CHARITABLE CONTRIBUTIONS AND BANKRUPTCY

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"A tithe of everything from the land...The entire tithe of the herd and the flock...will be holy to the Lord." Leviticus 27:1, 30, 32.[1]

I. INTRODUCTION

Bruce and Nancy Young were members of the Crystal Evangelical Free Church, which is located in Minnesota. They were active members of the Church, holding a number of volunteer positions and attending church activities.

In the year ending February 1992, the Youngs contributed a total of $13,450 to the Church as tithes in accordance with their religious beliefs. They received no money or tangible property in exchange for their contributions.

On February 3, 1992, the Youngs filed for bankruptcy under Chapter 7 of the Bankruptcy Code ("BC"). A trustee in bankruptcy was appointed and, as part of marshalling of the assets of the bankruptcy estate, she attempted to recover the $13,450 from the Church, relying on section 548 of the BC.

Section 548(a)(2) provides that a trustee in bankruptcy can recover ("avoid") prior transfers made by debtors who have filed for bankruptcy if the following conditions are met:

(1) The transfer(s) took place in the year previous to the bankruptcy petition being filed;

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[1] Other possible sources of the obligation to tithe are Genesis 28:22 and Malachi 3:8-12.

(2) the debtor was insolvent at the time the transfer(s) occurred (or the debtor became insolvent as a result of the transfer(s)); and

(3) the debtor received "less than a reasonably equivalent value in exchange for such transfer...."

The parties stipulated that the first two conditions were met.

The Bankruptcy Court[2] ordered the Church to turn the money over to the trustee in bankruptcy on the grounds that (1) the debtors did not receive reasonably equivalent value from the Church and (2) even if the court were to accept arguendo that they did in fact receive reasonably equivalent value, that value was not received by them in exchange for their contributions (as required by the statute).

The District Court affirmed on the same two grounds.[3] The court rejected a free exercise argument made by the Church for the first time on appeal, although it discussed the Church's claim.[4]

The Eighth Circuit reversed.[5] The Eighth Circuit did not express a view as to whether spiritual benefits could ever satisfy the requirement of "reasonably equivalent value"; rather,

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[2] In re Young, 148 Bankr. 886 (Bankr. D. Minn. 1992).

[3] In re Young, 152 Bankr. 939 (D. Minn. 1993).

[4] 152 Bankr. at 951-54. Among other things, the district court was heavily influenced by the change in free exercise jurisprudence wrought by Employment Div., Department of Human Resources of Oregon v. Smith, 494 US 872 (1990) (the peyote case). See 152 Bankr. at 952. The court did not consider RFRA.

[5] In re Young, 82 F.3d 1407 (8th Cir. 1996).

it agreed with the lower courts that the value received by the debtors was not "in exchange for" their transfers of money to the Church. The Eighth Circuit nonetheless reversed the decisions of the lower courts based upon its analysis of the Religious Freedom Restoration Act of 1993 (RFRA).[6] It did not reach the constitutional issues discussed by the district court.[7]

Tithing cases under section 548 have arisen in other jurisdictions at the bankruptcy court level. Some courts have protected the amounts tithed from recovery by the trustee in bankruptcy under section 548; others have not.[8] The Young case is the only section 548 tithing case decided by a United States Court of Appeals to date.[9]

The section 548 tithing cases[10] thus raise a host of statutory, constitutional, and policy issues, ranging from the

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[6] 42 USC §§ 1988(a), 2000bb to 2000bb-4; 5 USC 504(b).

[7] In re Young, 82 F.3d at 1416.

[8] See In re Newman, 183 Bankr. 239 (Bankr. D. Kan. 1995) (upholding the trustee's challenge to the tithes); In re Moses, 59 Bankr. 815 (Bankr. N.D. Ga. 1986) (upholding the church's right to keep the tithes).

[9] There are relatively few tithing cases under section 548 (or its state law equivalent). There are significantly more tithing cases where the issue is whether a debtor can include amounts to be tithed in a Chapter 13 plan of rehabilitation. The latter are discussed below, Part V.

[10] Throughout this paper I refer to "section 548 cases," which arise under the BC. The identical issue arises under state debtor-creditor law when a creditor challenges a completed transfer by a debtor to a third party on the grounds that the debtor was or became insolvent thereby and did not receive adequate consideration in exchange. See the Uniform Fraudulent Conveyance Act § 4 and the Uniform Fraudulent Transfer Act § 5(a).

interplay between the Internal Revenue Code (IRC) and the Bankruptcy Code (BC), on the one hand, to the relationship between the BC and the First Amendment and the Religious Freedom Restoration Act (RFRA), on the other.

II. THE DILEMMA OF THIS NUGGET

This nugget examines some of the issues raised by the tithing cases, using Young as the paradigm. My remarks here focus on the issues arising out of the BC and the IRC, rather than RFRA and the First Amendment, both because I lack expertise in the latter areas and because an outcome favorable to the debtor under the IRC and the BC would make it unnecessary to get entangled in the more complicated and speculative constitutional and RFRA issues.[11]

I begin from this basic dilemma. Leaving aside the possible protection afforded by the First Amendment and RFRA, under a technical (but not hypertechnical) reading of section 548 of the BC, the amounts tithed in the year preceding bankruptcy should be recoverable from the Church by the trustee for the benefit of the debtors' creditors. Yet this outcome leads to some results that bother my conscience. In particular, it means that the Youngs

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[11] Not only are these issues complex on the merits; the constitutionality of RFRA has not yet been established. RFRA's constitutionality is the question before the Court in Flores v. City of Boerne, which was argued before the Supreme Court in February. Even if RFRA is ultimately upheld by the Court, its impact on section 548 cases is unclear. The Eighth Circuit Young decision protected the church from the trustee's avoidance powers; however, in In re Newman, the court sided with the trustee even after applying RFRA to the facts of the case. 183 Bankr. at 250-52.

could have spent $13,450 in the year preceding bankruptcy on cosmetic surgery, a lavish week in Aruba, rolling the dice in Atlantic City, or group sex without the finality of these expenditures being subject to challenge in the ensuing bankruptcy.[12] Yet their contributions made to the church have less integrity for bankruptcy purposes, at least as far as section 548's avoidance power goes.

In order to resolve this anomaly, or, at the very least, to come to terms with it, I shall devote this nugget to examining the statutory and policy questions raised by the tithing issue.

III. VALUING RELIGIOUS BENEFITS

The main issues examined by the courts in section 548 cases are (1) whether the spiritual and related benefits received by the debtors from the act of tithing and from the donee church can be treated as "value" for purposes for section 548; (2) if so, whether they can be quantified or measured sufficiently to determine if such benefits constitute "reasonably equivalent value"; and (3) assuming they can, whether such benefits are received by the debtor "in exchange for" the amounts contributed to the church. This Part III deals with the first two of these questions.

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[12] Unless the debtors' intent in making these expenditures was to defraud their creditors.

A. Should Spiritual Benefits Be Considered Value for Purposes of Section 548?

1. The trustee's avoidance powers. In general, the estate in a bankruptcy case consists of the assets and liabilities that the debtor had at the time the petition for bankruptcy was filed.[13] A major exception to this rule results from the power of the trustee to undo certain transactions that were completed prior to the bankruptcy, usually within the year prior to the petition being filed. This power is referred to as the trustee's avoidance power.[14] Subject to exceptions not here relevant, when the trustee successfully avoids a pre-petition transaction, the assets formerly conveyed away by the debtor as part of that transaction must be turned over to the trustee.

One policy justifying the trustee's avoidance powers is maximizing the assets available for the benefit of creditors whose sole recovery for the debts in question will come (in a Chapter 7 proceeding) from their share of the bankruptcy estate. Regardless of how small a percentage of the debt owed to creditors is paid to them by the estate, they will (in general) have no claim on the debtor's post-petition assets or income. In light of the debtor's post-bankruptcy fresh start and the typically puny recoveries for unsecured creditors, there is a

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[13] The "estate" in a bankruptcy case is defined in BC § 541 as "all legal or equitable interests of the debtor in property as of the commencement of the case," wherever located and by whomever held.

[14] The trustee has a series of avoidance powers, each linked to a specific section of the BC. See BC §§ 544-549.

strong public policy in favor of maximizing the bankruptcy estate. This policy underlies some of the strictures of section 548.

Also underlying the enactment of the avoidance powers is the belief that the BC should discourage aggressive creditors from taking advantage of the debtor or of one another on the eve of bankruptcy, for example, by last minute grabbing.[15]

A third policy is to prevent the debtor who realizes she is going to file a petition soon from a last minute impulse (or calculation) to give what little she has to family and friends rather than let her creditors have it. This policy also underlies part of section 548.

2. Spiritual benefits as value. The lower courts in the Young case wrestled, as did the courts in other tithing cases, with the meaning of "value" in section 548 as applied to spiritual benefits. "Value" is defined in the statute as "property, or satisfaction or securing of an antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or the relative of the debtor." [16] Since satisfaction of an antecedent debt was not an issue, for the Church to keep the amounts tithed, the Youngs would have to

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[15] This underlies the trustee's power to avoid preferential payments on valid claims to legitimate creditors, even though such preferences would be legal (and untouchable) under state law.

[16] BC § 548(d)(2)(A).

have received "property" in return for their contributions. "Property" is not defined in section 548 or in the BC.[17]

The bankruptcy court in Young took the position, based upon Black's Law Dictionary and Webster's Third New International Dictionary, that property means "legal or equitable rights" or an "ownership interest" and that an ownership interest means possession to the exclusion of others.[18] The court then rejected the Church's services as property based upon this definition and because the services did not enhance the debtors' estate economically.[19] The district court agreed with the bankruptcy court's analysis and added that the contributions were made out of a "sense of religious obligation" and that there can be no reasonably equivalent value if the payments are made to satisfy a moral rather than a legal obligation.[20] The district court also noted its opinion in a non-tithing case to the effect that indirect benefits can under certain circumstances meet section 548's standard, but that the benefit in such cases must be "fairly concrete" in any event.[21] The Eighth Circuit viewed the district court's indirect benefits theory as potentially broader

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[17] "Property of the estate" is defined in BC § 541.

[18] 148 Bankr. at 890-91.

[19] 148 Bankr. at 893.

[20] 152 Bankr. at 948-49.

[21] 152 Bankr. at 945. An indirect benefit would be a benefit to a third party to whom the debtor is related. In re Chomakos, 170 Bankr. 585, 590 (Bankr. E.D. Mich. 1993).

than the bankruptcy court's standard,[22] but it declined to analyze the benefits provided by the Church in terms of the value requirment because of its conclusion that the "in exchange for" requirement wasn't met in any event.

The bankruptcy court in In re Newman basically agreed with the Young courts' analysis of value. It clarified that "any economic benefit" would constitute value under section 548, regardless of whether the value is something "tangible or leviable that can be sold to satisfy the debtor's creditors' claims."[23] The tithes, the court argued, did not confer on the debtors "an enforceable property right to attend or partake in the services" offered by the Church because they would never have been able to sue the Church to obtain these services "on contract principles or even on equitable grounds such as unjust enrichment."[24]

The contrasting rationale is provided in In re Moses.[25] The bankruptcy court in Moses upheld the debtors' tithes against the trustee's challenge based upon the rationale of a non-tithing case.[26] In the earlier case, the court upheld charitable donations made at the expense of creditors by one nonprofit to

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[22] 82 F.3d at 1415.

[23] 183 Bankr. at 246-47 (citing Epstein, Nickles, and White, Bankruptcy § 6-49, at 23 (1992) for this proposition).

[24] 183 Bankr. at 247.

[25] 59 Bankr. 815 (Bankr. N.D. Ga. 1986).

[26] In re Missionary Baptist Foundation of America, Inc., 24 Bankr. 973 (Bankr. N.D. Tex. 1982).

another on the eve of the bankruptcy of the first based upon the view that goodwill and accomplishing one's mission supply the requisite value.[27] The Moses court concluded accordingly that section 548 value can be found in benefits that have no monetary equivalent.[28] The Moses court also emphasized the array of services provided by the Church to the debtors (extensive marital and other counseling, informal financial counseling related to their business, the provision of technical information for their business, and making contacts to help them find employees) as well as the cost to the Church of providing all these services (heat, air conditioning, electricity).[29] These facts aren't relevant under the court's own rationale, which eschews the need for a monetary equivalent, and its attention to them suggests that the court continued to feel the need to show value in economic terms.[30]

A few non-tithing cases brought under section 548 (or its state law counterparts) bear on the question of the nature of value in this context. Love and affection never qualify as value in determining whether a debtor has received reasonably

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[27] Missionary Baptist Foundation, 24 Bankr. at 979.

[28] 59 Bankr. at 819.

[29] 59 Bankr. at 815-16, 818-19.

[30] The Moses court also noted that there was no indication of fraudulent intent on the part of the debtors to defraud their creditors. Since intent is irrelevant in such cases, this part of the decision also shows the court's confusion or else its uneasiness with its holding.

equivalent value.[31] Thus, gifts to family and friends always fail the value test. The rationale is that love and affection are not acceptable value from the perspective of creditors because such things do not enhance the debtor's estate. That the creditors' perspective should be the touchstone of value is a premise adopted by many courts,[32] one that is consistent with the fact that the policy of protecting creditors' interests underlies section 548 taken as a whole.

Yet, despite the policy underlying section 548 as a whole, not all courts accept the "creditors' perspective" standard in determining what constitutes value, both because section 548 never stipulates that the value exchanged be "attachable or liquid" and because, as a practical matter, expenditures by a debtor for items consumed in the year preceding bankruptcy are not usually avoidable, even though they in no way enhance the debtor's estate.[33] Possibly, then, the policy underlying the

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[31] See Marine Midland Bank v. Stein, 433 NYS2d 325, 327 (1980) (stating that under the state law equivalent of section 548, love and affection are insufficient consideration as a matter of law); U.S. v. West, 299 F. Supp. at 665-66 (stating that love and affection are not adequate consideration under the state's equivalent of section 548 because the criterion must be determined from the standpoint of creditors); Walker v. Treadwell, 699 F.2d 1050 (11th Cir. 1983).

[32] See U.S. v. West, 299 F. Supp. 661, 666 (D. Del. 1964); Larrimer v. Feeny, 192 A.2d 351, 354 (Pa. 1963).

[33] See Marine Midland Bank-New York v. Batson, 332 NYS2d 714, 717 (1972). Of course, when the debtor spends money or other assets on consumption that does not create leviable assets, one may still ask if the debtor received a fair equivalent. When this happens, however, the question is whether the amount exchanged was "fair" or "reasonably equivalent," and not whether what the debtor received was really value in the first place.

gift cases is also influenced by "the notorious tendency of the spouses [and other close relatives] to aid each other in enjoying secretly reserved property interests and to be generous to each other before they are just to creditors."[34]

In a section 548 case brought by the trustee in bankruptcy against a casino to recover amounts gambled away by the debtors in the year preceding bankruptcy, the casino won. The wife had reported $9,000 in winnings to the IRS and had lost $16,710 in total losses; the husband, apparently, only lost.[35] The court adopted a "totality of circumstances" approach, listing three considerations bearing on the outcome: was the transaction arms-length; was property or value transferred to the debtor; and did the debtor receive "additional valuable benefits"?[36] In answer to the second, the court found that gambling could be seen as an "investment" with economic value because it gives the gambler the opportunity to win more money than she has bet.[37] The court also noted in this connection that the debtors "received whatever psychic and other intangible values are attendant to being at

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[34] See U.S. v. West, 299 F. Supp. at 665 (quoting from McLaughlin, Application of the Uniform Fraudulent Conveyance Act, 46 Harv. L. Rev. 404, 428 (1933)).

[35] In re Chomakos, 170 Bankr. 585, 585-86 (Bankr. E.D. Mich. 1993).

[36] 170 Bankr. at 593-94.

[37] 170 Bankr. at 593 and n.4 (noting that Ms. Chomakos could win $8,000 on a $10 bet on one machine she played and $5,000 on a $15 bet on another).

Flamingo's establishment and gambling."[38] Addressing the third consideration, the court observed that the debtor "apparently enjoyed the excitement of gambling at the Flamingo."[39] In holding for the casino, the court thus seemed to accept psychic income and entertainment as acceptable types of value for section 548 purposes.[40]

B. Measuring the Value of Spiritual Benefits

Assuming that we agree that religious or spiritual benefits should in principle be recognized as value for purposes of section 548, there remains the practical question of measuring these benefits in a concrete case to determine whether the debtor has received reasonably equivalent value. The courts are in agreement that reasonably equivalent does not require identical value.[41] The conceptual problem is thus how can we measure the value of spiritual or religious benefits at all, even as a rough approximation.

As a threshold matter, it seems that we cannot begin to apply our measuring rods until we decide from whose perspective the benefits should be measured. From the perspective of the church (its out-of-pocket costs, or perhaps these plus its lost opportunity costs when it expends its finite resources on this

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[38] 170 Bankr. at 593.

[39] 170 Bankr. at 594.

[40] Psychic value has often been accepted as legally cognizable value in the context of other statutes.

[41] Peter A. Alces, The Law of Fraudulent Transactions 5-59 (199).

congregant rather than another)? From the perspective of the open market, assuming the value of participation in religious organizations can be thus quantified (and assuming we could agree on the appropriate sub-group to establish comparables)? From the perspective of the debtor/congregant?

Even if we could agree that the benefits should be measured from the perspective of the debtor, challenging questions are raised when we try to apply this general principle.[42] For example, assume there are two couples that both attend the same church and tithe ten percent of their respective incomes. Assume that the household income of couple A is $25,000 a year and that of couple B is $250,000. Thus, couple A contributes $2,500 a year; couple B, $25,000. If both couples attend (and are entitled to attend) the same services, sit in the same pews, serve in the same official capacities (as board members, for example), and otherwise participate in the life of the church to the same degree, how shall we quantify (even approximately) the value of the benefits each couple receives?

At the lower amount for both couples (or the lowest amount that any congregant tithes at that church); at the larger amount for both couples; at the average amount for all congregants (or for all who tithe) at that church; or at the lower amount for the lower earning couple and the higher amount for the higher earning

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[42] See, for example, In re Young, 148 Bankr. at 894 ("It is highly probable that each of the members values their spiritual experience differently, if the experience can be valued at all.").

couple? Each of these alternatives creates anomalies, and thus problems of justification.

For example, it might be tempting (administratively, if for no other reason) to say that each couple can tithe ten percent of its (gross, net, or adjusted gross) income, but this suggests that a front-row pew or a Sunday service is somehow worth ten times more to couple B than couple A. This is probably false as a factual matter.[43] Further, the percentage test, by virtue of being relative to the debtor's situation may open the door to subjective measures, such as sincerity, which is unworkable. And despite its divine origin, the percentage approach contradicts what some might consider the central fact in these cases, namely, that in the decisive respect the two couples were identical: both were insolvent (or became insolvent) at the time the contributions were made and thus neither couple could afford to pay anything at all to their respective churches.

Finally, given that the benefits in question are religious, any attempt by a government official (the trustee in bankruptcy or a court) to substitute its idea of the value of these benefits for the value proposed by the debtors could well run into First Amendment problems.[44]

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[43] See In re Newman, 183 Bankr. at 247 (arguing that the spiritual value received by congregants "may not be accurately reflected by the amount of their tithe").

[44] For example, although the Eighth Circuit in In re Young did not undertake to calculate the value of the benefits received by the debtors, it did note in passing that any attempt by a court to engage in such a calculation would be "constitutionally suspect," presumably by excessive entanglement in religious

IV. THE "IN EXCHANGE FOR" REQUIREMENT

Section 548(a)(2) also requires that the debtor receive reasonably equivalent value "in exchange for" the debtor's assets transferred to a third party. Most of the courts have concluded that this requirement cannot possibly be met when a debtor tithes because the essence of tithing is that it is done "out of a sense of religious obligation and not in order to attend church (or receive a tax deduction)."[45] This principle of debtor psychology is consistent with the fact, stipulated in Young and most other tithing cases, that the churches in question would have provided the same benefits to the debtors had they not tithed.[46] Thus, as a factual matter, it appears that neither the debtor nor the donee church viewed the contributions as representing a quid pro quo.

Further, as a matter of tax law, a charitable contribution is by definition made without expectation of a benefit. In

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affairs. 82 F.3d at 1415 n.4.

[45] In re Young, 148 Bankr. at 895 ("the contributions were purely voluntary driven only by the debtors' feelings of association and goodwill"); In re Young, 152 Bankr. at 949 (the parties' stipulation that the church's support and services were available to all regardless of whether they contributed precludes finding a quid pro quo); In re Young, 82 F.3d at 1415 (same); In re Newman, 183 Bankr. at 247. The only section 548 case in which the debtor won did not discuss the "in exchange for" requirement. In re Moses 59 Bankr. 815 (Bankr. N.D. Ga. 1986).

[46] See In re Young, 82 F.3d at 1410; In re Newman, 183 Bankr. at 248. The constitution and bylaws of the church in Newman required members to tithe, but the court noted that no one had ever been expelled for not tithing and that the minister made "no effort" to learn which members were in fact tithing. 183 Bankr. at 243.

Hernandez v. C.I.R., the Supreme Court supported the Service's position that, for purposes of section 170, payments made to a charitable entity are not deductible charitable contributions if they are made in exchange for a benefit, even if the benefit is "purely religious."[47] Thus, it would appear that as a matter of law, tax law at any rate, the amounts tithed can not be treated as having been made "in exchange for" the ensuing benefits.

This outcome is not entirely satisfactory. Just eyeballing the facts, and focusing only on the BC, it seems artificial to say that the debtors gave away something for nothing in the year preceding bankruptcy. Common sense says that the debtors tithed as part of a reciprocal (mutually dependent, mutually enhancing) relationship. From a common sense perspective, the problem isn't really a lack of reciprocity. The problem is that one of the parties to the relationship is a religious entity purveying spiritual benefits and representing (ultimately) the divine will. The problem, in other words, may be our skittishness in dealing with religious matters.

Further, I believe that the factual predicate of these cases is open to question. Even granting the sincerity of the church's willingness in any specific case to welcome congregants who do not contribute to the church's financial well-being,[48] it is also

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[47] 490 U.S. 680, 692 (1989).

[48] In my experience, people can attend services at a house of worship without paying (except, perhaps, on major holidays). I am curious whether the same is true for serving on committees, the Board, and other leadership positions.

true that this generosity of spirit is predicated upon a certain (reasonably large) number of congregants in fact making contributions. In other words, my hunch is that it would be false to say that every (or most, or large numbers of) congregants could decide not to tithe and yet expect to receive the same level and type of benefits. What is true as a snapshot of one congregant in one year might not be true if that congregant generalized his behavior over many years, and would certainly not be true if substantial numbers of congregants failed to tithe over the course of many years. Thus, the mantra in these cases (that participation in the religious and other spiritual benefits available through the church is not linked to tithing) can be repeated only if we ignore the larger economic realities.

Based upon this analysis, perhaps one strategy would be for debtors in bankruptcy to introduce the expert testimony of reputable public choice theorists as to the free rider problem. They could then argue that their specific contribution in the year preceding bankruptcy was "in exchange for" the collective good of the survival of the church community (and not the specific benefits they received). Although they would also benefit from the church's survival, their private benefit would be incidental to the public benefit. This reasoning appears to overcome the Hernandez problem, but it raises the additional problem of how a court should calculate the value of a piece of a public good.

In sum, under existing precedents, debtors who tithe are not entitled to have their tithes in the year preceding bankruptcy respected because they fail the test of adequate value being exchanged in return. The Internal Revenue Code is implicated in two respects. Most importantly, if the IRC pronouncements on the meaning of "in exchange for" in the section 170 context are allowed to determine its meaning in the BC context (as is the case in several section 548 cases), the debtors' tithes will by definition be avoidable under the section 548 test. (Possibly an exception could be carved out for debtors who never claimed a charitable deduction for their tithes in the first place, thereby providing relief for the tithes of the lowest income or least informed debtors.) Second, and relatedly, the IRC pronouncements reinforce the belief that spiritual benefits shouldn't count as value. This appears to be the conceptual basis of Rev. Rul. 70-47, 1970-1 CB 49, which holds that individuals can take charitable deductions for payments to houses of worship even though they are directly linked to such things as pew rents, dues, and building fund assessments. Thus, if we assume that the two statutory regimes should be consistent, the religious taxpayer friendly expansion of section 170 rulings on the IRC side necessitates a commensurate narrowing of religious debtor friendly rulings on the BC side.

V. TITHING IN CHAPTER 13

The status of tithing in bankruptcy also arises in the context of Chapter 13. The fact pattern invariably involves a

debtor who has proposed a (three-year) plan of rehabilitation that includes tithing as one of the debtor's expenditures.

Under BC § 1325, for a debtor's plan of rehabilitation to be confirmed, it must meet the standards outlined in section 1325(a).[49] However, if the trustee or an unsecured creditor objects to the plan, an additional requirement is imposed, namely, that all of the debtor's "projected disposable income" during the duration of the plan will be used to make payments to creditors.[50] Disposable income is all of the debtor's income during that period that is "not reasonably necessary to be expended--(A) for the maintenance or support of the debtor or of a dependent of the debtor; and (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business."[51]

In the reported cases, the trustee or an unsecured creditor objects to confirmation of a plan that includes monthly amounts for tithing among the debtor's expenses. The issues raised are: (1) whether tithes to the debtor's church should be classified as "reasonably necessary for the maintenance or support" of the debtor; (2) whether such expenditures should be permitted on some other basis, for example, as being reasonable amounts for

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[49] These include that the plan complies with all relevant statutory requirements, is proposed in good faith, gives unsecured creditors at least as much as they would receive in a Chapter 7 proceeding, and affords secured creditors certain kinds of protection.

[50] BC § 1325(b)(1)(B).

[51] BC § 1325(b)(2).

recreation or entertainment; (3) whether failure to approve a plan setting aside sums for tithes because of the inclusion of tithes would violate the free exercise clause of the First Amendment; and (4) whether approval of a plan that proposed tithes would violate the establishment clause of the First Amendment. In the last two years at least one case has explored the impact of RFRA on issues (3) and (14).[52]

The majority of courts have upheld the challenge to confirmation made by the trustee or unsecured creditor. The basis of their position is that tithing should not be considered an expense necessary for maintenance or support.[53] Ultimately this holding is based upon one or more of the following beliefs. First, tithing is a wholly discretionary activity;[54] the comfort, etc. that debtors experience from tithing is not a necessity for

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[52] See In re Tessier, 190 Bankr. 396 (Bankr. D. Mont. 1995) (holding that BC § 1325 precludes tithing, that RFRA would change the outcome to favor the debtor, and that RFRA is unconstitutional).

[53] See In re Packham, 126 Bankr. 603, 610 (Bankr. D. Utah 1991) (debtors' plan included $285 a month for creditors and $217 a month for tithes, which was a twenty percent return for unsecured creditors); In re Lees, 192 Bankr. 756, 758 (Bankr. D. Mont. 1994); In re Lynn, 168 Bankr. 693, 699 (Bankr. D. Ariz. 1994).

[54] See In re Lees, 192 Bankr. at 758 (there was no showing that the Church required tithing or that the debtors would lose any privileges were they to reduce or eliminate their tithing); In re Packham, 126 Bankr. at 609 (citing In re Breckenridge, 12 Bankr. 159, 160 (Bankr. S.D. Ohio 1980). In Packham the debtors claimed they would lose the opportunity to receive a "temple recommend" if they didn't tithe. The court discounted this assertion because the debtors submmitted no evidence to support it. The court also said that it would have upheld the trustee's position even if the debtors' claim had been substantiated. Id. at 608.

their support but a voluntary choice. Second, not only did the drafters of Chapter 13 hope to maximize creditor recovery. The legislative history of Chapter 13 reveals that Congress expected "a substantial effort by the debtor to pay his debts" even if this should require "some sacrifice."[55] Confirming a plan of rehabilitation that includes tithes would thus run contrary to the expectation of effort and sacrifice contemplated by Chapter 13.[56] Moreover, since the sums spent on tithing reduce the amount paid to creditors dollar for dollar, confirming such a plan would be tantamount to forcing creditors to make a charitable contribution to the charity of the debtor's choice.[57]

Some of the courts upholding the trustee's position in Chapter 13 cases (the majority view) focus exclusively on the analysis of the BC.[58] Of the recent cases addressing constitutional issues, the consensus appears to be that the Supreme Court's 1990 holding in Smith[59] undermined any constitutional bar that may have existed to denying confirmation of Chapter 13 plans based upon the inclusion of expenses for

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[55] Packham, 126 Bankr. at 610 (citing S. Rep. No. 65, 98th Cong., 1st Sess. 22 (1983)).

[56] In re Lees, 192 Bankr. at 760; In re Packham, 126 Bankr. at 610.

[57] In re Packham, 126 Bankr. at 610; In re Lees, 192 Bankr. at 759.

[58] See In re Peckham, 126 Bankr. 603 (Bankr. D. Utah 1991).

[59] Employment Div., Dept. of Human Resources of Oregon, 494 US 872 (1990).

tithing.[60] The reason is that, by virtue of applying section 1325(b)'s disposable income provisions neutrally, for example, to all charitable contributions and not just to religious donations, the constitutional standards are not violated.[61] How the Chapter 13 issue will play out under RFRA is unclear: one court found that the more protective RFRA standards would compel the courts to confirm plans with provisions for tithing (assuming all other statutory requirements were met), but then held that RFRA was unconstitutional.[62]

V. CONCLUDING THOUGHTS

Perhaps, then, it is time to return to the rationale underlying BC 548 and examine how the Young facts fit into the larger purposes of the statute. As was noted above, the avoidance power authorized by this section is justified in terms of maximizing the estate available for distribution to creditors,

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[60] See In re Lynn, 168 Bankr. at 699; In re Lees, 192 Bankr. at 759. See also In re Cavanaugh, 175 Bankr. 369 (Bankr. D. Idaho 1994); In re Navarro, 83 Bankr. 348, 353 (Bankr. E.D. Pa. 1988) (although upholding the debtor's ability to tithe in a Chapter 13 plan, court conceded that this is not required by the Constitution as interpreted by the Supreme Court in Hobbie v. Unemployment Appeals Commission of Florida, 480 US 136 (1987)).

[61] In Smith, the Supreme Court held that the free exercise clause is not violated if individuals are not exempted from an otherwise valid, facially neutral law of general applicability even if the failure to provide an exemption interferes with the individuals' religious practices. See Smith, 494 US at 882.

[62] In re Tessier, 190 Bankr. at 403-407. See Aric D. Martin, Comments: Chapter 13 and the Tithe: Is God A Creditor?, 56 Ohio St. L.J. 307 (1995) (concluding, after a review of constitutional doctrine and RFRA, that it may still be permissible to disallow a tithe under Chapter 13 because debtors can file under Chapters 7 or 11 and lose only minimal benefits).

discouraging last minute grabbing by some creditors at the expense of others, and obstructing attempts by the debtor to defraud creditors by reducing or hiding assets on the eve of bankruptcy.

Section 548 was thus written in such a way that pure, genuinely altruistic gifts made without even a scintilla of malice towards creditors also fall under its purview.[63] Thus, a wedding gift to one's child is subject to avoidance if the other terms of the statute are met. In addition, a "bad deal" can be undone if the transferee of the debtor's assets conveyed less than reasonably equivalent value in return and the other conditions of the statute are met.[64]

The statute does not make knowledge of the inadequacy on the part of either debtor or transferee a prerequisite of the transaction being avoidable. This aspect of the statutory provision reflects the policy of maximizing the debtor's estate for the benefit of the creditors. To be precise, since secured creditors are in general protected to the extent of their liens and, thus, do not need the trustee's help, the policy at issue is

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[63] The section authorizes the trustee to avoid transactions entered into with the actual intent to defraud creditors and transactions that merely have the effect of depleting the assets of the estate.

[64] Thus, if a corporation declares a dividend in the year prior to filing for bankruptcy and is subsequently found to have been insolvent at the time or become insolvent as a result of the dividend, the trustee can avoid the dividend. It is also under this prong of section 548 that leveraged buyouts (LBOs) have been successfully challenged in bankruptcy (and outside bankruptcy under parallel state law provisions).

to maximize the estate for the benefit of unsecured creditors.[65] As was stated above, this policy is based upon the circumstance that the assets of individuals who file for Chapter 7 protection rarely are sufficient to allow unsecured creditors more than a small recovery.

Where does the tithing fact pattern fit against the policy background of this statute. If we bracket the First Amendment implications of the contributions, they would appear to be analogous to an innocent, good faith gift made in the year preceding bankruptcy. No harm is intended, but some harm is wrought. The debtor's estate is thereby reduced, and unsecured creditors are harmed. It is clear that the drafters of the BC intended to give priority to the interests of the unsecured creditors as compared with those of the donor/debtor and even the innocent donee who must unexpectedly give up what she had reason to believe was rightfully hers. Their decision can be defended on the grounds supporting the whole idea of cancellation of debts/fresh start for the debtor in the first place. The statute seeks to balance the debtor's and society's interest in letting the debtor start over with those of the (unsecured) creditors in getting repaid.[66]

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[65] Or partially secured creditors to the extent that they are undersecured.

[66] Some have argued that the unsecured creditors do not deserve our sympathy: they could have taken a security interest in some of the debtor's property and thereby protected themselves. Yet Congress clearly believe access to unsecured credit was essential for facilitating such things as small businesses. Forcing ordinary folks to enter into security

If we add back the First Amendment concepts, but bracket the First Amendment jurisprudence, the case is admittedly more difficult. I mean by this, let's assume that the values of religious freedom, freedom of expression, and freedom of association, are involved, but not to the point of being protected constitutionally. Treating these values from a policy perspective, do we want to except tithing from the reach of section 548?

With these additional values in mind, we can obviously distinguish tithing from wedding gifts. In the former case we have all of the First Amendment values, whereas in the latter we have "merely" altruism and the reasonable expectations of the innocent bride and groom. At this point it seems useful to recall that one of the elements of section 548 is that the debtor was insolvent at the time the transfer took place or became insolvent as a result of the transfer.[67]

Emphasizing this aspect of the dilemma, perhaps we should not feel too sympathetic to the Youngs and those like them, since presumably they were in a position to know they were skating on thin ice. In any event, it would not seem to be unfair to impose

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agreements with the butcher, the baker, and the phone company would impede commercial activity as well. At the other extreme, some have argued that secured credit is a burden to the economy and creates an unjustifiable preference.

[67] Insolvency means that the sum of the debtor's debts "is greater than all of such entity's property, at a fair valuation, exclusive of --(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and (ii) property that may be exempted from property of the estate under section 522 of this title."

on people who want to make gifts the responsibility for assessing their own financial condition and balancing their sincere desire to give a gift against what should be their sincere desire to repay their creditors in full. This is obviously true in the case, not only of wedding gifts, but of gifts to universities, museums, hospitals, and charities that feed the poor. The reason is that all these gifts are discretionary in the sense of luxuries, something people do after they make sure that their own children are fed, clothed, and educated.[68]

How much does the religious/free speech/free association aura affect the categorization as discretionary? And should the outcome be the same once we focus on the fact that the donors were insolvent at the time? As a policy matter, should the religious character of the gift shift it from under the heading of luxuries to the heading of necessities? Can something that is not required be a necessity? After thinking this through, I still am puzzled and look forward to hearing your thoughts.

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[68] I find this argument much more difficult to make with respect to tithing and Chapter 13 plans. Hopefully we can discuss this issue as well on Thursday.