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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

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In re:)	BAP No.	NC-08-1100-JuMkD
)		
ANTHONY S. GOULD,)	Bk. No.	05-50292
)		
Debtor,)		
_____)		
UNITED STATES OF AMERICA,)		
)		
Appellant,)		
)		
v.)	O P I N I O N	
)		
ANTHONY S. GOULD,)		
)		
Appellee.)		
_____)		

Argued and Submitted on November 20, 2008
at San Francisco, California

Filed - February 11, 2009

Appeal from the United States Bankruptcy Court
for the Northern District of California

Hon. Arthur S. Weissbrodt, Bankruptcy Judge, Presiding.

Before: JURY, MARKELL and DUNN, Bankruptcy Judges.

1 JURY, Bankruptcy Judge:

2

3 The United States of America, on behalf of the IRS, appeals
4 the bankruptcy court's order denying its motion for relief from
5 stay.

6 The IRS sought relief from stay under § 362(d)(1) and (2)¹ in
7 order to set off the prepetition tax payments of Anthony S. Gould
8 ("Debtor") against his prepetition tax liabilities under 26 U.S.C.
9 § 6402(a)² and § 553.

10 In a published decision, In re Gould, 389 B.R. 105 (Bankr.
11 N.D. Cal. 2008), the bankruptcy court ultimately denied the IRS's
12 motion based on its conclusion that the IRS could not establish a
13 right of setoff under § 553 for two reasons. First, the
14 bankruptcy court held that Debtor's allowed exemption in certain
15 tax refunds was superior to the IRS's setoff rights under § 553.
16 The court reasoned that the Supreme Court's holding in Taylor v.
17 Freeland & Kronz, 503 U.S. 638 (1992), controlled because the IRS
18 did not object to Debtor's exemption claim. Therefore, the court
19 determined that even if Debtor had no colorable basis for his
20 claimed exemption, it was allowed and could no longer be
21 challenged by the IRS through setoff.

22

23 ¹ Unless otherwise indicated, all chapter, section and rule
24 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
25 to the Federal Rules of Bankruptcy Procedure, as enacted and
26 promulgated prior to October 17, 2005, the effective date of most
27 of the provisions of the Bankruptcy Abuse Prevention and Consumer
28 Protection Act of 2005, Pub. L. 109-8, April 20, 2005, 119 Stat.
23 ("BAPCPA"), as the debtor's case was filed in advance of the
BAPCPA effective date.

² Citations to the Internal Revenue Code, 26 U.S.C. § 1 et
seq. will be referred to as "IRC".

1 Second, the bankruptcy court exercised its equitable
2 discretion to disallow the IRS's setoff under § 553 even though
3 (1) the IRS established that it had a right of setoff under IRC
4 § 6402(a) and (2) the bankruptcy court had found the requirements
5 of § 553 were met.

6 Because we hold that the bankruptcy court premised its ruling
7 on an erroneous view of the law, we REVERSE for the reasons set
8 forth below and REMAND for entry of an order consistent with this
9 opinion.

10 I. FACTS³

11 The material facts relevant to this appeal are undisputed and
12 raise two straightforward issues: (1) whether the IRS
13 demonstrated the requisite cause for relief from the automatic
14 stay under § 362(d)(1),⁴ and (2) whether the IRS demonstrated that
15 Debtor did not have equity in the tax refunds and whether they
16 were necessary for an effective reorganization under § 362(d)(2).⁵

18 ³ Most of the facts are taken from the bankruptcy court's
19 published decision, Gould, 389 B.R. 105.

20 ⁴ This subsection provides: "On request of a party in
21 interest and after notice and a hearing, the court shall grant
22 relief from the stay provided under subsection (a) of this
23 section, such as by terminating, annulling, modifying, or
conditioning such stay--(1) for cause, including the lack of
adequate protection of an interest in property of such party in
interest;...."

24 ⁵ This subsection provides: "On request of a party in
25 interest and after notice and a hearing, the court shall grant
26 relief from the stay provided under subsection (a) of this
27 section, such as by terminating, annulling, modifying, or
28 conditioning such stay-- ... (2) with respect to a stay of an act
against property under subsection (a) of this section, if--
(A) the debtor does not have an equity in such property; and
(B) such property is not necessary to an effective
reorganization;...."

1 Debtor filed his petition, schedules and chapter 13 plan on
2 January 20, 2005. The IRS filed its initial proof of claim
3 against Debtor on February 24, 2005, which included estimated
4 taxes due for 1999 to 2004.

5 On March 2, 2005, the IRS objected to the confirmation of
6 Debtor's plan on the grounds that (1) the plan failed to provide
7 for full payment of the IRS's priority claim and (2) Debtor's
8 failure to file federal income tax returns for the years
9 1999-2004 made it difficult to determine the plan's feasibility.
10 The confirmation hearing was continued so that Debtor could
11 prepare and file his federal income tax returns and resolve the
12 IRS's objections.

13 On May 26, 2005, Debtor filed an amended plan and amended
14 Schedules B, C, D, and E. In his amended Schedule B, Debtor
15 listed claims for federal income tax refunds for tax years 2002,
16 2003 and 2004. In his amended Schedule C, Debtor listed federal
17 income tax refunds for tax years 2002, 2003 and 2004 totaling
18 \$11,047⁶, claimed exempt under Cal. Code Civ. Proc. ("CCP")
19 § 703.140(b)(5).⁷ No party objected to Debtor's exemptions.

21 ⁶ Debtor claimed refunds of \$11,047, but subsequently
22 acknowledged that the amount was \$6,852. While the balances owing
23 between the parties were unclear, they agreed that the IRS sought
to set off \$6,852.

24 ⁷ This section, known as the wildcard exemption, states that
25 Debtor may exempt his "aggregate interest, not to exceed in value
26 nine hundred twenty-five dollars (\$925) plus any unused amount of
the exemption provided under paragraph (1), in any property."
27 Paragraph (b)(1) of CCP § 703.140 referred to in (b)(5) provides
an exemption for Debtor's "aggregate interest, not to exceed
28 seventeen thousand four hundred twenty-five dollars (\$17,425) in
value, in real property or personal property that the debtor or a
dependent of the debtor uses as a residence...." CCP § 703.140(b).

1 Debtor's amended plan was confirmed on October 5, 2005,
2 without objection.⁸

3 In June and July of 2005, Debtor filed his tax returns for
4 the years 1999 to 2004. Subsequently, the IRS filed several
5 amended proofs of claim; however, the only one relevant for
6 purposes of this appeal is its fourth and final amended proof of
7 claim ("Fourth Amended Claim") in the amount of \$9,972.44 divided
8 as follows: (1) secured - \$6,852, based on the IRS's right to
9 setoff under IRC § 6402(a); (2) unsecured priority - \$307.51 and
10 (3) general unsecured - \$2,812.93.

11 On October 25, 2005, the IRS filed its Motion for Relief from
12 Stay to Set Off Tax Refund ("Motion"), which sought to apply the
13 \$6,852 that the IRS owed to Debtor against the \$9,972.44 that
14 Debtor owed the IRS. The IRS argued that (1) the tax refunds
15 claimed by Debtor were not part of his bankruptcy estate because
16 none were actually due and, therefore, Debtor was not entitled to
17 exempt them; (2) setoff under § 553 was appropriate because the
18 tax refunds due Debtor were for prepetition periods and his tax
19 liabilities were for prepetition periods; and (3) its right of
20 setoff under IRC § 6402(a) constituted cause for relief from the
21 automatic stay.⁹ Debtor objected to the relief sought on the
22 ground that his claimed exemption in the tax refunds was allowed

23

24

25 ⁸ Debtor's amended plan called for payments of \$75 per month
26 based on his excess income over expenses, which would pay
approximately two percent to general unsecured claims over thirty-
seven months.

27

28 ⁹ However, throughout the briefing in this case, the IRS has
argued, in the alternative, for relief from stay under either
§ 362(d)(1) or (2).

1 under § 522 and CCP § 703.104(b) (5) and, therefore, his exemption
2 rights were superior to the IRS's setoff rights.

3 After protracted briefing and hearings, the bankruptcy court
4 issued a Memorandum Decision on March 31, 2008, denying the IRS's
5 Motion. The decision was amended on June 13, 2008, and published,
6 In re Gould, 389 B.R. 105. The court viewed the primary issue to
7 be whether the IRS's setoff should be allowed against property
8 that Debtor had already fully exempted without challenge by the
9 IRS or any other party. Id. at 111.

10 The bankruptcy court concluded that the IRS's failure to
11 object to Debtor's exemption in the tax refunds triggered the
12 consequences of the Supreme Court's decision in Taylor, 503 U.S.
13 638, which held that a party is barred from contesting the
14 validity of an exemption after the thirty-day deadline to object
15 set forth in Rule 4003 expires, regardless of whether Debtor had a
16 colorable statutory basis for claiming it. The bankruptcy court
17 held that once the tax refunds were deemed exempt, they no longer
18 were subject to setoff. Accordingly, the court denied the IRS's
19 motion for relief from stay.

20 As an alternative reason for denying the IRS's motion, the
21 bankruptcy court exercised its equitable discretion to disallow
22 the IRS's setoff rights under § 553 even though the IRS had
23 established that it had a right of setoff under IRC § 6402(a) and
24 all the requirements under § 553 were met.¹⁰ Gould, 389 B.R. at
25 127-29.

26 The order denying the IRS's Motion and requiring the IRS to

27 ¹⁰ The court found the equities weighed in Debtor's favor as
28 discussed infra in Section V(D).

1 promptly pay Debtor \$6,852 was entered on April 16, 2008.

2 The IRS filed a Motion to Alter or Amend Judgment or, in the
3 Alternative for Stay of Order ("Motion for Stay"), which became
4 moot after the IRS mistakenly paid Debtor pursuant to the court's
5 order.

6 The IRS timely appealed.

7 **II. JURISDICTION**

8 The bankruptcy court had subject matter jurisdiction pursuant
9 to 28 U.S.C. § 1334 over this core proceeding under
10 § 157(b)(2)(G). We have jurisdiction under 28 U.S.C. § 158.

11 **III. ISSUES**

12 A. Whether the bankruptcy court abused its discretion by
13 denying the IRS's motion for relief from stay under § 362(d)(1)
14 and (2).

15 B. Whether the bankruptcy court abused its discretion in
16 disallowing the IRS's setoff under § 553 based on the equities of
17 the case.

18 **IV. STANDARDS OF REVIEW**

19 The decision to deny a motion for relief from stay and
20 disallow a setoff is reviewed for abuse of discretion. Arkison v.
21 Frontier Asset Mgmt., LLC (In re Skagit Pac. Corp.), 316 B.R. 330,
22 335 (9th Cir. BAP 2004); United States v. Carey (In re Wade Cook
23 Fin. Corp.), 375 B.R. 580, 588 (9th Cir. BAP 2007). "A bankruptcy
24 court abuses its discretion if it bases its ruling on an erroneous
25 view of the law." Wade Cook, 375 B.R. at 588.

26 We review the bankruptcy court's conclusions of law de novo,
27 and factual findings for clear error. Clear Channel Outdoor, Inc.
28 v. Knupfer (In re PW, LLC), 391 B.R. 25, 32 (9th Cir. BAP 2008).

1
2 **V. DISCUSSION**

3 **A. Mootness**

4 We first consider Debtor's argument that this appeal is moot.
5 Debtor maintains that he has "quite possibly" spent the tax
6 refunds and, therefore, ordering him to return the funds to the
7 IRS may be impossible. He further argues that ordering him to
8 return the money would derail the completion of his chapter 13
9 plan.

10 Debtor, as the party advocating mootness, bears the heavy
11 burden of establishing that we cannot provide any effective relief
12 to the IRS. Suter v. Goedert, 504 F.3d 982, 986 (9th Cir. 2007).
13 Debtor has not met his burden here.

14 Constitutional mootness derives from Article III of the
15 United States Constitution, which provides that the exercise of
16 judicial power depends on the existence of a case or controversy.
17 DeFunis v. Odegaard, 416 U.S. 312, 316 (1974); PW, LLC, 390 B.R.
18 at 33. The doctrine of constitutional mootness is essentially a
19 recognition of Article III's prohibition against federal courts'
20 issuing advisory opinions. North Carolina v. Rice, 404 U.S. 244,
21 246 (1971). While the Article III mootness doctrine has a
22 "flexible character," U.S. Parole Comm'n v. Geraghty, 445 U.S.
23 388, 400 (1980), it applies when events occur during the pendency
24 of the appeal that make it impossible for the appellate court to
25 grant effective relief. See PW, LLC, 390 B.R. at 33, citing
26 Church of Scientology of Cal. v. United States, 506 U.S. 9, 12
27 (1992). If no effective relief is possible, we must dismiss for
28 lack of jurisdiction. Church of Scientology, 506 U.S. at 12.

A variation of the mootness rule, the equitable mootness

1 doctrine, "applies when appellants 'have failed and neglected
2 diligently to pursue their available remedies to obtain a stay'
3 and circumstances have changed so as to 'render it inequitable to
4 consider the merits of the appeal.'" Darby v. Zimmerman (In re
5 Popp), 323 B.R. 260, 271 (9th Cir. BAP 2005) (citation omitted).
6 We conclude that neither the constitutional nor equitable mootness
7 doctrines apply to this appeal.

8 The rule in the Ninth Circuit is that where the order
9 appealed involves the distribution of money and the party who
10 received the funds is a party to the appeal, the appeal is not
11 moot because the appellate court has the power to fashion
12 effective relief by ordering the party to return the money. See
13 Spirtos v. Moreno (In re Spirtos), 992 F.2d 1004, 1007 (9th Cir.
14 1993); United States v. Arkison (In re Cascade Rds., Inc.), 34
15 F.3d 756, 760 (9th Cir. 1994); United States v. Valley Nat'l Bank
16 (In re Decker), 199 B.R. 684, 687 (9th Cir. BAP 1996). Under this
17 rule, we can implement effective relief because Debtor is a party
18 to the appeal, and we can order him to repay the money to the IRS
19 upon reversal of the bankruptcy court's rulings.

20 Debtor maintains that he has "quite possibly" spent the
21 money, thereby making effective relief impossible. Simply because
22 Debtor may have a present inability to repay the government does
23 not mean effective relief is unavailable. See United States v.
24 Campbell, 2003 WL 23241957 (W.D.N.Y. 2003) (finding that neither
25 taxpayer's present inability to make restitution for an
26 erroneously paid tax refund, nor mistake by the IRS in issuing an
27 erroneous refund, excused taxpayer's legal obligation to repay
28 amount of refund to the government). Therefore, the appeal is not

1 constitutionally moot.

2 Further, although the IRS did not obtain a stay pending
3 appeal, we perceive no reason to apply the equitable mootness
4 doctrine and Debtor has not offered one. In response to our
5 questions at oral argument in this appeal, we learned that the IRS
6 had mistakenly refunded Debtor's tax overpayments to him while its
7 Motion for Stay was pending. The IRS's mistaken payment explains
8 why its Motion for Stay became moot and, therefore, the bankruptcy
9 court never had an opportunity to rule on the IRS's request. We
10 conclude that it is not inequitable to consider the merits of the
11 appeal when the IRS's failure to obtain a stay was based on an
12 administrative mistake.

13 We also cannot conceive how the money, which Debtor claims
14 exempt, could derail the completion of his plan. Debtor committed
15 excess income of \$75 per month to fund his plan, and the record
16 contains no evidence that the tax refunds were used toward any of
17 his plan payments.

18 Put simply, Debtor erroneously received the overpayments from
19 the IRS. Debtor was aware that the IRS appealed the bankruptcy
20 court's decision and would seek to recover the money from him if
21 successful on appeal. Debtor "quite possibly" spent the money.
22 We conclude that it would not be unjust to require him to repay
23 it.

24 We recognize that the Eighth Circuit BAP has decided
25 differently the mootness issue presented here. Internal Revenue
26 Serv. v. Ealy (In re Ealy), 396 B.R. 20 (8th Cir. BAP 2008). In
27 Ealy, the IRS moved for relief from the automatic stay to permit
28 offset of the debtor's postpetition tax overpayment and economic

1 stimulus payment under the Economic Stimulus Act of 2008 against
2 his postpetition tax liability. The bankruptcy court denied the
3 IRS's motion, concluding that the IRS was adequately protected by
4 the debtor's confirmed plan, which provided for periodic payments
5 in full of the postpetition tax liability.

6 The IRS appealed and sought a stay of the order pending
7 appeal from the bankruptcy court. The bankruptcy court denied
8 its request. The IRS paid the tax overpayment and the stimulus
9 payment to the debtor. The IRS appealed the bankruptcy court's
10 order denying it relief from stay.

11 The Eighth Circuit BAP concluded that the IRS no longer had a
12 right of setoff because the mutuality aspect of § 553 was lost
13 because of the IRS's payment to the debtor. Therefore, the BAP
14 held that even if it did reverse the bankruptcy court, it was
15 impossible to grant the IRS effective relief since the IRS had
16 sought relief from stay to effectuate its setoff rights.

17 We disagree with the Eighth Circuit BAP's decision in Ealy
18 because it summarily ignores basic principles that underlie the
19 doctrine of constitutional mootness. For example, there is no
20 requirement that a court must return the parties "to the status
21 quo ante." Cascade Rds., 34 F.3d at 759. In the Ninth Circuit,
22 the standard is that "'an appeal is not moot if the court can
23 fashion some form of meaningful relief.'" Id. (emphasis in
24 original). Here, reversal of the bankruptcy court's order simply
25 will require Debtor to pay the IRS back.

26 Further, to follow Ealy's holding would

27 'have the unwelcome effect of encouraging disobedience
28 to a court's order if a stay could not be obtained, thus
presenting the [IRS] with a choice of losing its right

1 to appeal or noncompliance.' [This] result would
2 contravene the fundamental principle that 'a debtor
3 against whom a judgment for money is recovered may pay
4 that judgment and bring a writ of error to reverse it
5[In so doing], the defendant has merely submitted to
6 perform the judgment of the court and has not thereby
7 lost [its] right to seek a reversal of that judgment by
8 writ of error or appeal.'

9 Cascade Rds., 34 F.3d at 760 (citations omitted). We conclude
10 Ealy is unpersuasive and nonbinding.

11 Because the appeal is not moot, we consider the merits.

12 **B. The IRS's Setoff Rights Were Preserved Under § 553**

13 Setoff rights under the Bankruptcy Code are governed by
14 § 553, which provides in relevant part that,

15 Except as otherwise provided in this section and in
16 sections 362 and 363 of this title, this title does not
17 affect any right of a creditor to offset a mutual debt
18 owing by such creditor to the debtor that arose before
19 the commencement of the case under this title against a
20 claim of such creditor against the debtor that arose
21 before the commencement of the case. . . .

22 As this panel, and the bankruptcy court, recognize, § 553 does not
23 establish independent setoff rights in bankruptcy but rather
24 preserves setoff rights existing under law independent of the
25 Bankruptcy Code. Cascade Rds., 34 F.3d at 763; see also Wade
26 Cook, 375 B.R. at 591.

27 Setoff has venerable origins in Roman and common law,
28 recognizing the principle that mutually offsetting debts between
29 parties should be applied against each other to determine the
30 balance owed. See Tigar, Michael E., Automatic Extinction of
31 Cross-Demands: Compensatio from Rome to California, 53 Cal. L.
32 Rev. 224 (1965). "Since that time, setoffs in bankruptcy have
33 been 'generally favored,' and a presumption in favor of their
34 enforcement exists." Carolco Television, Inc. v. Nat'l Broad. Co.

1 (In re DeLaurentiis Entm't Group Inc.), 963 F.2d 1269, 1277 (9th
2 Cir. 1992).

3 While setoff is by its nature equitable, setoff rights in
4 many cases are governed by statute and are applied consistent with
5 the governing statutory terms. See, e.g., CCP § 431.70.¹¹

6 The IRS's setoff rights arise under IRC § 6402(a), which
7 provides that,

8 In the case of any overpayment, the Secretary, within
9 the applicable period of limitations, may credit the
10 amount of such overpayment, including any interest
11 allowed thereon, against any liability in respect of an
internal revenue tax on the part of the person who made
the overpayment and shall . . . refund any balance to
such person. (Emphasis added.)

12 The statute allows the IRS to credit "overpayments" against
13 liabilities for taxes before determining whether a taxpayer is
14 entitled to a "refund." The IRS contends that the bankruptcy
15

16 ¹¹ CCP § 431.70 provides:

17 Where cross-demands for money have existed between
18 persons at any point in time when neither demand was
19 barred by the statute of limitations, and an action is
20 thereafter commenced by one such person, the other
21 person may assert in the answer the defense of payment
22 in that the two demands are compensated so far as they
23 equal each other, notwithstanding that an independent
24 action asserting the person's claim would at the time of
25 filing the answer be barred by the statute of
26 limitations. If the cross-demand would otherwise be
27 barred by the statute of limitations, the relief
28 accorded under this section shall not exceed the value
of the relief granted to the other party. The defense
provided by this section is not available if the cross-
demand is barred for failure to assert it in a prior
action under Section 426.30. Neither person can be
deprived of the benefits of this section by the
assignment or death of the other. For the purposes of
this section, a money judgment is a "demand for money"
and, as applied to a money judgment, the demand is
barred by the statute of limitations when enforcement of
the judgment is barred under Chapter 3 (commencing with
Section 683.010) of Division 1 of Title 9.

1 court did not recognize the legal distinction between an
2 overpayment and a refund, which the IRS maintains contributed to
3 the error in the court's decision. We agree. When Congress uses
4 different words in a statute, "'it usually means different
5 things.'" Shaw v. County of San Bernardino (In re Shaw), 157 B.R.
6 151, 153 (9th Cir. BAP 1993) (citation omitted).¹²

7 The Fifth Circuit specifically recognized that difference
8 between an "overpayment" and a "refund" in Internal Revenue
9 Service v. Luongo (In re Luongo), 259 F.3d 323, 335 (5th Cir.
10 2001), as follows:

11 [U]nder 26 U.S.C. § 6402(a) the debtor is generally only
12 entitled to a tax refund to the extent that her
13 overpayment exceeds her unpaid tax liability. . . . In
14 the present case, the estate had a tax liability
15 totaling \$3,800, while the 1997 overpayment totaled only
16 \$1,395.94. Section 6402(a) grants the IRS discretion
17 whether to offset against a debtor's unpaid tax
18 liability or to refund the overpayment to the taxpayer.
19 The IRS elected to exercise that discretion to apply the
20 overpayment to Appellant's past liability. Because the
21 prior unpaid tax liability exceeded the amount of the
22 overpayment, the debtor was not entitled to a refund and
23 the tax refund did not become property of the estate.
24 Absent an interest in the estate to the refund, it could
25 not properly be exempted by the debtor under § 522.

26 Also, see Pettibone Corp. v. United States, 34 F.3d 536, 538 (7th
27 Cir. 1994):

28 The Internal Revenue Code leaves to the Commissioner's

23 ¹² It is an elementary precept of statutory construction that
24 the definition of a term in the definitional section of a statute
25 controls the construction of that term wherever it appears
26 throughout the statute. See 1A Sutherland, Sutherland on
27 Statutory Construction § 20.08 at 88 (6th ed. 2008). IRC
28 § 6401(c) defines an "overpayment" negatively: "An amount paid as
tax shall not be considered not to constitute an overpayment
solely by reason of the fact that there was no tax liability in
respect of which such amount was paid." Although IRC § 6401(c)
does not define what constitutes a refund, several statutes
throughout the IRC use the terms overpayment and refund. See
§§ 6402(a), (d) and (e), 6511 and 6512(b).

1 discretion whether to apply overpayments to
2 delinquencies or to refund them to the taxpayer. 26
3 U.S.C. § 6402(a). Until the Commissioner exercises this
4 discretion, the taxpayer has no right to payment.

5 In Lyle v. Santa Clara County Dept. of Child Support Servs. (In re
6 Lyle), 324 B.R. 128, 131 (Bankr. N.D. Cal. 2005), the court
7 observed:

8 [T]he debtor's interest in a refund does not necessarily
9 extend to the full value of any overpayment of taxes in
10 a given tax year. [Luongo, 259 F.3d at 335.] Rather,
11 the express provisions of the Internal Revenue Code make
12 it clear that the debtor's interest in a refund is
13 contingent on the subsequent statutory determination of
14 what portion of the overpayment, if any, the debtor is
15 entitled to receive as a refund. [In re Martin, 167
16 B.R. 609, 612-13 (Bankr. D. Or. 1994).] (Emphasis in
17 original).

18 The bankruptcy court recognized from "relevant caselaw" that
19 the terms "tax overpayment" and "tax refund" are not
20 interchangeable, but based on certain unexplained analytical
21 assumptions, treated them as essentially fungible despite that
22 recognition. See Gould, 389 B.R. at 108 n.3. However, if the
23 terms "overpayment" and "refund" in IRC § 6402(a) are treated as
24 distinct, the record in this appeal appears in a very different
25 light from the perception of the bankruptcy court.

26 Debtor had not filed his federal income tax returns for 1999
27 through 2004 when he filed his petition. His failure to file
28 prompted the IRS to object to his plan on feasibility grounds.
29 Debtor amended his Schedule C, claiming an exemption in "2002,
30 2003, 2004 Income Tax Refund[s]" even though Debtor had still not
31 filed his federal income tax returns for 1999 to 2004. At that
32 time, he had a contingent and unliquidated claim to a refund or
33 refunds, and that claim was property of his bankruptcy estate, as
34 recognized by the bankruptcy court. See Gould, 389 B.R. at 114;

1 Luongo, 259 F.3d at 335; Lyle, 324 B.R. at 131.

2 The IRS did not object to Debtor's claimed exemption in the
3 income tax refunds. Under IRC § 6402(a), if Debtor was entitled
4 to a refund after his prepetition tax overpayments were applied
5 against his unpaid prepetition income tax liabilities, the IRS
6 arguably would have no basis to object to his exemption claim.

7 Debtor filed his federal income tax returns for 1999 to 2004
8 in June and July 2005. In his amended plan, Debtor committed
9 excess disposable income of \$75 a month for thirty-seven months to
10 plan payments, but there was no provision for disposition of any
11 tax refunds received by Debtor.

12 The IRS filed several amended proofs of claim. The IRS's
13 Fourth Amended Claim included a secured setoff claim of \$6,852, an
14 unsecured priority claim of \$307.51, and a general unsecured claim
15 in the amount of \$2,812.93, for a total claim of \$9,972.44. The
16 automatic stay, however, prevented the IRS from exercising its
17 setoff rights. See § 362(a)(7)¹³; see also Pieri v. Lysenko (In re
18 Pieri), 86 B.R. 208, 210 (9th Cir. BAP 1988) (noting that the
19 automatic stay does not defeat the right of setoff, but merely
20 stays its enforcement pending an orderly examination of the
21 debtor's and creditor's rights).

22
23 ¹³ We observe that if this case had been filed under BAPCPA,
24 the IRS would not have to seek relief from stay to set off
25 Debtor's tax overpayments. BAPCPA includes § 362(b)(26) which
26 expressly excepts the setoff of prepetition tax refunds from the
27 automatic stay. Section 362(b)(26) states in pertinent part: "The
28 filing of a petition under section 301, 302, or 303 of this title,
... does not operate as a stay- ... under subsection (a), of the
setoff under applicable nonbankruptcy law of an income tax refund,
by a governmental unit, with respect to a taxable period that
ended before the date of the order for relief against an income
tax liability for a taxable period that also ended before the date
of the order for relief...."

1 Accordingly, the IRS filed its Motion seeking relief from
2 stay on October 25, 2005.¹⁴

3 **C. The IRS's Motion for Relief from Stay**

4 **1. Section 362(d)(1): The IRS Established That Cause**
5 **Existed for Granting Relief From Stay**

6 The IRS, as the party seeking relief, must first establish a
7 prima facie case that cause exists for relief under § 362(d)(1).
8 Duvar Apt., Inc. v. FDIC (In re Duvar Apt., Inc.), 205 B.R. 196,
9 200 (9th Cir. BAP 1996). Once a prima facie case has been
10 established, the burden shifts to Debtor to show that relief from
11 the stay is not warranted. See § 362(g)(2)¹⁵; Duvar Apt., 205 B.R.
12 at 200.

13 The IRS argues that its right of setoff under IRC § 6402 and
14 § 553 constitutes "cause" for relief from stay under § 362(d)(1).
15 "Courts generally recognize that, by establishing a right of

16 _____
17 ¹⁴ The IRS's Motion was not decided until the court issued
18 its published decision on June 13, 2008. Generally, the hearing
19 on a motion for relief from stay is a summary proceeding that
20 requires the bankruptcy court's action to be quick and is limited
21 to determining whether "the creditor has a colorable claim to the
22 property of the estate." Biggs v. Stovin (In re Luz Int'l, Ltd.),
23 219 B.R. 837, 842 (9th Cir. BAP 1998). Here, the hearing was
24 hardly accelerated, and both parties were able to fully brief and
25 argue the substantive merits of the IRS's right to setoff under
26 § 553. The IRS and Debtor have also extensively asserted their
27 relative positions on the substantive setoff within the context of
28 this appeal. We thus consider the merits of both rulings made by
the bankruptcy court – denial of the IRS's motion for stay relief
under § 362(d)(1) and (2) and disallowance of its setoff rights
under § 553 on equitable grounds. See United States v. Offord
Fin., Inc. (In re Medina), 205 B.R. 216 (9th Cir. BAP 1996)
(deciding setoff rights in the context of a motion to lift stay).

26 ¹⁵ Section 362(g) provides: "In any hearing under subsection
27 (d) or (e) of this section concerning relief from the stay of any
28 act under subsection (a) of this section-(1) the party requesting
such relief has the burden of proof on the issue of the debtor's
equity in property; and (2) the party opposing such relief has the
burden of proof on all other issues."

1 setoff, the creditor has established a prima facie showing of
2 'cause' for relief from the automatic stay under § 362(d)(1)." In
3 re Ealy, 392 B.R. 408, 414 (Bankr. E.D. Ark. 2008) (citing cases).

4 Here, it is undisputed that the IRS possessed a valid right
5 of setoff under § 553(a) and the bankruptcy court so found.
6 Therefore, we conclude that the IRS made a prima facie showing
7 that cause existed for relief from stay, thereby shifting to
8 Debtor the burden of proving that relief was inappropriate in this
9 case.

10 Debtor's only defense was that his exemption in the
11 anticipated tax refunds was superior to the IRS's setoff rights.
12 However, the amount of any claimed refund could not even be
13 determined under IRC § 6402(a) until the IRS had applied Debtor's
14 prepetition tax overpayments to his unpaid prepetition tax
15 liabilities. That was the precise reason the IRS sought relief
16 from stay, and the bankruptcy court erred as a matter of law in
17 denying the IRS relief from stay under § 362(d)(1) to allow that
18 process to proceed.

19 The bankruptcy court's Taylor analysis is not relevant
20 because Debtor's contingent and unliquidated claim to tax refunds
21 clearly was property of his estate, and the IRS had no basis to
22 object to the claimed exemption. Ultimately, based on the factual
23 record before the bankruptcy court and application of § 6402(a),
24 Debtor's prepetition unpaid tax liabilities exceeded his
25 prepetition tax overpayments, and there was no refund to which
26 Debtor's claimed exemption could attach. See Luongo, 259 F.3d at
27 335; Lyle, 324 B.R. at 131-33.

28 Moreover, the Supreme Court in Taylor did not discuss, let

1 alone offer any rationale, for the bankruptcy court's conclusion
2 that its holding operated to cut off a creditor's setoff rights,
3 which are preserved in § 553. Notably, the Supreme Court was
4 neither called upon to examine the plain language of § 553, nor
5 did it discuss case law that analyzed the interplay between
6 § 522(c)¹⁶ and § 553.

7 While there was no conflict between § 553 and § 522(c) under
8 this set of facts, if such a conflict did exist, our former
9 decision in Pieri, 86 B.R. 208, would control.¹⁷ See California v.
10 Rowley (In re Rowley), 208 B.R. 942, 944 (9th Cir. BAP 1997)
11 (noting that the panel is bound by its former decisions). In
12 Pieri, the panel reconciled the conflict between § 553 and
13 § 522(c) – which bars exempt property from being liable for any
14 debt, with certain enumerated exceptions, that arose before the
15 beginning of the case. In construing the two statutes, the panel
16 noted that “[i]t is long settled that where there is an
17 irreconcilable conflict between different parts of the same act,
18 the last in order of arrangement will control.” Pieri, 86 B.R. at
19 212-13. The BAP held that “[§] 553 would control over [§] 522(c)
20 on any point of conflict.” Id.

21 The Ninth Circuit's reasoning in DeLaurentiis, 963 F.2d
22

23 ¹⁶ Section 522(c) provides: “Unless the case is dismissed,
24 property exempted under this section is not liable during or after
25 the case for any debt of the debtor that arose, or that is
26 determined under section 502 of this title as if such debt had
27 arisen, before the commencement of the case....”

28 ¹⁷ In Pieri, the BAP affirmed the right of the landlord to
set off her claims for damage to leased premises against the
debtors' cause of action against the landlord arising out of the
same circumstances, even though debtors claimed the cause of
action as exempt property in their respective bankruptcy cases.

1 1269, also provides support for deciding that § 553 trumps
2 § 522(c). In DeLaurentiis, the Ninth Circuit considered the
3 conflict between § 553 and § 1141¹⁸ and found that § 553
4 controlled. In reaching its conclusion, the court relied on the
5 language and structure of § 553 and the policies that underlie it.
6 Id. at 1276.

7 Section 553 provides that, with listed exceptions not
8 relevant here, “this title does not affect the right of any
9 creditor to offset a mutual debt....” The Ninth Circuit found
10 that this language established a right to setoffs in bankruptcy
11 and manifested a Congressional intent that it control
12 “notwithstanding any other provision of the Bankruptcy Code.”
13 (Emphasis added.) Id. at 1276-77.

14 The Ninth Circuit also found that a contrary conclusion would
15 essentially nullify § 553, because § 553 does not create the right
16 of setoff, but merely preserves it. The court opined that if
17 § 1141 were given precedence over § 553, then setoffs would be
18 allowed under Chapter 11 only where they were written into a plan
19 of reorganization. Id. at 1277.

20 Finally, the Ninth Circuit acknowledged the long history of
21 setoffs in both the nonbankruptcy and bankruptcy contexts. The
22 court found no indication, from § 553 or elsewhere, of an intent

23
24 ¹⁸ Section 1141, titled “Effect of confirmation”, provides in
25 subsection (a): “Except as provided in subsections (d)(2) and
26 (d)(3) of this section, the provisions of a confirmed plan bind
27 the debtor, any entity issuing securities under the plan, any
28 entity acquiring property under the plan, and any creditor, equity
security holder, or general partner in the debtor, whether or not
the claim or interest of such creditor, equity security holder, or
general partner is impaired under the plan and whether or not such
creditor, equity security holder, or general partner has accepted
the plan.”

1 to deviate from this historical precedent of recognizing setoff
2 rights. Id.

3 Following the analysis in Delaurentiis, we reach the same
4 conclusion that our former panel did in Pieri, albeit using a
5 different vein of statutory construction. We conclude that the
6 plain language of § 553 provides the answer to what the bankruptcy
7 court viewed as the primary question before it: whether the IRS's
8 setoff should be allowed against property that Debtor had already
9 fully exempted without challenge by the IRS or any other party.
10 Gould, 380 B.R. at 111. Section 553(a), applied by its terms,
11 dictates that the IRS's right to offset a mutual debt is not
12 affected by any other section of the Code (with certain exceptions
13 not relevant here). United States v. Ron Pair Enters. Inc., 489
14 U.S. 235, 241-42 (1989) (as with all issues of statutory
15 interpretation, we begin with the words of the statute; if it is
16 clear, we must apply it by its terms unless to do so would lead to
17 absurd results). We conclude that to give Debtor's exemption in
18 his claim to the tax refunds precedence over § 553 would be to
19 ignore the plain language of § 553.

20 Moreover, under these circumstances the rule adopted by the
21 bankruptcy court recognizing allowed exemptions as being superior
22 to a creditor's setoff rights under nonbankruptcy law puts
23 creditors in a position of having to object to a debtor's
24 exemptions to preserve their setoff rights already provided for in
25 § 553. This approach would result in needless objections to
26 exemptions and would render § 553 largely meaningless.

27 Finally, we discern no policy arguments that would induce us
28 to deviate from the presumption in favor of setoffs under this set

1 of facts.

2 Therefore, we reinforce our previous holding in Pieri that
3 § 553 controls over § 522(c). We conclude that the bankruptcy
4 court abused its discretion in denying the IRS relief from stay
5 under § 362(d)(1) by basing its ruling on the holding in Taylor,
6 503 U.S. 638.

7 **2. Section 362(d)(2)**

8 Under § 362(d)(2), the court must grant relief from stay
9 against property if Debtor does not have equity in the property
10 and it is not necessary to an effective reorganization. The IRS
11 has the burden of proof on the issue of Debtor's equity in the
12 property. See § 362(g).

13 The bankruptcy court did not directly address whether the IRS
14 had established that Debtor had no equity in his claimed tax
15 refunds. If such a showing were made, the burden would shift to
16 Debtor to establish that the claimed tax refunds were necessary
17 for an effective reorganization of his affairs in chapter 13.
18 Consistent with the Fourth Amended Claim and the parties'
19 agreement in arguing the Motion, the amount of Debtor's
20 prepetition overpayments totaled \$6,852.00. In the Fourth Amended
21 Claim, the IRS claimed unpaid prepetition tax liabilities totaling
22 \$9,972.44. Applying Debtor's prepetition tax overpayments to his
23 prepetition unpaid tax liabilities leaves a balance of unpaid tax
24 liabilities of \$3,120.44. Accordingly, if the IRS in its
25 discretion under IRC § 6402(a) applied Debtor's tax overpayments
26 to his unpaid liabilities, there is no equity for Debtor, and
27 further, there is no refund to which Debtor's claimed exemption
28 could attach. See Luongo, 259 F.3d at 335; Lyle, 324 B.R. at 131-

1 33.

2 Debtor presented no evidence that the tax refunds in which he
3 claimed an exemption were necessary to an effective reorganization
4 in chapter 13. In fact, his confirmed plan provided for payments
5 only from excess disposable income and did not specify how any tax
6 refunds recovered for prepetition periods were to be spent. On
7 this record, the bankruptcy court erred as a matter of law in
8 denying the IRS relief from stay under § 362(d)(2).

9 **D. The Bankruptcy Court's Alternative Holding: Disallowance of**
10 **the IRS's Setoff Rights on Equitable Grounds**

11 Allowance of setoff rights under § 553 is permissive, not
12 mandatory. Cascade Rds., 34 F.3d at 763 (noting that the
13 allowance of setoff rights is discretionary)¹⁹; FDIC v. Bank of Am.
14 Nat'l Trust & Sav. Ass'n, 701 F.2d 831, 836-37 (9th Cir. 1983)
15 (denying the bank's claim of setoff against the debtors' bank
16 deposits on public policy grounds). However, we have previously
17 observed that "the setoff right is an established part of our
18 bankruptcy laws [and] should be enforced 'unless compelling
19 circumstances' require otherwise." Camelback Hosp., Inc. v.
20 Buckenmaier (In re Buckenmaier), 127 B.R. 233, 237 (9th Cir. BAP
21 1991) (citation omitted).

22 Against this background, we consider whether the bankruptcy
23 court's decision to disallow the IRS's setoff right on equitable
24 grounds was an abuse of its discretion. We cannot reverse on this
25 ground unless we have a definite and firm conviction that the

26 _____
27 ¹⁹ In Cascade Rds., the bankruptcy court's decision denying
28 setoff was affirmed based on the fact that the case was replete
with inequitable conduct on the part of the party seeking setoff.
Id. at 762.

1 bankruptcy court committed a clear error of judgment in the
2 conclusion it reached after weighing the relevant factors. Cashco
3 Fin. Servs., Inc. v. McGee (In re McGee), 359 B.R. 764, 769-70
4 (9th Cir. BAP 2006). However, a bankruptcy court necessarily
5 abuses its discretion if it bases its decision on an erroneous
6 view of the law or clearly erroneous factual findings. Id.

7 In finding that the equities weighed in Debtor's favor, the
8 court considered the following factors: (1) the IRS did not
9 object to Debtor's exemption in the tax refunds; (2) the IRS did
10 not ask for an extension of time to object, under Rule 4003(b);
11 (3) the IRS's rights under IRC § 6402(a) "were just the same as
12 any other creditor's setoff rights...."; (4) the IRS's
13 discretionary right of setoff was not timely exercised because it
14 did not move for relief from stay until several months after
15 Debtor claimed his exemption;²⁰ and (5) Debtor's financial position
16 weighed heavily in favor of denying the IRS's claim of setoff.

17 With respect to the last factor, the court observed that
18 Debtor had absolutely nothing else but the tax refunds in question
19 to provide him with the "basic necessities of life." The court
20 concluded that allowing the IRS to set off the tax refunds would
21 take from Debtor his wildcard exemption, which was the most
22 "important exemption available to him as a nonhomeowner" and
23 contrary to "bankruptcy policy and California state exemption
24

25 ²⁰ We observe that § 553 does not contain a time limitation
26 by which the IRS must move for relief from stay to accomplish its
27 setoff rights. According to the record, Debtor claimed his
28 exemption in the tax refunds before he had filed the returns for
the years he sought the refunds. Gould, 389 B.R. at 109. Thus,
it was not surprising that the IRS waited to file its motion for
stay relief.

1 policy." Gould, 389 B.R. at 129.

2 The bankruptcy court relied heavily for its equitable
3 determination on the fact that the IRS did not object to Debtor's
4 claimed exemption in the tax refunds and waited several months
5 before filing the Motion. As explained above, the IRS had no
6 basis to object to Debtor's exemption because his contingent and
7 unliquidated claim to the tax refund clearly was property of his
8 estate. Moreover, applying IRC § 6402(a) shows that there was no
9 refund to which Debtor's claimed exemption could attach because
10 his prepetition unpaid tax liabilities exceeded his prepetition
11 tax overpayments. Accordingly, there are no tax refunds in which
12 the bankruptcy estate had a property interest. Luongo, 259 F.3d
13 at 335; Lyle, 324 B.R. at 131-33.

14 The bankruptcy court also treated the IRS's setoff rights as
15 analogous to setoff rights available to other creditors. However,
16 the IRS's setoff rights are specified by IRC § 6402(a) and must be
17 applied according to its terms. Being based on statute, the IRS's
18 setoff rights are not "just the same as any other creditor's
19 setoff rights." The bankruptcy court's decision disregarded the
20 distinct terms under which the IRS can exercise a setoff, and that
21 lapse alone constitutes an abuse of discretion.

22 The bankruptcy court also based its equitable determination
23 on Debtor's having absolutely nothing else but the tax refunds in
24 question to provide him with the "basic necessities of life."²¹

25
26 ²¹ There was no evidence in the record that Debtor needed the
27 tax refunds to provide him with the basic necessities of life. The
28 only offer of proof was that Debtor was a single father with
teenage children and, therefore, needed the money. Moreover,
Debtor was funding his plan with excess income of \$75 a month,

(continued...)

1 Gould, 389 B.R. at 129. The bankruptcy court concluded that
2 allowing the IRS to set off the tax refunds would take from Debtor
3 his wildcard exemption, which was the most "important exemption
4 available to him as a nonhomeowner" and contrary to "bankruptcy
5 policy and California state exemption policy." Gould, 389 B.R. at
6 129.

7 The last equitable factor weighed by the bankruptcy court
8 implicates important public policies behind bankruptcy and
9 California exemption laws. In Pieri, the panel recognized that
10 exemption statutes are to be given a liberal construction and that
11 "[t]his liberal view will be maintained in state policy governing
12 the use of setoff against exempt property." 86 B.R. at 213.
13 Thus, while the Pieri panel held that § 553 would control over
14 § 522(c), we acknowledge that it did not foreclose a bankruptcy
15 court from considering whether any state policy of protecting the
16 rights of a debtor is present in the case.

17 Nevertheless, we question whether California exemption policy
18 holds any weight under these circumstances when a federal statute
19 such as IRC § 6402 controls the IRS's setoff rights. In Pieri,
20 the right of setoff was authorized under California law based on
21 equitable principles. Here, the IRS's right of setoff is not
22 based on equitable principles but on IRC § 6402, which is a
23 federal statute that does not recognize state exemptions. See In
24 re Bourne, 262 B.R. 745, 749-50 (Bankr. E.D. Tenn. 2001).
25 Arguably, the Supremacy Clause of the United States Constitution
26 prevents state exemption laws from defeating federal setoff rights

27
28 ²¹(...continued)
which directly conflicts with the bankruptcy court's finding.

1 provided under IRC § 6402. Id.

2 However, even if a consideration of state exemption policy
3 could override the IRS's setoff rights preserved in § 553, the
4 circumstances in Pieri are distinguishable from those in this
5 case. California courts have disallowed a setoff against exempt
6 property that provides income necessary to pay daily living
7 expenses. Kruger v. Wells Fargo Bank, 11 Cal. 3d 352 (1974)
8 (disallowing setoff against the debtor's bank account, which
9 contained unemployment compensation and disability benefits);
10 Barnhill v. Robert Saunders & Co., 125 Cal. App. 3d 1 (Cal. Ct.
11 App. 1981) (preventing an employer from setting off debts owed to
12 it by an employee's exempt wages owed to him). In each case,
13 state policies protecting the debtor's interest apparently
14 outweighed the creditor's right to setoff. The record in this
15 appeal does not support Debtor's claim of exemption to provide a
16 source of income to pay his daily living expenses. Debtor's
17 confirmed chapter 13 plan provides for payments of \$75 disposable
18 income in excess of expenses during each month of the term of the
19 plan.

20 Finally, the Ninth Circuit in DeLaurentiis discussed the
21 equities in favor of setoff. The court noted that the defense of
22 setoff allows the creditor to claim an amount large enough to set
23 off its debt. DeLaurentiis, 963 F.2d at 1277. Absent such a
24 right, it would have to pay its debt in full, yet receive pennies
25 on the dollar. The court observed that this result was unfair,
26 which was why setoffs "were allowed in bankruptcy in the first
27 place." Id.

28 We recognize the unfairness that would result from barring a

1 setoff in the case before us. The IRS initially objected to
2 Debtor's plan on the ground that he had unpaid tax liabilities for
3 the very years he claimed refunds. The IRS asserted its setoff
4 rights during the pendency of the bankruptcy proceeding by filing
5 a motion for relief from stay and a proof of claim, a portion of
6 which was based on its setoff rights. Therefore, Debtor was on
7 notice that the IRS would seek to set off his overpayments against
8 his liabilities.

9 The record reflects that as a matter of procedure, the IRS
10 played by the rules. It did not attempt to offset Debtor's tax
11 overpayments against his tax liabilities in the absence of relief
12 from stay. After Debtor filed his tax returns for 1999 to 2004,
13 the IRS filed the Motion to obtain that relief. The bankruptcy
14 court denied the Motion, and the IRS turned over the \$6,852.00 in
15 tax overpayments to Debtor pursuant to the bankruptcy court's
16 order before there was a formal application of the overpayments to
17 determine if Debtor even was entitled to a refund. Under these
18 circumstances, as a matter of equity, we do not see any factors
19 weighing in Debtor's favor based on the IRS's conduct in this
20 matter.

21 Accordingly, we conclude that the court abused its discretion
22 in disallowing the IRS's setoff rights under § 553 on equitable
23 grounds.

24 VI. CONCLUSION

25 We REVERSE the bankruptcy court's denial of the IRS's motion
26 for relief from stay for the reasons set forth above and REMAND
27 for entry of an order consistent with this opinion.

28