



The Plan provides for the IRS to recover \$73,974.36 from enforcement of its lien on the Debtors' personal property. Plan at 3. The balance of the IRS's claims are treated in the Plan as general unsecured claims which are to receive no distribution.

Through the Objections the Trustee and the IRS object to confirmation of the Plan on grounds that it fails to provide for payment in full of both the IRS's allowed secured claim, Claim S, as required by Bankruptcy Code §1325(a)(5)(B)(ii), and its allowed priority unsecured claim, Claim P, as required by §1322(a)(2).

The Debtors contend that §1322(b)(2) permits them to "modify" the IRS claims by applying the IRS tax liens, in reverse chronological order, to secure Claim P (rather than Claim S), leaving Claim S, which is not entitled to priority status under §507(a)(8) as a general unsecured claim -- a category which receives no distribution under the Plan.

For the reasons set forth hereinafter, the Court sustains the Objections and denies confirmation of the Plan.

## II. JURISDICTION

The United States District Court for the District of Connecticut has jurisdiction over the instant matter by virtue of 28 U.S.C. §1334(b); and this Court derives its authority to hear and determine this matter on reference from the District Court pursuant to 28 U.S.C. §157(a), (b)(1) and the District Court's General Order of Reference dated September 21, 1984. This is a "core proceeding" pursuant to 28 U.S.C. §157(b)(2)(L).

## III. DISCUSSION

### A. *Sovereign Immunity*

As a threshold matter, the Court finds no merit in the IRS's argument that the

doctrine of sovereign immunity precludes the Debtors from modifying its claims under §1322(b)(2) because the waiver of sovereign immunity in §106 is applicable only to the specified provisions of the Bankruptcy Code listed therein, which do not include §1322. Notwithstanding the language of §106, however, the United States Supreme Court has held:

Bankruptcy jurisdiction, as understood today and at the time of the framing, is principally *in rem* jurisdiction. In bankruptcy, the court's jurisdiction is premised on the debtor and his estate, and not on the creditors. As such, its exercise does not, in the usual case, interfere with state sovereignty even when States' interests are affected.

*Central Virginia Community College v. Katz*, 546 U.S. 356, 369-370, 126 S.Ct. 990, 1000 (2006) (citations and internal quotation marks omitted).

The Court finds that the present matter is within its *in rem* jurisdiction and does not implicate the IRS's sovereign immunity.

**B. Plan Confirmation Issues**

The plain language of §§ 1322(a)(2) and 1325(a)(5)<sup>4</sup> requires that the Plan provide for payment in full of all secured and priority claims. Straightforward application of these provisions would entitle the IRS to a total distribution of \$147,564.02 (\$73,974.36 on secured Claim S plus \$73,589.66 on priority unsecured Claim P).

Distilled to its essence what the Debtors seek to accomplish in their Plan is (1) treat the IRS' priority claim (Claim P) as secured by the IRS' tax lien; and (2) treat the IRS' secured claim (Claim S) as a general unsecured claim. Thus, under the proposed Plan,

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<sup>4</sup> Section 1325(a)(5) states, *inter alia*, that, with respect to each allowed secured claim, the Plan provide that "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." 11 U.S.C. §1325(a)(5)(B)(ii).

the IRS would receive a total distribution of only \$73,974.36. The Debtors argue that their proposed treatment of the IRS claims is permissible under the modification provisions of §1322(b)(2). The Court finds the Debtors' position contrary to the plain language of §1322, which states, in relevant part:

- (a) The plan --  
...  
(2) *shall* provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim;
- (b) **Subject to subsections (a) and (c)** of this section, the plan *may* --  
...  
(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; . . . .

11 U.S.C. §1322 (emphasis added).

As the IRS points out in its brief, the claim it filed as a priority unsecured claim (Claim P) is an allowed unsecured claim that, under §507(a)(8), is entitled to priority treatment. Its treatment under the Plan, therefore, is mandated by §1322(a)(2). Since the modifications permitted under §1322(b)(2) are subject to the requirements of subsection (a), the treatment of Claim P may not be modified by subsection (b)(2).

The Debtors contend that the Plan complies with §1322(a)(2) because in treating Claim P as a secured claim, rather than a priority unsecured claim, the Plan still proposes to pay Claim P in full. This argument ignores that Claim S is an allowed claim determined under §506(a) to be secured to the extent of \$73,974.36 and is required to be paid in full under §1325(a)(5).

A "modification" of a secured claim under §1322(b)(2) may treat such a claim as

unsecured only to the extent permitted under §506(a). Here, the Stipulated §506 Order provided that the IRS secured claim (Claim S) shall be treated by the Plan as secured to the extent of \$73,974.36; and §1325(a)(5) requires that the Plan provide for payment in full of such secured claim. The Plan treats Claim S as a general unsecured claim and proposes to pay no distribution whatsoever on account thereof. Such a plan, "in effect, adjust[s] the priority of the claim, and this it cannot do." *United States v. Haas (In re Haas)*, 162 F.3d 1087, 1089 (11th Cir. 1998) (reversing confirmation of a Chapter 11 plan that similarly applied an IRS tax lien to secure a priority tax claim rather than a non-priority tax claim)<sup>5</sup>.

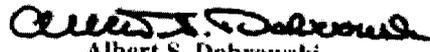
#### IV. CONCLUSION AND ORDER

In light of the foregoing discussion, the Court concludes that the "modifications" permitted under §1322(b)(2) do not include altering the priorities established elsewhere in the Bankruptcy Code. Because the Debtors' Plan does not provide for payment in full of both (1) the IRS's \$73,974.36 claim designated on its Proof of Claim No. 1-3 as "secured," and (2) its \$73,589.66 claim designated thereon as "priority unsecured," it cannot be confirmed. Accordingly,

**IT IS HEREBY ORDERED** that the Objections to confirmation are **SUSTAINED**, and confirmation of the Plan is **DENIED**.

Dated: March 3, 2015

BY THE COURT

  
Albert S. Dabrowski  
United States Bankruptcy Judge

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<sup>5</sup> The language of §1123(b)(5), permitting "modification" of claims in a Chapter 11 plan, is almost identical to that of §1322(b)(2).