IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF IOWA

IN RE: )
) Chapter 7
DAVID L. ZIMMERMAN, )
DOROTHY ZIMMERMAN, ) Bankruptcy No. 02-00782
)
Debtors. )

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

This matter came before the undersigned on April 16, 2002 on the U.S. Trustee's Motion to Dismiss. Debtors David L. and Dorothy Zimmerman appeared personally, with their Attorney Michael Bowman. Attorney John Schmillen represented the U.S. Trustee. After the presentation of evidence and argument, the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

**STATEMENT OF THE CASE**

The U.S. Trustee seeks an order dismissing this case for "substantial abuse" pursuant to 11 U.S.C. § 707(b). Debtors resist asserting they do not have an ability to fund a Chapter 13 plan.

**FINDINGS OF FACT**

Debtors are a husband and wife who jointly filed for Chapter 7 relief on March 15, 2002. Subsequent to U.S. Trustee's motion to dismiss, Debtors filed amended Schedules I and J on April 1, 2002. Their amended Schedules reflect a combined net income of $2,173.20 and expenses totaling $2,675.76 per month. Debtors' schedules list six creditors with unsecured claims totaling $33,924.10.

Mr. Schmillen claims that there are three separate sources of disposable income which could increase Debtors' net income and fund a Chapter 13 plan. He argues that: (1) two payroll deductions, a 401(k) life insurance deduction of $135.61 and a savings deduction of $107.28, would be included as disposable income in a Chapter 13 case; (2) Debtors' excess federal and state tax withholdings should be included as disposable income under § 707(b); and (3) credit card payments of $673 per month would be paid through a Chapter 13 plan, and, therefore, should be removed as an expense from Schedule J. Utilizing these calculations, Debtors actually have net income of $2,565.16 and expenses of $2,002.76. This constitutes disposable income of $562.40 which could pay off 52% of Debtors' unsecured claims in a hypothetical Chapter 13 plan.

Debtors argue that although Mr. Schmillen's figures may be accurate, the ramifications of those figures do not establish a substantial ability to pay. They feel dismissal for substantial abuse is unwarranted and ask the Court to consider their overall situation based on the "total facts." They ask the Court to invoke the presumption of granting Debtors Chapter 7 relief.
They claim that failure to pay the 401(k) loan will generate tax consequences and penalties of approximately $1,500. They assert that this would be a significant expense for Debtors next year.
They also state that they do not take vacations, nor have they incurred any debts due to gambling.

Debtors argue that Mr. Schmillen's figures were calculated improperly. In estimating income, Mr. Schmillen used a multiplier of 4.3 representing the average number of weeks in a month. Debtors argue the same multiplier should be

used when calculating expenses.

Mr. Schmillen acknowledges that Debtors have filed their Chapter 7 petition in good faith. He admits that "they have not padded their expenses." He argues, however, that despite Debtors' commendable behavior in providing relatively conservative figures on their Schedule J, the adjusted numbers under both Schedule I and J, nevertheless, establish that Debtors have substantial ability to pay creditors.

## CONCLUSIONS OF LAW

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

> the court ... 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. Further, egregious conduct is not a required element of substantial abuse dismissal. Harris, 960 F.2d at 76.

For § 707(b) purposes, ability to pay creditors is measured by evaluating a debtor's financial condition in a hypothetical Chapter 13 proceeding. Koch, 109 F.3d at 1288. All of a debtor's projected disposable income to be received during a three-year plan will be applied to plan payments. In re Harger, 267 B.R. 848, 851 (Bankr. N.D. Iowa 2001). "Disposable income" is income not reasonably necessary for support of the debtor, debtor's dependents, or debtor's business. Id.Evaluating a debtor's ability to fund a Chapter 13 plan necessitates a review of disposable income. Id. A conclusion that debtors have disposable income to pay between 30% to 80% of their unscheduled debts under a hypothetical Chapter 13 plan may necessitate dismissal of a Chapter 7 case under § 707(b). In re Beckel, 268 B.R. 179, 185 (Bankr. N.D. Iowa 2001).

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

### Payroll Deductions

Deductions for repayment of loans from funds borrowed on a 401(k) plan are not allowed in a hypothetical Chapter 13 plan. In re Shirley, No. 99-02365-W, slip op. at 5-6 (Bankr. N.D. Iowa January 5, 2000) (where debtor borrowed $7,000 on the $8,000 equity in a 401(k) plan and deductions of $370.86 per month to repay loan were not allowed). Due to the "voluntary nature" of the deductions, the repayment to the 401(k) plan is not considered a debt to a creditor. It is a debt to one's self. In re Fulton, 211 B.R. 247, 264 (Bankr. S.D. Ohio 1997). If a debtor fails to make the payments, the retirement system will deduct the balance owed from the account, therefore any payments made are voluntary contributions to a debtor's retirement account. In re Anes, 195 F.3d 177, 180-81 (3d Cir. 1999). These voluntary payments on loans are not necessary for support or maintenance. Id.; In re Harshbarger, 66 F.3d 775, 777 (6th Cir. 1995). This holds true even if the failure to repay incurs

a tax liability for an early withdrawal of retirement benefits. Fulton, 211 B.R. at 263-64.

The second payroll deduction U.S. Trustee disputes is Mrs. Zimmerman's "savings" deduction of $107.28 per month. Current earnings are part of a Chapter 13 bankruptcy estate. Therefore, voluntary postpetition contributions to pension or savings plans must be included in a debtor's income for the purpose of calculating disposable income. In re Delnero, 191 B.R. 539, 542 (Bankr. N.D.N.Y. 1996); In re Cavanaugh, 175 B.R. 369, 373 n.3 (Bankr. D. Idaho 1994); In re Fountain, 142 B.R. 135, 137 (Bankr. E.D. Va. 1992). The Eighth Circuit has held that all income, including exempt income, not reasonably necessary for a debtor's support at the time of the bankruptcy filing must be included in making a disposable income calculation. Koch, 109 F.3d at 1290. Debtors argue this deduction is not really a savings plan because the deduction is ordinarily withdrawn rapidly and used for ordinary expenses. Thus, the account never accumulates. The Court accepts this explanation and does not consider this potential amount in its evaluation.

**Tax Withholdings**

Excess tax withholdings are disposable income for purposes of determining a debtor's substantial ability to pay. Harger, 267 B.R. at 851. Regular tax refunds must be included in the substantial ability to pay analysis. In re Nelson, No. 97- 03710S, slip op. at 5-6 (Bankr. N.D. Iowa Mar. 5, 1998), aff'd, 223 B.R. 349 (B.A.P. 8th Cir. 1998). Simply put, 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. Shirley, No. 99-02365-W, slip op. at 4.

**Credit Card Expenses**

In determining disposal income under a hypothetical Chapter 13 plan, a debtor's monthly payments for credit card debt are considered disposal income. In re Bryant, 47 B.R. 21, 23 (Bankr. W.D.N.C. 1984). Credit card debts are unsecured debts which are paid through a Chapter 13 plan. They are not properly scheduled as monthly expenditures. In re Schmonsees, 2001 WL 1699664, at *5 (Bankr. M.D.N.C. 2001). Allowing Debtors to make payments for unsecured credit card debt as a monthly expense in Schedule J would, in effect, be permitting them to make postpetition transfers under § 549(a). See 11 U.S.C. § 549(a).

**INCOME AND EXPENSES**

Based on the foregoing, the Court finds that the 401(k) deduction must be included as disposable income. The excess tax withholdings and the payments on credit card debt must also be included within the disposable income analysis. Based on these calculations, Debtors have a substantial ability to pay unsecured debt as that term is defined in bankruptcy law. Under a hypothetical Chapter 13 plan, Debtors could pay a significant percentage of their unsecured debt under a three year plan.

**SUBSTANTIAL ABUSE STANDARD**

This case essentially boils down to what standard the Court will use to determine substantial abuse. Debtors are asking the Court to evaluate their financial status using a "totality of the circumstances" standard. Debtors urge the Court to examine their entire financial history as well as their behavior in this case to support a finding that Debtors are sincere. There is certainly support in the record to conclude that Debtors are honest and hard-working people. However, a finding of egregious conduct is not necessary to a finding of substantial abuse.

Mr. Zimmerman testified that Debtors made some financial mistakes in paying for their daughter's college education and her wedding, and perhaps paying too much for their home, which has led to their present financial condition. Debtors are not living an extravagant lifestyle at the expense of creditors and the Court is not unsympathetic to Debtors' present circumstances. Nevertheless, the law in the Eighth Circuit is clear that a "totality of the circumstances" test is not the standard to use when analyzing § 707(b) dismissals. Rather, bankruptcy courts must evaluate whether funds are available to pay unsecured debts. If funds exist to support a Chapter 13 plan, a dismissal is warranted.

The U.S. Trustee has shown that disposable income exists to pay unsecured creditors. Debtors have the ability to pay almost 50% of their scheduled unsecured debt. This percentage is based on figures derived from Debtors' amended income and expense schedules, and the foregoing adjustments.

Debtors maintain that they are unable to make payments under a plan. Chapter 13 is designed to be flexible. It allows for modification of a plan if changes occur in Debtors' financial picture. In a worst case scenario, Chapter 13 allows for conversion back to Chapter 7. With that in mind, the Court finds that the evidence in this case warrants dismissal of
Debtors' Chapter 7 petition for substantial abuse under § 707(b).

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

**FURTHER,** Debtors are given until May 20, 2002 to convert to Chapter 13 if they so elect to do so.

**FURTHER,** if Debtors elect not to convert to Chapter 13 by May 20, 2002, this case will be dismissed without further notice or hearing.

**SO ORDERED,** this _3rd_ day of May, 2002.

PAUL J. KILBURG
CHIEF BANKRUPTCY JUDGE