

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

IN RE:)

) Chapter 7

JAMES E. ELLIOTT)

PAMELA M. ELLIOTT) Bankruptcy No. 02-00227

)

Debtors.)

ORDER RE: U.S. TRUSTEE'S MOTION TO DISMISS UNDER § 707(b)

The U.S. Trustee's Motion to Dismiss was heard on April 10, 2002. Debtors James E. and Pamela M. Elliott appeared, represented by Attorney Kevin Ahrenholz. 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).

FINDINGS OF FACT

The U.S. Trustee requests an order dismissing this case for "substantial abuse" under 11 U.S.C. §707(b). Debtors are husband and wife who jointly filed a petition for Chapter 7 relief on January 25, 2002. Debtors' Schedule I reflects a combined income of \$4,837.79 per month. Their Schedule J reveals expenditures of \$4,895 per month. The U.S Trustee asserts that Debtors could generate disposable income by reducing monthly payments for housing and utilities. Further, the U.S. Trustee argues that Debtors' budget contains disposable income that should be devoted to payments under a Chapter 13 plan.

Debtors' Schedule J includes expenses of \$1,911 for home mortgage, \$181 for electricity and heating fuel, \$33 for homeowner's insurance, and \$178 for real estate taxes. Trustee argues that these expenses exceed the IRS's Collection Financial Standards by \$1,365 per month. He argues that Debtors could reduce their monthly expenditures to pay the twelve unsecured creditors in this case with claims of \$63,954.19.

Debtors argue that a dismissal in this case is not warranted. They testified they have refinanced their home on eight occasions, which turned unsecured debt into secured, to support a contention that unsecured creditors will be paid. Further, they claim that their \$30,000 per year gambling addiction is the primary reason for their indebtedness. Debtors, in their Statement of Financial Affairs, section 8, list \$20,000 in gambling losses.

Mr. Elliot testified that Debtors are supporting themselves and two dependants. He also testified to believing he would receive a 3% COLA raise in July of 2002, and that Debtors would pay \$546 in federal taxes for 2001, but may get a refund from the State. Debtors stated that they will surrender their Chrysler Concorde to Chrysler Credit. Debtors' per month expenditure for the Concorde was \$445.75. Debtors assert that they have no equity in their home, as the current value of the house is \$200,000, and it is subject to a mortgage of \$211,000.

CONCLUSIONS OF LAW

Section 707(b) of the Code provides that a bankruptcy court may dismiss a case filed by a Chapter 7 debtor 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. 11 U.S.C. § 707(b). Section 707(b) was enacted due to concerns that debtors may file Chapter 7 cases to avoid paying obligations that they could otherwise pay. See S.

Rep. No. 65, 98th Cong. 1st Sess. 54 (1983). Section 101(8) of the Code defines "consumer debts" as those debts incurred primarily for a personal, family, or household purpose. At least one court has determined that gambling debts, for purposes of § 707(b), are considered consumer debts. In re Vianese, 192 B.R. 61, 68 (Bankr. N.D. N.Y. 1996).

"Substantial abuse" is not defined in the Code. The Eighth Circuit has held that the "primary factor to be considered" by a court to evaluate whether substantial abuse exists is whether the Chapter 7 debtor can fund a Chapter 13 plan. In re Koch, 109 F.3d 1256, 1288 (8th Cir. 1997). Substantial ability to pay creditors standing alone warrants dismissal of a Chapter 7 petition for substantial abuse. Id.

For § 707(b) purposes, ability to pay creditors is measured by evaluating debtors' financial condition in a hypothetical Chapter 13 proceeding. In re Beckel, 268 B.R. 179, 182 (Bankr. N.D. Iowa 2001); In re Harger, 267 B.R. 848, 851 (Bankr. N.D. Iowa 2001) (citing Koch, 109 F.3d at 1288). Confirmation of a Chapter 13 plan requires, if an objection to confirmation is advanced, that the plan provide that all of the debtors' projected disposable income received during a three year plan be applied to plan payments. Beckel, 268 B.R. at 182 (citing 11 U.S.C. § 1325(b)(1)(B)); Harger, 267 B.R. at 851. "Disposable income" is income not reasonably necessary for support of the debtor, debtor's dependants or debtor's business. Beckel, 268 B.R. at 182; Harger, 267 B.R. at 851. Evaluating Debtors' ability to fund a Chapter 13 plan necessitates a review of their disposable income. Beckel, 268 B.R. at 183; Harger, 267 B.R. at 851.

Whether income is "reasonably necessary" for Debtors' maintenance and support is open to interpretation. See In re Gleason, 267 B.R. 630, 633 (Bankr. N.D. Iowa 2001) (considering requirements for Chapter 13 plan confirmation). In Chapter 13, the Code requires a meaningful and realistic budget, accompanied by the devotion of most of the debtors' surplus income to repay creditors. Beckel, 268 B.R. at 183. Section 1325(b) contemplates some sacrifices or alteration in prepetition consumption levels by debtors, while allowing them to sustain basic needs not related to their former lifestyles. In re Webb, 262 B.R. 685, 692 (Bankr. E.D. Tex. 2001); In re Jones, 55 B.R. 462, 467 (Bankr. D. Minn. 1985).

In evaluating whether expenses are reasonably necessary, this Court seeks a balance between allowing a debtor a reasonable lifestyle and insuring a serious effort to pay creditors by eliminating "unnecessary and unreasonable expenses." Beckel, 268 B.R. at 183; In re Gleason, 267 B.R. at 633. First, the Court determines which expenses are essential and which are discretionary. After delineating expenses as either essential or discretionary, this Court "lumps together" discretionary expenses to determine whether they are excessive in light of the debtor's lifestyle and the burden of his or her unpaid debts. Beckel, 268 B.R. at 183-84 (where \$643 per month in discretionary expenses were high).

Some expenditures are clearly essential, or nondiscretionary, such as reasonable amounts budgeted for food, clothing and shelter. Gonzales, 157 B.R. at 608. Examples of discretionary expenses identified by courts include: charitable contributions, gifts, recreation, private school tuition, payments for boats, campers and other luxuries, health club and country club dues, newspapers and magazines, and cable TV and cell phone services. See 2 Keith M. Lundin, Chapter 13 Bankruptcy § 165.1 (3d ed. 2000); In re Attanasio, 218 B.R. 180, 201-10 (Bankr. N.D. Ala. 1998).

Excessive amounts in the nondiscretionary items, such as food, utilities, housing, and health expenses, must also be added to the discretionary spending category. Beckel, 268 B.R. at 184 (where the Court found \$400 in excessive nondiscretionary expenses, coupled with discretionary income could pay off 48% of

unsecured claims over three years). To determine whether any essential or nondiscretionary expenses are excessive, that is, not reasonably necessary for support, and therefore deserving of placement within the discretionary spending category, a court may compare expenses with the IRS Collection Financial Standards. *Id.*; *Gleason*, 267 B.R. at 634 (where confirmation of Chapter 13 plan was denied as debtors had aggregate discretionary income of between \$550 to \$650 per month, while unsecured creditors would receive only 29% of their claims over three-year plan); *In re Nissly*, 266 B.R. 717, 720-21 (Bankr. N.D. Iowa 2001) (where discretionary spending of \$370 per month was too high, and \$1,960 for monthly mortgage and real estate taxes was excessive in light of the small amount of equity the debtors had in the home).

ANALYSIS

The Court concludes that granting Debtors Chapter 7 relief would be substantial abuse pursuant to § 707(b) of the Code. Debtors' scheduled debts are primarily consumer debts. Further, Debtors have the ability to pay creditors by funding a hypothetical Chapter 13 plan.

Separating Debtors' expenses into essential/non-discretionary and discretionary categories, this Court notes that Debtors have a total of \$4,589 in non-discretionary expenses, and \$306 in discretionary expenses based on Debtors' Schedule J. Debtors have revealed that they will have an extra \$445.75 per month, as a result of surrendering the Chrysler Concorde. Mr. Elliot testified that he will receive a 3% COLA raise in July of 2002. This will increase his pay by \$70.51 per month. Added together, these numbers reflect that Debtors have an aggregate discretionary income of \$822.26 per month. Over the course of a hypothetical three-year plan Debtors could, with this amount alone, pay off 46% of the unsecured scheduled debts.

Of the arguably nondiscretionary expenses, the Court finds that some expenses are higher than the IRS standards. In particular, the Court finds that Debtors' expenses for housing and utilities for a family of four are excessive at \$2,405 per month. This includes Debtors' mortgage, utilities, real estate taxes, and homeowner's insurance. The IRS standards indicate that the maximum allowance for a family of four living in Black Hawk County is \$938 per month. The mortgage and real estate taxes seem especially high in light of Debtors having no equity in their home. Debtors' expenses for housing and utilities exceed the IRS standards by \$1,467. This amount over three years under a hypothetical plan could generate payments of 82% of the unsecured scheduled debts.

A Chapter 13 plan mandates that Debtors make some sacrifice and alter their prepetition consumption levels in order to pay creditors and alleviate spending habits which precipitated their financial problems in the first instance. Under the foregoing calculations, Debtors could pay between 46% to 82% of the unsecured scheduled debts over three years in a hypothetical Chapter 13 case. Debtors have the substantial ability to pay their creditors. As such, this filing constitutes substantial abuse warranting dismissal of this Chapter 7 case pursuant to 11 U.S.C. §707(b).

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

FURTHER, Debtors shall be given 14 days from the date of this order to file a Motion to Convert to Chapter 13 if they elect to do so.

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

SO ORDERED this 3rd day of May, 2002.

PAUL J. KILBURG

CHIEF BANKRUPTCY JUDGE