

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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GALEN P. REYNOLDS  
JENNIFER M. REYNOLDS

Bankruptcy No. 99-02132-C

*Debtor(s).*

Chapter 7

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### ORDER RE U.S. TRUSTEE'S MOTION TO DISMISS

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This matter came before the undersigned on October 13, 1999 on U.S. Trustee's Motion to Dismiss. Debtors Galen and Jennifer Reynolds appeared with their attorney, David Nadler. John Schmillen appeared for the U.S. Trustee. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A).

### STATEMENT OF THE CASE

U.S. Trustee requests an order dismissing the case for "substantial abuse" under 11 U.S.C. §707(b). Debtors resist. They assert they do not have the ability to pay debts from future income.

### FINDINGS OF FACT

Debtors' Schedule I discloses \$4,035 of current monthly income. Schedule J discloses \$3,487.44 of current expenditures. This indicates Debtors have \$547.56 of disposable income. The apparent availability of disposable income, among other things, prompted the U.S. Trustee to question whether Debtors' Chapter 7 case should be dismissed for substantial abuse under §707(b).

Debtors respond that Schedules I and J show current, rather than projected or future, income and expenses. Mrs. Reynolds' wages fluctuate because she works as needed, averaging 35.8 hours per week at \$9.70 per hour. Debtors assert that Mr. Reynolds' current income is not representative of his projected income. He earns \$15.00 per hour. He testified that his work for a collision center is seasonal. Mr. Reynolds has worked significant overtime in the past two or three years which he states he will no longer be able to sustain. This year Mr. Reynolds has averaged 68 hours work per week. Debtors estimate his future income based on a 40-hour work week. They assert he cannot go on working longer hours because his marriage is deteriorating and he rarely sees his children.

Mr. Reynolds testified that Debtors received tax refunds of \$5,000 in 1998 and expect a similar refund for the 1999 tax year. This indicates that Debtors have been overwithholding for income taxes at the rate of approximately \$400 per month. Presumably their tax refund in 1999 would be less if Mr. Reynolds cuts back on his overtime hours.

According to Debtors, certain unexpected expenses have arisen which are not reflected in Schedule J. These include \$1,700 for repair of Mrs. Reynolds' truck; \$348 for Debtors' son's dental work; and an unknown amount for Mr. Reynolds' dental work and for their sons' allergy and ADHD treatments. Debtors also need a new roof with an estimated cost of \$4,660.

Debtors have unsecured debt of \$9,347. They owe back property taxes of \$2,680. They also owe \$51,000 secured by their home and \$9,540 secured by a vehicle. Debtors are paying Mrs. Reynolds' stepmother, Jaci Chess, \$150 a month on an unsecured loan which has a balance due of approximately \$1,232. Debtors are also paying \$150 a month on a \$20,000 real estate contract they entered into on June 30, 1999 for an acreage in Benton County where they hope to live in the future. Debtors filed their Chapter 7 petition on August 11, 1999.

## CONCLUSIONS OF LAW

Section 707(b) of the Bankruptcy Code provides that:

the court, on its own motion, or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under [chapter 7] whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of [chapter 7]. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b). "Substantial abuse" is not a defined term. In the Eighth Circuit, "[a] Chapter 7 debtor's ability to fund a Chapter 13 plan 'is the primary factor to be considered in determining whether granting relief would be substantial abuse.'" In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997); In re Walton, 866 F.2d 981, 983 (8th Cir. 1989). The Eighth Circuit has declined to adopt the "totality of circumstances" approach. In re Harris, 960 F.2d 74, 77 (8th Cir. 1992). A debtor's "substantial ability to pay creditors standing alone warrants dismissal of a Chapter 7 petition for substantial abuse." Koch, 109 F.3d at 1288; Harris, 960 F.2d at 76. Egregious conduct is not a required element of substantial abuse dismissal. Harris, 960 F.2d at 76.

## PRIMARILY CONSUMER DEBTS

Debtors argue their debts are not primarily consumer debts under §707(b). They state the debts secured by real estate and their property tax debt are not consumer debts. These constitute more than half of their total debt. The Court finds that Debtors' assertion is contrary to existing law.

In determining whether a debt is a consumer debt, the courts look to see the purpose for which the debt was incurred. In re Palmer, 117 B.R. 443, 446 (Bankr. N.D. Iowa 1990). If the credit transaction involves a profit motive, it is not a consumer debt. Id. Section 101(8) defines consumer debt as debt incurred "primarily for a personal, family or household purpose". Not all courts are in agreement about whether debts secured by real property are consumer debts. See In re Bertolami, 235 B.R. 493, 495 (Bankr. S.D. Fla. 1999). This court as well as a majority of the courts considering the question, however, have concluded that debts incurred to purchase, finance, or improve a home are consumer debts. Palmer, 117 B.R. at 447; In re Kelly, 841 F.2d 908, 912 (9th Cir. 1988); Bertolami, 235 B.R. at 497.

The debts involved in this case are primarily consumer debts under §707(b), including the debts secured by real estate. They were obviously incurred primarily for a personal, family or household purpose.

## ABILITY TO PAY

For §707(b) purposes, ability to pay creditors is measured by evaluating Debtors' financial condition in a hypothetical Chapter 13 proceeding. Koch, 109 F.3d at 1288. Confirmation of Chapter 13 plans requires, if an objection to confirmation is advanced, that the plan provide that all of the debtors' projected disposable income to be received during a three-year plan will be applied to plan payments. 11 U.S.C. §1325(b)(1)(B). "Disposable income" is income not reasonably necessary for support of the debtors, debtors' dependents or debtors' business. 11 U.S.C. §1325(b)(2). Evaluating Debtors' ability to fund a Chapter 13 plan necessitates a review of Debtor's disposable income.

Revenues received from exempt sources during the life of a Chapter 13 plan are "income," the disposable portion of which must be paid to unsecured creditors if the plan is to be confirmed. Koch, 109 F.3d at 1289. This court has held that regular tax refunds should be taken into account in this analysis. In re Nelson, No. 97-03710S, slip op. at 5-6 (Bankr. N.D. Iowa March 1998), aff'd, 223 B.R. 349 (B.A.P. 8th Cir. 1998). An analysis of projected disposable income necessarily considers the amount of the debtor's current income tax withholdings and whether any tax refund will be generated. In re O'Brien, 181 B.R. 71, 76 (Bankr. D. Ariz. 1995).

Including a cushion for emergencies or general maintenance in debtors' schedule of expenses may be appropriate if it is not excessive and is sufficiently evidenced in the record. In re Smith, 222 B.R. 846, 859 (Bankr. N.D. Ind. 1998). Treating payment for nonessential assets as expenses, however, operates to the detriment of unsecured creditors and violates the disposable income requirement. In re Kasun, 186 B.R. 62, 65 (Bankr. E.D. Va. 1995). Payments on a 40-acre parcel of non-income producing investment real property was not necessary for the support of the debtors or their dependants and was considered a violation of the disposable income requirement in In re Lindsey, 122 B.R. 157, 158 (Bankr. M.D. Fla. 1991).

Debtors assert that the disposable income analysis should not include overtime pay received by Mr. Reynolds in the past. Courts are divided when considering whether earnings from second jobs or overtime hours should be factored into a determination of "ability to pay" under §707(b). See In re Killough, 900 F.2d 61, 65 (5th Cir. 1990); In re Attanasio, 218 B.R. 180, 214 (Bankr. N.D. Ala. 1998). In In re Helmick, 117 B.R. 187, 190 (Bankr. W.D. Pa. 1990), the court found that debtor had presented no evidence explaining why a job transfer would drastically reduce overtime hours. In In re Laury-Norvell, 157 B.R. 14, 17 (Bankr. N.D. Ohio 1993), the court denied a §707(b) motion to dismiss. The debtor had previously worked "an inordinate amount of overtime and double shifts to the detriment of her health". Id. The court found credible and uncontroverted the debtor's testimony that she would not be capable of working such a substantial number of hours in the future. Id.

Based on the foregoing, Debtors' tax refunds must be included as disposable income for purposes of determining Debtors' ability to pay under §707(b). Debtors received \$5,000 in tax refunds in 1998. This amount is includable as part of Debtors' disposable income. As to unexpected expenses, Debtors have documented a total of approximately \$7,200 for truck and home maintenance and for dental and medical expenses. The Court will consider this amount when determining whether Debtors have sufficient disposable income to fund a Chapter 13 Plan. Delinquent and future real estate taxes also constitute necessary expenses.

As to Mr. Reynolds' income from overtime pay, it is reasonable to exclude income from overtime hours from disposable income if it is speculative or uncertain, or where a debtor is forced to work overtime prepetition to satisfy burdensome debt payments. The record indicates that Mr. Reynolds has a lengthy history of working overtime; two or three years, at least. Debtors assert he cannot continue

because of the effect it has on his marriage and his children. Debtors' Exhibit C shows that in 1999, Mr. Reynolds sometimes worked more than 80 hours a week and usually worked more than 60, averaging 68 hours a week over the year through September 9, 1999.

Debtors assert that there is more work in the spring and summer because of the seasonal nature of the work performed at the collision center. This is not supported by the printouts in the record of Mr. Reynolds wages since mid-1998. The Court concludes that Mr. Reynolds has a history of working more than 40 hours a week. It appears overtime hours are available to him on a fairly regular basis although the weekly amount of overtime fluctuates. A reasonable conclusion to be drawn from the available data is that Mr. Reynolds has in the past and will continue in the future to work overtime. However, the recent hours of 80 per week is unsustainable. Reality would indicate that Mr. Reynolds' income should be based on a 55 hour work week which has a historical base and is reasonably sustainable.

### INCOME AND EXPENSES

Based on the foregoing, the Court has calculated Debtors' income and expenses for purposes of the "ability to pay" analysis under §707(b). This establishes the amount of Debtors' disposable income for purposes of determining whether they could fund a hypothetical Chapter 13 plan. The Court notes that Debtors have presented several different versions of their income and expenses, including Schedules I and J, a letter to the U.S. Trustee dated September 14, 1999, testimony and exhibits, and Debtors' Brief filed October 25, 1999. Debtors changing numbers present for consideration an illusive "shifting target". The continual changes in income and expenses casts some doubt on the credibility of the entire financial picture.

The Court has compared Debtors' Schedules I and J with the numbers set out in Debtors' post-trial brief. Debtors have miscalculated state withholding tax in their estimate of Mrs. Reynolds' net pay. See U.S. Trustee's Exhibit 2, page 2. The Court is providing for Debtors' established, unexpected expenses of \$7,200 as a separate line entry. These include roofing, auto repair, and dental and medical expenses. Debtors have not shown that future property taxes will be more than the \$76 per month set out in their original Schedule J. The \$150 payment to Jaci Chess is not a necessary expense because she is an unsecured creditor who would be paid from plan payments in a Chapter 13 case.

Debtors list the \$150 monthly payment for the Benton County acreage as an expense on Schedule J. This is a payment under a real estate contract. Debtor's Exhibit G. Real estate contracts in Iowa are executory contracts under §365. In re Bockes Brothers, Inc., Adv. No. 93-60881KW, slip op. at 1-2 (Bankr. N.D. Iowa Apr. 4, 1994); In re Cochran, No. 92-12082LC, slip op. at 4 (Bankr. N.D. Iowa Mar. 30, 1993), relying on Brown v. First Nat'l Bank, 844 F.2d 580, 582 (8th Cir.); In re Hill, No. C 86-0115, slip op. at 3 (N.D. Iowa Jan. 14, 1987). The provisions of §365 govern treatment of executory contracts, allowing Chapter 13 debtors to accept or reject such contracts. In re Osborne, 170 B.R. 367, 370 (Bankr. M.D. Tenn. 1994). A debtor's acceptance of a real estate contract in a Chapter 13 plan is not an absolute right, however. Courts have refused to allow Chapter 13 debtors to assume or reject an executory contract where it produces no benefit to creditors or indicates bad faith. 1 Keith M. Lundin, Chapter 13 Bankruptcy §§4.88, 4.95 (2d ed. 1997).

Without deciding the issue, the Court assumes that, in a hypothetical Chapter 13 case, Debtors would elect to accept the executory contract at issue. They would continue making payments on the real estate contract and retain their interest in the Benton County real estate. The Court is of the opinion that Debtors' real estate contract payment is not a necessary expense for the purposes of a disposable

income analysis. For the sake of argument, however, the Court will include it as a monthly expense below.

Based on the foregoing, the Court makes the following conclusions regarding Debtors' disposable income:

<u>Monthly Income</u>	
Mrs. Reynolds' net pay (35.8 hours/week):	\$1,070
Mr. Reynolds' net pay (55 hours/week):	2,320
Income tax refund/overwithholding	
(approx. \$5,000/year):	400
<u>Total Monthly Income:</u>	<u>\$3,790</u>
<u>Monthly Expenses</u>	
Home mortgage payment	\$ 710
Utilities	221
Home maintenance (repairs and upkeep)	50
Food	600
Clothing	50
Laundry	30
Medical and dental expenses	25
Transportation	240
Recreation, entertainment, etc.	70
Insurance	110
Taxes, real estate	76
Auto installment payment	420
Real estate contract payment	150
Other (daycare, school expenses, etc.)	435
Unexpected expenses (roof/auto maintenance,	
medical/dental; \$7,200 in 36 monthly payments)	200
<u>Total Monthly Expenses:</u>	<u>\$3,387</u>
<u>Disposable monthly income</u>	<u>\$ 403</u>

In arriving at this amount, the Court feels that it has given Debtors a liberal interpretation and the benefit of the doubt in questionable areas. Even so, the Court concludes that Debtors have the ability to fund a Chapter 13 plan over three years with payments of \$403 per month, which totals \$14,508. This amount would substantially pay the priority property tax claim of \$2,680, unsecured debt of \$9,347.12, trustee fees, estimated attorney fees and a Chapter 13 filing fee. With payments of \$403 per month, a fair evaluation of this record would indicate that Debtors could pay 100% of these amounts in 37 months. Debtors have the ability to fund a Chapter 13 plan. Their ability to pay creditors standing alone warrants dismissal of their Chapter 7 petition for substantial abuse.

**WHEREFORE**, U.S. Trustee's Motion to Dismiss is SUSTAINED.

**FURTHER**, Debtors are given 10 days from the date of this ruling to file a motion to convert to Chapter 13, if they wish to do so.

**FURTHER**, if Debtors do not convert to Chapter 13 within 10 days, this case will be dismissed without further notice or hearing.

**SO ORDERED** this 3rd day of November, 1999.

Paul J. Kilburg  
Chief Bankruptcy Judge