' household goods and furnishings is \$5,000. Subtracting Smulekoffs' security interest, Debtors' equity is \$1,097. Debtors also have a property interest valued at \$500 in wearing apparel.

The total of Debtors' property interests in real and personal property for purposes of valuing the IRS's secured claim is \$10,897. This is the amount of the IRS's allowed secured claim which must be provided for in the plan pursuant to § 1325(a)(5). The remainder of the IRS's nonpriority claim is

unsecured. Debtors' plan may modify the IRS's tax lien by avoiding it to the extent it exceeds \$10,897.

WHEREFORE, Debtors' Objection to Proof of Claim by Internal Revenue Service is GRANTED IN PART and DENIED IN PART.

FURTHER, the claim of the IRS is classified as follows: priority claim of \$47,509.37, secured claim of \$10,897 and unsecured nonpriority claim of \$74,995.13.

SO ORDERED this 20 day of August, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge