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Friday, April 21, 2000

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re

RICHARD and SHARON EDGINGTON,

No. 98-12795

[Debtor](#)ⁱ(s).

Memorandum

In this [Chapter 13](#)ⁱ case, the debtors' confirmed [plan](#)ⁱ provides that [priority](#)ⁱ debt will be paid in full. However, the dividend to general unsecured creditors will be nominal. The Internal Revenue Service filed a [claim](#)ⁱ for \$55,268.61, of which it claimed that \$46,239.29 was entitled to priority. The debtors objected to the priority status of \$12,900.00 as a penalty for early distributions from a retirement plan. The IRS conceded that the debtors were correct on this issue. However, the IRS then filed an amended claim which deducted the penalty from the priority amount, but re-allocated withholding payments made before bankruptcy so that they were applied to the penalty and not the priority portion of the taxes. The net result was a priority claim only about \$4,000.00 less than the original claim. The debtors object to the amended claim. As a general rule, the IRS is free to go back and re-allocate tax payments. [Davis v. U.S.](#), 961 F.2d 867, 878-79 (9th Cir.1992). The only time the IRS may not re-allocate is when the taxpayer has made a voluntary payment and designated the liability to which the payment should be applied. If the taxpayer failed to target the funds to a specific liability, the IRS may apply the payment as it sees fit. [Davis v. U.S.](#), at 878. The debtors' argument is

that the taxes withheld from their wages by their employers is to be deemed designated by the debtors as payment of priority taxes. They cite no legal authority for this position, nor can the court find any. Even if the court assumes that withholding payments made by an employer according to law are considered voluntary payments of the employees, the debtors point to no communication or court order designating the payments in any way. Absent authority, the court is not prepared to take the leap urged by the debtors and find that all withholding payments are deemed "designated" by the taxpayers to be payments on the income tax liability attributable to the income earned from the withholding party. For the foregoing reasons, the debtors' objection to the amended IRS claim will be overruled. Counsel for the IRS shall submit an appropriate form of order.

Dated: April 21, 2000

Alan Jaroslovsky

U.S. [Bankruptcy Judge](#) 

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