

In the United States Bankruptcy Court

for the Northern District of Iowa

HARTSEL SHIRLEY JR.
GINGER SHIRLEY
Debtor(s).

Bankruptcy No. 99-02365-W

Chapter 7

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

This matter came on for hearing on December 22, 1999 pursuant to assignment. The matter before the Court is the U.S. Trustee's Motion to Dismiss. Debtors Hartsel and Ginger Shirley appeared with their attorney, Cathy Fitzmaurice. Janet Reasoner appeared for the U.S. Trustee. Evidence was presented and the matter was taken under advisement. 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 seeks an order of dismissal based upon "substantial abuse" pursuant to 11 U.S.C. §707 (b). Debtors resist asserting that they do not have the ability to pay debts from future income.

FINDINGS OF FACT

Debtor Hartsel Shirley, Jr. has been employed by O'Neal Steel for 26 years as a supervisor. His original Schedule I, as well as amended Schedule I, lists \$3,253.38 as monthly gross wages. In addition to standard payroll taxes and social security, Debtor deducts payments for a 401K plan, a tax payment for delinquent taxes, and a modest charitable contribution to United Way. However, Debtor's gross wages for calendar year 1998 were listed on his W-2 in the amount of \$49,415.67. (Exhibit 7) After deducting taxes, social security, medicare and State income tax withholding, Debtor Hartsel Shirley had net income of \$35,855.24 or \$2,988 per month take-home pay if 401K payments, income tax repayment, and United Way were not considered.

At the time of filing, Debtors had a substantial tax delinquency. Mr. Shirley testified that they owed approximately \$8,000 in Federal taxes. In the initial Schedule I, Debtors listed tax payments of \$300 per month which were applied toward this delinquency. However, substantial payments have been made since the time of filing and now there is a total owing in delinquent taxes of \$1,450. In the amended Schedule I filed in this matter, Debtors no longer specify a monthly payment for delinquent taxes. Debtors received a Federal tax refund of \$589 for taxable year 1998.

In the initial Schedule I, Debtors list a payroll deduction of \$185 for a 401K loan repayment. Mr. Shirley has a 401K plan at his employment. At one time, this account totaled \$8,000. Over time, he has borrowed \$7,000 from this account. In his original Schedule I, he listed a repayment toward this loan of \$185. However, the amended Schedule I now reflects a payment of \$370.86 per month. He

testified that the initial payment was in error because this was the amount withheld bi-weekly. He testified that the correct monthly loan repayment to this 401K plan is \$370.86. Debtor characterizes this loan repayment as a secured obligation.

Mrs. Shirley is employed at the John Deere Foundry and is a relatively new employee. She has been earning \$1,700 per month in gross income since August of 1999. She was initially hired as an hourly employee at a rate of \$10.38 per hour. This was later changed to a salary based upon incentives. Commencing in July of 1999, she was offered and accepted a job in the office as a salaried employee. This job will remain until August of the year 2000 when she will return to being an hourly employee. She testified that as a new hire, there is no limit on the number of times that she can be laid off during the course of a year. She testified that she was laid off seven times during 1999. If she is laid off, she is entitled to \$200 per week in unemployment benefits though there are certain restrictions and limitations on these benefits. Mrs. Shirley lists current gross income of \$1,732.01 per month with a net take home of \$1,249.63. The U.S. Trustee does not dispute the accuracy of Mrs. Shirley's income declarations.

In summary, therefore, Mr. Shirley's net income without deduction for repayment of the 401K plan, repayment of delinquent taxes, and withdrawal for charitable deductions, is approximately \$2,987 per month. Mrs. Shirley's net disposable income on her amended Schedule I is \$1,249. This leaves a total disposable net income of approximately \$4,236 per month which is substantially more than that declared on the amended Schedule I.

Debtors claim monthly expenses of \$2,887.94. The U.S. Trustee has brought into question the reasonableness of certain of these expenses. Debtors claim average monthly telephone bills of \$90. Debtors explained that their daughter is a student in Des Moines and they live in Waterloo. The majority of the telephone bills are long distance bills in communicating with their daughter. Debtors have a monthly cable bill of \$49.52. They pay support for their daughter in college of \$200 per month. She is over the age of 18 and there is no specific Court order directing payment of this amount. Mr. Shirley explained that these are funds used for living expenses above and beyond those associated with college costs.

Debtors have total secured debt in the amount of \$59,942.66. This consists of a first and second mortgage on the parties' home in Waterloo, Iowa. The remaining secured debt relates to automobiles owned by Debtors. The mortgage payments and payments on the secured automobiles is included in Debtors' Schedule J. As previously discussed, Debtors have reduced their delinquent tax obligations substantially. They have listed, in their Schedule E, an obligation owing to the IRS in the amount of \$2,500. However, the testimony at hearing indicates that this has been reduced to approximately \$1,450. Finally, Debtors have total scheduled unsecured debt of \$11,018.09.

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.

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

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).

Based on the foregoing, Debtors' tax refunds must be included as disposable income for purposes of determining Debtors' ability to pay under §707(b).

INCOME AND EXPENSES

Based on the foregoing, the Court has calculated Debtors' income expenses for the 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. As indicated, Mr. Shirley's income is substantially understated on the amended Schedule I. Based on the numbers presented, Mr. Shirley earns approximately \$39,040 per year. However, his W-2 form for calendar year 1998 reflects gross income of \$49,415.67. His interim earnings report for calendar year 1999 (Exhibit 8) establishes a projected income in excess of that figure. Based on the 1998 figures, Mr. Shirley has net disposable income, not including deductions to be discussed hereafter, of \$2,987.52. In conjunction with Mrs. Shirley's income of \$1,249, Debtors have net income of \$4,236 per month.

Mr. Shirley has deducted from his Schedule I a payment toward repayment of a 401K plan loan, a tax payment for unpaid Federal taxes, and a payment to United Way. The United Way deduction is not in dispute. On his amended Schedule I, Mr. Shirley eliminated the tax payment as a monthly deduction. Any residual amount owed to the IRS or the State of Iowa could be payable through a Chapter 13 plan. The real matter at issue in these deductions involves the repayment of a loan from Debtor's 401K plan. Debtor had approximately \$8,000 in this 401K plan. He has borrowed approximately \$7,000 from this plan. On his amended Schedule I, Debtor deducts \$370.86 per month designated as

"401K loan repayment". Debtors designate this obligation as a secured obligation. However, an examination of the case law reflects that not only does the case law not recognize such a repayment as a secured obligation, it does not recognize this repayment as a debt. This conclusion and a compilation of recent cases is concisely stated as follows:

The case law is fairly uniform in holding that voluntary contributions to pension, savings and investment type plans and accounts are not reasonably necessary for a debtor's support and maintenance during the three to five year term of a Chapter 13 plan. In re Harshbarger, 66 F.3d 775 (6th Cir. 1995); In re Anes, 216 B.R. 514 (Bankr. M.D. Pa.1998); In re Fulton, 211 B.R. 247 (Bankr. S.D. Ohio 1997); Rothman, 204 B.R. at 157-58; In re Cornelius, 195 B.R. 831, 835 (Bankr. N.D.N.Y. 1995); In re Moore, 188 B.R. 671 (Bankr. D. Idaho 1995); In re Cavanaugh, 175 B.R. 369, 372-73 (Bankr. D. Idaho 1994); In re Jones, 138 B.R. 536 (Bankr. S.D. Ohio 1991). Under this body of cases, the fact that a contribution is made in the form of a loan repayment to a 401K plan does not change the result. As long as the payment is voluntary, it is not considered necessary for support or maintenance. Harshbarger, 66 F.3d at 775; Anes, 216 B.R. at 514; Fulton, 211 B.R. at 247; Moore, 188 B.R. at 671; Jones, 138 B.R. at 536. Although the failure to repay a loan from a 401K plan may result in a setoff against a debtor's future benefits and cause the debtor to incur a tax liability for an early withdrawal of retirement benefits, courts have tended not to recognize the obligation as a debt. e.g., Fulton, 211 B.R. at 263- 64; Jones, 138 B.R. at 538. The obligations are nonrecourse in nature, with the only asset "liable" for the debt being future benefits. Most importantly, the obligations are in substance debts to oneself. Fulton, 211 B.R. at 264; Jones, 138 B.R. at 538.

In re John Devine, 1998 W.L. 386380, at *8 (Bankr. E.D. Pa. July 7, 1998).

This Court concurs with the result reached in the Devine case. Debtors are not allowed to deduct \$370.86 toward repayment of this 401K loan. In fact, Debtors are not allowed, in a hypothetical Chapter 13, to treat this as a unsecured obligation. Because Debtors cannot deduct this amount, the only deduction from their income, other than taxes, is insurance and a contribution the United Way. Minus these deductions, Debtors have a net monthly take home pay of approximately \$4,135.

Debtors have listed expenses of \$2,887.94 in their amended Schedule J. The U.S. Trustee has questioned certain of these deductions: substantial telephone bills, cable bills and home maintenance costs. Additionally, she has brought into question the sum of \$200 paid each month toward the parties' college age daughter. There is authority in this district that payments to creditors must take precedence over payments to emancipated family members. Nevertheless, the Court feels that it need not decide, with exactitude, the appropriateness of the amended Schedule J expenditures. It is clear that in a hypothetical Chapter 13 case, even assuming all listed monthly expenses, that Debtors would have in excess of \$1,300 per month to contribute to a Chapter 13 plan. The Court, therefore, concludes that Debtors have the ability to fund a Chapter 13 plan over a three year period. The amount available would pay all priority taxes, all unsecured debt, all Trustee's fees, all estimated attorney's fees as well as the Chapter 13 filing fee. Debtors do have the ability to pay their creditors, and as such, this filing constitutes substantial abuse warranting dismissal of this Chapter 7 case under 11 U.S.C. §707(b).

WHEREFORE, the U.S. Trustee's Motion to Dismiss is sustained.

FURTHER, Debtors are given until January 21, 2000 to file a motion to convert to Chapter 13 if they elect to do so.

FURTHER, if Debtors do not convert to a Chapter 13 by that date, this case will be dismissed without further notice or hearing.

SO ORDERED this 4th day of January, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge