

# RECENT DEVELOPMENT

## SERVITUDE WITHOUT SOLVENCY: THE DEBTOR'S RIGHT TO CONTINUE RELIGIOUS CONTRIBUTIONS DURING A CHAPTER 13 REHABILITATION PLAN

Few courts have decided by published opinion whether a debtor can continue to make religious contributions, commonly called tithes,<sup>1</sup> during bankruptcy.<sup>2</sup> Most of these courts have held that a bankrupt cannot continue tithing at the expense of his creditors. The court decisions rationalize that a debtor under reorganization should not be allowed to continue making religious contributions until he pays his creditors in full.<sup>3</sup> A recent case, however, not only allows tithing during a reorganization plan, but holds that tithing must be allowed to avoid interference with the free exercise clause.<sup>4</sup>

This Recent Development consists of five sections: Section I briefly discusses the free exercise and establishment clauses;<sup>5</sup> Section II describes the bankruptcy reorganization process;<sup>6</sup> Section III summarizes the reported cases disallowing tithing during reorganization; Section IV briefs the recent case allowing tithing during reorganization;<sup>7</sup> and Section V critiques this recent development.

### I. THE FREE EXERCISE AND ESTABLISHMENT CLAUSES

The first amendment of the Constitution guarantees several rights.<sup>8</sup>

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1. A "tithe" is "[a] tenth part of one's income, contributed for charitable or religious purposes." BLACK'S LAW DICTIONARY 1330 (5th ed. 1979).

2. The case law is even more paltry when one looks at each chapter of bankruptcy individually. Only two such reported cases in Chapter 7 bankruptcy exist, and only five Chapter 13 cases on tithing have been published.

3. It is nearly unheard of for an unsecured creditor to receive any amount close to one hundred percent of the debt owed her. The average amount that debtors actually pay in Chapter 13 cases is 57% (not discounted to present value). U.S. General Accounting Office, Report to the Chairman, Committee on the Judiciary, House of Representatives, Bankruptcy Reform Act of 1978—A Before and After Look 45 (1983).

4. *In re Green*, 73 Bankr. 893 (W.D. Mich. 1987).

5. The free exercise and establishment clauses derive from the first clause of the first amendment.

6. 11 U.S.C. §§ 1301-1330 (1986).

7. See *supra* note 4.

8. "Congress shall make no law respecting an establishment of religion, or prohibiting the free

The first clause of that amendment contains the religion clauses.<sup>9</sup> The free exercise clause refers to that portion of the first clause guaranteeing citizens the freedom to choose their own religion. The establishment clause prohibits the government from creating a religion.<sup>10</sup>

The free exercise and establishment clauses have wider application than their express language indicates. The modern construction of the first amendment prohibits the government from interfering with a person's religious practices unless a substantial state interest exists.<sup>11</sup> Courts construe the establishment clause to require the government to refrain from substantially advancing any religion.<sup>12</sup>

A government regulation must pass a three-prong test to avoid violating the free exercise and establishment clauses.<sup>13</sup> First, the regulation must have a secular legislative purpose.<sup>14</sup> Second, the principal effect of the regulation must neither advance nor inhibit religion. Third, the regulation must not foster an excessive entanglement with religion.<sup>15</sup>

## II. THE REORGANIZATION PROCESS

Chapter 13 of the U.S. Bankruptcy Code<sup>16</sup> offers debtors the opportunity to construct a workable plan for the payment of their debts without losing their property.<sup>17</sup> In brief, a debtor files for relief with the bankruptcy court and then submits a plan that describes how she will pay the debt.<sup>18</sup> The plan lists the debtor's income, expenses, and the surplus available to apply against the debt she owes. If the debtor makes the scheduled payments, most remaining debts disappear, or are "discharged," at the expiration of the plan.<sup>19</sup>

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exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. CONST. amend. I.

9. "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; . . ." *Id.*

10. *Green*, 73 *Bankr.* at 893.

11. *Larkin v. Grendel's Den, Inc.*, 459 U.S. 116 (1982); *Potter v. Murray City*, 760 F.2d 1065 (10th Cir. 1985).

12. *See Larkin v. Grendel's Den, Inc.*, 459 U.S. 116 (1982).

13. *Id.*

14. A secular legislative purpose generally means the regulation must have a legitimate purpose other than advancing religion. *Id.*

15. *Id.*

16. *See supra* note 6.

17. 11 U.S.C. §§ 1321-28 (1982 & Supp. III 1985).

18. 11 U.S.C. §§ 1321, 1322 (1982 & Supp. III 1985).

19. 11 U.S.C. § 1328 (1982 & Supp. III 1985).

A plan must meet numerous requirements in order for the court to confirm it.<sup>20</sup> Creditors must receive as much under the plan as they would have had the court liquidated the debtor's property and used the sale proceeds to pay off her debts.<sup>21</sup> Additionally, if a creditor objects to the plan,<sup>22</sup> the plan must provide either: (1) that the creditor will not receive his entire debt,<sup>23</sup> or, (2) that while the plan is in effect, all the debtor's "dischargeable income" will be used to pay debts.<sup>24</sup> The Code defines "dischargeable income" as all income received by the debtor not "reasonably necessary" for the support of this debtor and her dependents.<sup>25</sup>

The debtor must also propose the plan in good faith.<sup>26</sup> The Code does not specifically address the details of this requirement. Courts generally look to the plan as a whole and judge whether the debtor has proposed it in good faith in accordance with equitable principles.<sup>27</sup>

### III. COURTS DENYING CONFIRMATION OF TITHING PLAN

Courts that have denied the confirmation of Chapter 13 plans that include tithing have made that decision under two theories. Some courts have found a plan providing for tithing fails the "good faith" test,<sup>28</sup> while other courts base their holdings on the plan's failure to meet the "disposable income" test.<sup>29</sup>

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20. 11 U.S.C. § 1325 (1982 & Supp. III 1985).

21. Most commentators call this the "best interests test." 11 U.S.C. § 1325(a)(4) (1982).

22. Actually, only a creditor with an unsecured claim can object to confirmation. Because of the Code's terminology, however, *undersecured* creditors also have unsecured claims, and can therefore object to confirmation. 11 U.S.C. § 506(a) (1982). The trustee in the case can also object to confirmation. 11 U.S.C. § 1325(b)(1) (Supp. III 1985).

23. 11 U.S.C. § 1325(b)(1)(A) (Supp. III 1985). The creditor, in fact, is only guaranteed the entire amount of his claim. Although the claim usually equals the debt, certain circumstances may disallow part of the debt, thus reducing the bankruptcy claim. *See* 11 U.S.C. § 502 (Supp. II 1982).

24. This is commonly referred to as the "disposable income test." 11 U.S.C. § 1325(b)(1)(B) (Supp. III 1985).

25. 11 U.S.C. § 1325 (b)(2)(A) (Supp. III 1985). Disposable income does not include amounts used for the "continuation, preservation and operation" of a business. 11 U.S.C. § 1325(b)(2)(B) (Supp. III 1986).

26. 11 U.S.C. § 1325(a)(3) (1982).

27. *See In re Breckenridge*, 12 Bankr. 159, 160 (S.D. Ohio 1980); *In re Cook*, 3 Bankr. 480 (S.D. W. Va. 1980).

28. *See supra* note 26.

29. *See supra* notes 24-25.

### A. *Good Faith Test*

Whether a debtor proposed a plan in good faith cannot be determined by a static test. Courts usually judge "compliance with the requirement based upon the overall picture presented by the debtors' Chapter 13 statement and plan."<sup>30</sup> Courts have used several arguments in finding that a plan fails the good faith requirement.

The court in *In re Breckenridge* denied confirmation of a Chapter 13 plan donating nearly one-half of the debtor's disposable income<sup>31</sup> to his church.<sup>32</sup> Because the plan allowed the debtor to retain "imprudently purchased assets" and provided for a tithe of almost one-half of the debtor's net income, the court found a lack of good faith and denied confirmation.<sup>33</sup>

*In re Curry*<sup>34</sup> presents a unique case in which the court combined the two prevalent arguments and found a plan failed the good faith test because it failed the "disposable income" test.<sup>35</sup> After noting that the plan tithed half of the debtor's disposable income to his church, the court stated, "[g]ood faith requires, at least, that the debtor is willing to pay to the trusts for the benefit of his creditors all of his disposable income after provision for his necessary and reasonable living expenses. . . . A charitable contribution . . . does not constitute a reasonably necessary living expense."<sup>36</sup>

### B. *The Disposable Income Test*

Courts also deny confirmation to Chapter 13 plans that include tithing because they fail to pass the disposable income test. The Code requires

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30. *Breckenridge*, 12 Bankr. at 160.

31. The plan provided for payment of only 10% of the amount owed unsecured creditors. *Id.* at 159. Without the tithe, the plan would have provided unsecured creditors more than 70% of their claims (these figures do not represent payments discounted to present value).

32. *Id.*

33. *Id.* at 160.

34. *In re Curry*, No. 87-02256 slip op. (Bankr. S.D. Fla. Aug. 20, 1987).

35. See *supra* notes 24-26. Although the good faith and disposable income standards remain separate tests, the *Curry* court seemed to hold that the good faith test requires, at a minimum, compliance with the disposable income test. *Curry*, No. 87-02256, slip op. (Bankr. S.D. Fla. Aug. 20, 1987).

36. *Id.* See also *In re Taff*, 10 Bankr. 101, 107 (D. Conn. 1981) ("the appropriate amount to be set aside for the debtor ought to be sufficient to sustain basic needs, not related to his former status in society or the lifestyle to which he is accustomed."); *In re Tinneberg*, 59 Bankr. 634 (E.D.N.Y. 1986).

the debtor to pay all disposable income to his creditors.<sup>37</sup> Disposable income equals a debtor's gross income less reasonably necessary living expenses for the debtor and the debtor's dependents.<sup>38</sup>

The debtor in *In re Sturgeon*<sup>39</sup> scheduled ten percent of her gross income as a tithe in her chapter plan.<sup>40</sup> The court found, as a matter of law, the tithe was not a necessary living expense.<sup>41</sup> The plan did not distribute all disposable income to creditors, and thus precluded court confirmation.<sup>42</sup>

#### IV. CONFIRMATION OF A TITHING PLAN

Only one reported case, *In re Green*,<sup>43</sup> has allowed a Chapter 13 debtor to tithe during the life of the plan.<sup>44</sup> In *Green*, the debtor devoted ten percent of her gross income each month to her church in accordance with the church's doctrine.<sup>45</sup> An unsecured creditor<sup>46</sup> objected to confirmation of the debtor's plan.

The objecting creditor argued that confirmation of a plan including tithing advanced religion and therefore violated the establishment clause.<sup>47</sup> The creditor claimed confirming a tithing plan would favor religions that required tithing over those that did not, and favor debtors who tithed over those who did not.<sup>48</sup>

Before considering the constitutional issue, the *Green* court considered other cases addressing the tithing question. Because the creditor did not object to the "reasonableness" of the debtor's plan, the *Green* court did

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37. See *supra* notes 24-25.

38. 11 U.S.C. § 1325(b)(2) (Supp. III 1985).

39. *In re Sturgeon*, 51 Bankr. 82 (S.D. Ind. 1985).

40. *Id.* at 83. The tithe was one hundred and forty dollars per month.

41. *Id.* at 84.

42. After an objection to confirmation by a creditor or trustee, a court cannot confirm a plan that does not meet the disposable income test. 11 U.S.C. § 1325(b)(1) (Supp. III 1985).

43. See *supra* note 4 and accompanying text.

44. At least two cases, however, have allowed tithing in Chapter 7 proceedings. *In re Gaukler*, 63 Bankr. 224 (D.N.D. 1986); *In re Edwards*, 50 Bankr. 933 (S.D.N.Y. 1985).

45. The amount of the tithe was \$140 per month. Without the tithe, the plan would have paid the unsecured creditors 50% of their claims. After payment of the tithe, however, those same creditors received only 17% of the amount the debtor owed to them (These figures do not represent payments discounted to present value).

46. The unsecured creditor in this case, the State of North Dakota, sought to recover on the debtor's defaulted student loans.

47. See *supra* notes 9-10 and accompanying text.

48. *Green*, 73 Bankr. at 893.

not find the cases disallowing tithing, such as *Sturgeon*<sup>49</sup> and *Breckenridge*,<sup>50</sup> relevant.<sup>51</sup>

The court then applied the *Lemon v. Kurtzman* three-prong test<sup>52</sup> to determine if a tithing plan violated the establishment clause.<sup>53</sup> The court found that the relief of debtors from burdensome debts was the Bankruptcy Code's secular legislative purpose, thereby satisfying the first prong. Second, the *Green* court noted the government did not advance religion by allowing tithing under the Code because the tithe came from the debtor, and not the government. Finally, the court decided that because the government did not become involved in the tithe, the last prong of the test was satisfied; there was no excessive entanglement.<sup>54</sup> Because the tithing plan satisfied the three-prong test, the court did not violate the establishment clause by confirming the plan.<sup>55</sup>

Conversely, the *Green* court held that a denial of confirmation of the plan solely because of the tithe would violate the free exercise clause.<sup>56</sup> The court based its rationale on an unemployment case.<sup>57</sup> In that case, a convert to a religion that did not allow work on Fridays and Saturdays informed her employer she would no longer work on those days. The employer fired the convert, and she applied for unemployment compensation. The compensation board denied the benefits, deciding refusal to work constituted misconduct. The United States Supreme Court reversed the Board's decision, and held that forcing a person to make an election between her religion and a government benefit put too great a burden on the freedom of religion.<sup>58</sup> The *Green* court stated that by

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49. See *supra* notes 39-42 and accompanying text.

50. See *supra* note 27.

51. Judge Howard, writing for the court, criticized courts that disallowed tithing in Chapter 13. Since the State is not challenging the reasonableness of the confirmed plan, the Court does not believe that the case of *In re Sturgeon*, [citation omitted], is relevant. The *Sturgeon* opinion does not address the constitutional questions involved. . . . *Sturgeon* presents the unfortunate situation of a judge evaluating the religious beliefs and practices of debtors without seeking any guidance from the large body of first amendment case law. This criticism applies equally well to two other cases which have considered the question of tithing, and for that reason the court rejects them also. (citing *Breckenridge* and *In re Cadogan*, 4 Bankr. 598 (W.D. La. 1980) (dismissed on other grounds)).

*Green*, 73 Bankr. at 894 n.1.

52. See *supra* notes 13-15 and accompanying text.

53. See *supra* notes 9-10 and accompanying text.

54. *Green*, 73 Bankr. at 895.

55. *Id.*

56. *Id.*

57. *Hobbie v. Unemployment Appeals Commission of Florida*, 107 S.Ct. 1046 (1987).

58. *Id.* at 1049.

analogy forcing a debtor to choose between bankruptcy relief and tithing placed a similar burden on the free exercise clause that only a "compelling state interest" could justify. There was no compelling state interest here.<sup>59</sup>

## V. CRITIQUE OF *IN RE GREEN*

The *Green* court erred both by finding it constitutionally necessary to allow tithing in a Chapter 13 plan, and by improperly applying the "disposable income" test.

### A. *The Constitutional Question*

In *Green*, the court held that to disallow tithing under a reorganization plan violates the free exercise clause because it conditioned an important government benefit, bankruptcy relief, on the debtor abandoning her religious beliefs.<sup>60</sup> The *Green* opinion, however, acknowledged that tithing could be disallowed if a compelling governmental interest existed.

Such a compelling government interest does exist in a Chapter 13 reorganization. "[T]he purpose of Chapter 13 is to provide the maximum recovery to creditors while at the same time leaving the debtor sufficient money to pay his or her basic living expenses."<sup>61</sup> The government's compelling interest is to achieve the purpose of Chapter 13. Maximizing the creditor's recovery by disallowing tithing is essential to achieve that purpose.<sup>62</sup>

Even if no compelling government interest did exist, courts could still disallow tithing in Chapter 13 plans without offending the free exercise clause. The *Green* decision rested on the theory that a debtor would not have adequate bankruptcy relief unless she abandoned her religious belief of tithing.<sup>63</sup> A debtor, however, has forms of bankruptcy relief other than Chapter 13 available to her.

A debtor wishing to tithe can seek bankruptcy relief under Chapter 7.<sup>64</sup> In Chapter 7, the court liquidates most of the debtor's property and

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59. *Green*, 73 Bankr. at 896.

60. *Id.*

61. *In re Jones*, 55 Bankr. 462, 466 (D. Minn. 1985).

62. If the court disallows tithing, any amount allocated in the plan for tithing then becomes available for distribution to the creditors. See *Green*, 73 Bankr. at 893-94.

63. See *supra* note 59.

64. 11 U.S.C. §§ 701-766 (Supp. III 1985).

applies the proceeds toward satisfaction of her debts.<sup>65</sup> Subsequent to liquidation, the court forgives, or "discharges," any remaining debts.<sup>66</sup> Since Chapter 7 does not use the disposable income test,<sup>67</sup> a debtor can continue to tithe while receiving Chapter 7's benefits. Because the Code does not deny bankruptcy relief to a debtor wishing to tithe, disallowing tithing in a Chapter 13 plan does not violate the Free Exercise Clause.

### B. *The Disposable Income Test*

The *Green* court erred in failing to apply the disposable income test.<sup>68</sup> Because no creditors objected to the tithe in the debtor's plan, the court decided the "reasonableness" of the plan was not at issue.<sup>69</sup>

The Bankruptcy Code does not require creditors to object to any particular item within a plan. If, however, a creditor<sup>70</sup> *does* object to the confirmation of the plan,<sup>71</sup> the court *must* apply the disposable income test.<sup>72</sup>

"Disposable income" equals all income received by the debtor less the amount "reasonably necessary ... for the maintenance or support of the debtor or a dependent of the debtor."<sup>73</sup> A tithe does not contribute to

65. 11 U.S.C. §§ 704(1), 726 (Supp. III 1985).

66. Certain debts, usually those involving fraud or unfair dealing, can be denied discharge by the court. 11 U.S.C. §§ 523, 727 (1982 & Supp. III 1985).

67. *See supra* notes 24-25. Generally, the court will grant Chapter 7 relief unless there is "substantial abuse" of the process. 11 U.S.C. § 707(b) (1986). Substantial abuse usually occurs with high-income, low asset debtors, who want to discharge debts while sacrificing very little property and without additional payment of their debts. *See also* Corish & Herbert, *The Debtor's Dilemma: Disposable Income as the Cost of Chapter 13 Discharge in Consumer Bankruptcy*, LA. L. REV. 47 (1986); *supra* note 44.

68. *See supra* notes 24-25.

69. *Green*, 73 Bankr. at 894.

70. Not every creditor can object to confirmation. *See supra* note 22.

71. 11 U.S.C. § 1325(b)(1) (Supp III 1985).

72. The court can not refuse to apply the test. *See supra* note 42. The *Green* court discusses the reasonableness of the proposed plan several times. 73 Bankr. at 893, 894 n.1. Chapter 13 does not require a plan to be reasonable. 11 U.S.C. § 1301 (1986).

73. 11 U.S.C. § 1325(b)(2) (Supp. III 1985). It is well settled that the disposable income test prohibits charitable contributions. *See, e.g., In re Red*, 60 Bankr. 113 (E.D. Tenn. 1986) (disallowing \$1.50 per week charitable contribution). "The courts have universally ruled that, if charity begins at home, it ends with bankruptcy." Corish & Herbert, 47 LA. L. REV. at 74. Tithing is, in effect, a charitable donation and should similarly be disallowed.

When a debtor tithes, it does not cost him anything because without the tithe, the plan would distribute the money to the bankrupt's creditors. 11 U.S.C. § 1325(b)(1) (Supp. III 1985). Thus, in effect, the creditors involuntarily tithe to the debtor's church if a Chapter 13 plan allows tithing. *See* Corish & Herbert, 47 LA. L. REV. at 72. The Author believes that Congress could not possibly have contemplated such an inequitable result.

the maintenance or support of the debtor or her dependents.

The court cannot exercise discretion in applying the disposable income test. If a creditor objects, "the court *may not* approve the plan unless the test is met."<sup>74</sup> The *Green* court, therefore, erred by choosing not to apply the disposable income test to the debtor's plan after the creditor's objection to confirmation. If the court had properly applied the test, the tithing provision would have prevented confirmation of the plan.

## VI. CONCLUSION

A debtor generally cannot continue religious tithing during a Chapter 13 plan. Nevertheless, the *Green* case decided that to deny confirmation of a plan permitting tithing violates the free exercise clause. Denying confirmation, however, does not create a free exercise violation because a compelling state interest justifies interfering with religious freedom, and a tithing debtor can obtain other forms of bankruptcy relief.

Furthermore, the *Green* court exercised its discretion in not applying the Chapter 13 disposable income test to the debtor's plan. The Code does not give courts discretion in applying this test. If the court had properly applied the test, the debtor's plan could not have been confirmed.

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74. 11 U.S.C. § 1325(b)(1) (Supp. III 1985) (emphasis added in text). *See also supra* note 2.

