



IT IS ORDERED as set forth below:

Date: June 15, 2012

Mary Grace Diehl

**Mary Grace Diehl
U.S. Bankruptcy Court Judge**

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION**

In re:	:	
	:	Case No. 12-40644-MGD
SHANNON DANIELL STILES	:	
MELISSA MAE STILES,	:	Chapter 13
	:	
Debtors.	:	Judge Diehl
	:	
SHANNON DANIELL STILES	:	
MELISSA MAE STILES,	:	
	:	Adversary Proceeding
Plaintiffs,	:	
	:	No. 12-04028-MGD
v.	:	
	:	
UNITED STATES OF AMERICA <i>BY AND</i>	:	
<i>THROUGH ITS</i> DEPARTMENT OF THE	:	
TREASURY & THE INTERNAL	:	
REVENUE SERVICE,	:	
	:	
Defendant.	:	

ORDER GRANTING DEFENDANT'S MOTION TO DISMISS

This adversary proceeding is before the Court on the Motion to Dismiss filed by the United States of America by and through its Department of the Treasury and Internal Revenue Service (“IRS”). (Docket No. 6). The IRS contends that the complaint filed by Shannon Daniell Stiles and Melissa Mae Stiles (“Plaintiffs”) fails to state a claim upon which relief can be granted. For the reasons stated below, the Court GRANTS the IRS’s Motion.

I. BACKGROUND

A. Factual History

Plaintiffs’ complaint sets forth the following facts. Plaintiffs, who are debtors in the underlying bankruptcy case, filed their joint petition under Chapter 13 of the Bankruptcy Code (“Code”) on March 2, 2012. (Complaint ¶ 4, Docket No. 1). In their voluntary petition, Plaintiffs scheduled a debt owed to the IRS for income taxes for the years 2001-2004. (*Id.* at ¶ 5). On March 5, 2012, Plaintiffs filed their 2011 tax return. (*Id.* at ¶ 6). Plaintiffs overpaid their assessed 2011 federal income tax by \$5,518.00. (*Id.* at Exhibit A). Instead of disbursing a refund to the Plaintiffs, the IRS offset the amount against the taxes Plaintiffs owed from 2001 and 2002. (*Id.*).

B. Procedural History

On April 18, 2012, before a Chapter 13 plan had been confirmed in the underlying bankruptcy case, Plaintiffs initiated this adversary proceeding by filing a complaint seeking (1) turnover of the tax refund pursuant to § 542 and (2) contempt against the IRS for violation of the automatic stay pursuant to § 362(a). (Complaint, ¶¶ 11, 13). Plaintiffs argue that the refund is property of the estate, which the IRS is withholding in violation of the automatic stay, and that they are entitled to turnover. (*Id.* at ¶ 11).

On May 17, 2012, the IRS moved to dismiss Plaintiffs' complaint for failure to state a claim upon which relief can be granted under Rule 12(b)(6). (Motion, p.1). First, the IRS argues that § 362(a)(26) of the Code excepts the setoff of the Plaintiffs 2011 refund from the automatic stay. (*Id.*) Second, the IRS argues that § 553(a) of the Code preserves the IRS's right to setoff, which is set forth in 26 U.S.C. § 6402(a). (*Id.* at 3).

In response, Plaintiffs argue that the IRS is not entitled to use exempt property to exercise its right to setoff against dischargeable claims. (Response, p.2, Docket No. 9). Plaintiffs first argue that § 553(a) of the Code is limited by § 522(c), which allows debtors to exempt assets. (*Id.* at 3). Further, Plaintiffs argue that the IRS has not objected to the exemption of the refund, as listed in their amended schedule C, and that allowing the setoff would allow the IRS to unilaterally alter the terms of their Chapter 13 plan. (*Id.* at 3-4).

II. DISCUSSION

A. Motion to Dismiss Standard

Rule 12(b)(6) of the Federal Rules of Civil Procedure, applicable to this Court pursuant to Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, permits a defendant in an adversary proceeding to move for dismissal when a plaintiff fails to state a claim upon which relief can be granted. FED. R. CIV. P. 12(b)(6); FED. BANKR. P. 7012(b). When determining whether a complaint states a claim upon which relief can be granted, the Court must accept as true the complaint's factual allegations. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955, 1975 (2007); *Daewoo Motor America, Inc. v. General Motors Corp.*, 459 F.3d 1249, 1271 (11th Cir. 2006). And the complaint must contain "sufficient factual matter... to 'state a claim to relief that is plausible on its face. A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable

inference that the defendant is liable for the misconduct alleged.” *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937, 1949 (2009) (quoting *Twombly*, 550 U.S. at 570). “Threadbare recitals of the elements of a cause action, supported by mere conclusory statements, do not suffice.” *Id.* at 1949 (citing *Twombly*, 550 U.S. at 555).

B. Application of Law

Defendant’s Motion is granted because Plaintiffs cannot obtain relief on the alleged facts, as the legal claim Plaintiffs assert has been soundly rejected by case law. In cases decided prior to the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) amendments to the Code, and therefore prior to the addition of § 362(a)(26), the majority of courts held that setoff was not permitted, while a minority of courts held that it was. *In re Jones*, 359 B.R. 837, 839–40 (Bankr. M.D. Ga 2006). Plaintiffs rely on the pre-BAPCPA majority view to sustain their claim. (Reply, p.3, Docket No. 9). This former majority view has been rejected since BAPCPA added § 362(a)(26) to the Code.

In cases decided after the BAPCPA amendments, courts have held that setoff is permissible on the basis that the refund is not estate property. *Id.* at 840–41. First, these courts reason that § 553(a) of the Code does not create a right to setoff, but instead preserves the creditor’s existing rights under non-bankruptcy law. *Id.*; *In re Ewing*, 400 B.R. 913, 915 (Bankr. N.D. Ga. 2008). Second, the IRS’s right to setoff precedes the issuance of a refund. The IRS’s right to setoff is governed by 26 U.S.C. § 6402(a), which provides:

In the case of an overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e), refund any balance to such person.

26 U.S.C. § 6402(a).

This statute distinguishes between an overpayment and a refund. A refund is the remaining balance after the overpayment has been applied to pre-existing tax liabilities. *In re Jones*, 359 B.R. at 841. Because only the remaining balance after setoff “shall” be refunded to the taxpayer, the taxpayer has a right to a tax refund “only to the extent his overpayment exceeds any pre-existing tax liability.” *Id.* Finally, courts point out that § 362(a)(26), added by the BAPCPA amendments, carves out a specific exception from the automatic stay for an income tax setoff by a government agency. 11 U.S.C. § 362(a)(26); *In re Ewing*, 400 B.R. at 916.

Here, the Plaintiffs allege that the IRS used the Plaintiffs’ 2011 overpayment to offset dischargeable tax liabilities from years 2001 and 2002. Under the law described above, the Plaintiffs cannot obtain relief on these facts. The IRS’s action constituted an exercise of its right to setoff under 26 U.S.C. § 6402(a), which falls within the automatic stay exception of § 362(a)(26) of the Bankruptcy Code. The Plaintiffs have therefore failed to state a claim upon which relief can be granted. Accordingly, it is

ORDERED that the IRS’s Motion to Dismiss is **GRANTED**.

The Clerk of Court shall serve a copy of this Order on Plaintiffs, counsel for Plaintiffs, Defendant, and counsel for Defendant.

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