

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
ENTERED
TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
ON THE COURT'S DOCKET

IN RE: §
§
RANDAL DALE LOGAN and REGINA § CASE NO. 02-39177-SAF-7
B. LOGAN, §
§
D E B T O R (S). §

MEMORANDUM OPINION AND ORDER

The United States Trustee moves to dismiss, pursuant to 11 U.S.C. § 707(b), the Chapter 7 case filed by Randal Dale Logan and Regina Beth Logan, asserting that the granting of relief to these debtors would amount to a substantial abuse of the provisions of Chapter 7. The debtors oppose the motion.

The motion raises a core matter over which this court has jurisdiction to enter a final order. 28 U.S.C. §§ 157(b)(2)(J) and 1334. The court conducted an evidentiary hearing on the motion on May 5, 2003. This memorandum opinion contains the court's findings of fact and conclusions of law. Bankruptcy Rules 7052 and 9014.

The Logans filed a petition for relief under Chapter 7 of the Bankruptcy Code on October 17, 2002. The United States Trustee moved to dismiss the petition on January 23, 2003,

pursuant to 11 U.S.C. § 707(a) and/or (b), contending that the debtors did not file in good faith and that their conduct supports a dismissal "for cause" for a period of one year as to the refiling of a case under Chapter 7. Alternatively, the United States Trustee submits that the petition amounts to a "substantial abuse." The Logans deny that they have abused the Chapter 7 process and assert that they have complied with all of their obligations under the Bankruptcy Code. The Logans further assert that dismissal is unconstitutional because the motion is based upon their use of federal income tax deductions.

Section 707(b) of the Bankruptcy Code provides:

After notice and a hearing, 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 this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

11 U.S.C. § 707(b). Section 101(8) provides: "'consumer debt' means debt incurred by an individual primarily for a personal, family, or household purpose[.]" 11 U.S.C. § 101(8). The Fifth Circuit has stated that the test for determining whether a debt

should be classified as a debt acquired for personal, family or household purposes, rather than as a business debt, is whether it was incurred with an eye for profit. In re Booth, 858 F.2d 1051, 1055 (5th Cir. 1988).

The Logans' debts are "primarily consumer debts."

The Fifth Circuit has not yet decided when a filing constitutes a substantial abuse of the provisions of Chapter 7. Bankruptcy courts in the Fifth Circuit have crafted a substantial abuse standard that reflects the "totality of the circumstances" approach set forth in In re Krohn, 886 F.2d 123 (6th Cir. 1989) and incorporates the Ninth Circuit's approach as articulated in In re Kelly, 841 F.2d 908 (9th Cir. 1988) and the Fourth Circuit's approach in In re Green, 934 F.2d 568 (4th Cir. 1991). See In re Rubio, 249 B.R. 689, 695 (Bankr. N.D. Tex. 2000).

"[S]ubstantial abuse can be predicated upon either lack of honesty or want of need." In re Krohn, 886 F.2d at 126. Among the factors that the bankruptcy court is to consider in assessing whether a debtor is honest are: whether the debtor sought Chapter 7 protection due to unforeseen or catastrophic events; the debtor's candor and good faith in filing schedules and other documents; and whether the debtor engaged in eve of bankruptcy purchases. Among the factors that the bankruptcy court is to consider in assessing whether a debtor is needy are: the debtor's ability to repay debts out of future earnings, whether

the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities. Id. at 126-27. The court observed that the debtor's ability to repay debts out of future earnings, standing alone, may be sufficient to warrant dismissal. By way of clarification, the court explained that "a court would not be justified in concluding that a debtor is needy and worthy of a discharge, where his disposable income permits liquidation of his consumer debts with relative ease." Id. at 126. Accordingly, the court should consider the totality of the circumstances. However, if a debtor's disposable income permits liquidation of his consumer debts with relative ease, dismissal for substantial abuse is appropriate. Id. at 126-27.

Furthermore, the Kelly court examined the debtor's ability to fund a Chapter 13 plan as the primary factor for assessing whether dismissal for substantial abuse is warranted. In re Kelly, 841 F.2d at 914. The Green court concluded that while a debtor's relative solvency may raise an inference that a debtor is seeking an unfair advantage over his creditors, evidence of both an ability to pay and lack of good faith must be present to

warrant dismissal for substantial abuse. In re Green, 934 F.2d at 572.

Ability to Repay Debts

Under any and all of the approaches, the court should look to the debtors' ability to pay. In evaluating whether the debtors' case should be dismissed as a substantial abuse of the provisions of Chapter 7, the court reviews the debtor's expenses in light of reasonableness. In determining disposable income, the court will examine whether, under a hypothetical Chapter 13 scenario, the expenses would be proper maintenance or support payments under 11 U.S.C. § 1325(b)(2)(A) and (B). See In re Laman, 221 B.R. 379, 382 (Bankr. N.D. Tex. 1998). Next the court will add up the amounts by which the various expenses are excessive. After modifying the expenses by reducing them to the extent they are excessive, the court evaluates the extent to which the debtors could repay their unsecured debt through a Chapter 13 plan.

Some courts calculate how much money the debtor had available to pay unsecured debt through a Chapter 13 plan, others calculate the percentage of unsecured debt that the debtor could service through a Chapter 13 plan. See, e.g., In re Laman, 221 B.R. at 383 ("Thus, it appears that, in a Chapter 13, the Debtors would have disposable income of approximately at least \$635, and, in thirty-six months, \$22,860 in payments could be made. Aside

from Chapter 13 Trustee's fees, it appears that there would be at least an approximate 25% dividend in a three year Chapter 13."); In re Heasley, 217 B.R. at 88 ("The excessive part of their budget is the \$633 per month they propose to pay on the credit card debts charged in Ms. Heasley's former husband's name, and the \$439.14 unexplained reaffirmation on retained property. These two items represent expenses of over \$1,000 per month; funds which could be paid to unsecured creditors."). But see In re Rubio, 249 B.R. at 698 (citing In re Laman, 221 B.R. at 384 for the proposition that "substantial abuse exists where debtors 'have the ability to pay a significant dollar amount to the unsecured creditors, irrespective of percentage'" and therefore declining to determine the amount of repayment or the percentage that unsecured creditors would receive in a hypothetical Chapter 13 case).

According to In re Laman, 221 B.R. at 384, the court should consider a debtor's ability to pay through a 3 year, as opposed to 5 year, plan (citing 11 U.S.C. § 1325(b)(1)(B)).

In its analysis, the court uses the Logans' original Schedule I, current income of individual debtors and their amended Schedule J, current expenditures of individual debtors, even though the amended Schedule J has not been filed with the court. The Logans' original Schedule I reported that they earn a monthly net income of \$6,237. U.S. Trustee, Ex. 1. The debtors'

amended Schedule J reflects average monthly expenses of \$6,423. Logan, Ex. 1. The net monthly income reflects monthly contributions made by both Randal Logan and Regina Logan to 401(K) retirement plans. The monthly expenses include repayment of a loan taken from the 401(K) plan, lunch/dining out expenses, and student loans.

Based on the original schedules, the Logans had a monthly disposable income of \$1,039. The revised expenses show a negative disposable income of \$186. Based on an exhibit admitted at the hearing and their testimony, Randal Logan increased his monthly 401(K) contribution at the time of filing from 5% to 25%, while Regina Logan increased her monthly retirement contribution from 7% to 15%. Logan, Ex. 2. Based on these increases, Randal currently contributes \$680 monthly to his 401(K) plan and Regina currently contributes approximately \$1,000 monthly to her 401(K) plan.

The evidence presented at the hearing suggests that the Logans' schedules do not provide accurate 401(K) contribution amounts. The revised schedules the Logans tendered at the hearing have not been filed. The correct 401(K) figure is approximately \$1,680 per month. At the hearing, Areya Holder, a staff attorney with the office of the Chapter 13 Trustee, testified regarding the Logans' expenses. According to Ms. Holder's Chapter 13 analysis, 70% of the 401(K) contributions

would be added back into the debtors' income, accounting 30% for tax consequences. See In re Watkins, 216 B.R. 394, 396 (Bankr. W.D. Tex. 1997).

Retirement planning is not necessary for current food, clothing, shelter or other necessities or maintenance and support. Income deferred for retirement should be available to pay current debts. The debtors contribute approximately \$1,680 per month for retirement. Considering the tax consequences, 70% of those funds should be devoted to debt repayment. Accordingly, \$1,176 should be available for debt service. The debtors' gross income should be reduced by \$504 to reflect the increased taxes incurred without the 401(K) contribution.

Randal's monthly income will also increase by \$225, because the credit union payments he has been making have ceased or will soon cease based on his testimony.

From the debtors' Schedule I, the court makes the following calculations. The court disallows the 401(K) payments and recognizes that in doing so the debtors' taxable income will increase. The court uses the Chapter 13 Trustee's accounting of 30% of the 401 (K) payment allowed for tax consequences. Accordingly, the debtors have \$504 less to spend (30% of the 401(K) payments of \$1,680), which the court assigned for analytical purposes to Regina.

<u>Income</u>	<u>Debtor</u>	<u>Spouse</u>
Current monthly gross wages salary & commissions:	\$2,721	\$7,346
Estimated monthly overtime:	40	
SUBTOTAL:	2,761	7,346
LESS PAYROLL DEDUCTIONS:		
Payroll taxes and social social security:	423	1,932
Insurance:	7	35
Union dues:	0	0
Other (specify):		
Health club:	0	54
401(K)	0	504
Credit Union Payments	0	0
TOTAL NET MONTHLY INCOME:	2,331	5,325
<hr/>		
TOTAL ADJUSTED NET MONTHLY INCOME:		<u>\$7,152</u>

Upon subtracting 30% of the \$1,680 monthly 401 (K) payments or \$504 from the debtors total gross income, the debtors would have a total adjusted monthly income of \$7,152.¹ The court also recognizes that Regina may receive a \$8,000 lump sum, year-end

¹The court has arrived at this amount by using the debtors' sworn statements less the tax consequences of not having 401 (K) plans, because it believes part of the debtors' income should not have been deferred for retirement payments. The court further recognizes that the debtors' misstated the amount Regina Logan deducted from her income for 401(K) payments. If any inaccuracy exists in the court's calculations, it is due to the incorrect manner in which the debtors filed their schedules.

bonus, which would also be added back into the debtors' total income.

Turning to expenses, the debtors are repaying a \$300 monthly retirement loan debt to themselves to the detriment of their creditors. Ms. Holder testified that for a Chapter 13 analysis, 70% of that monthly payment would not be recognized as an expense, while 30% would be recognized as a tax consequence. Seventy percent (70%) of that amount should be added back into the debtors' available monthly income.

The debtors schedule \$1,200 per month for food, including lunch/dining out expenses, for two people. As Ms. Holder testified, for two adults that is excessive and indeed not credible. The court finds that food and lunch/dining out expenses should be in the \$600 range.

In their amended schedule J, the debtors increase their charitable contributions from \$60 to \$135. They also increase their life insurance payments from \$75 to \$120. The clothing allowance was also increased from \$100 to \$290. The debtors signed and submitted their original Schedule J under penalty of perjury. The debtors have not established a basis to increase these expenses post-petition. The debtors cannot unilaterally change these amounts. Accordingly, the court will use the charitable, life insurance, and clothing amounts, from the original Schedule J, \$60, \$75, and \$100 respectively, in its

calculations of the debtors' monthly income.

The debtors increased their home maintenance expenses from \$200 to \$729, but give no basis for this increase. The court finds this expense excessive and adjusts it to \$465, half-way between the two numbers on the original and amended Schedule J.

The court further finds the monthly recreation expense of \$200 in the original Schedule J and \$195 in the amended Schedule J excessive and reduces it to \$100, as the court has recognized health club dues deducted from gross income.

From the debtors' amended Schedule J, the court makes the following calculations, in which the excessive food expenses, charitable contributions, home maintenance, clothing, and recreation expenses are reduced. The court also disallows the retirement loan payment of \$300, but accounts for tax consequences of 30% or \$90. The \$90 tax consequences are included in the Logans' total monthly expenses.

Rent or home mortgage:	\$1,384
Electricity and heating fuel:	200
Water and sewer:	65
Telephone:	80
Alarm system:	40
Cell phones:	140
Satellite tv:	80
Trash disposal:	20
Home maintenance:	465
Food:	600
Clothing:	100
Laundry and dry cleaning:	20
Medical and dental:	239
Transportation:	265
Recreation:	100
Charitable contributions:	60

Insurance:	
Homeowner's or renter's:	0
Life:	75
Health:	20
Auto:	150
Auto installment payments:	603
Student loans:	100
Bank fees:	45
Retirement loan tax consequences:	90
 TOTAL MONTHLY EXPENSES:	 <u>\$4,941</u>

Reducing the recreation expenses to \$100; reducing the food/lunch dining out expenses to \$600; and using the original amounts of \$60 for charitable contributions and \$75 for life insurance submitted in the debtors' original schedule J; the debtors have \$4,941 in total monthly expenses.

As this analysis of income and expenses reveals, the debtors would have \$2,211 per month to fund a Chapter 13 plan. To obtain a discharge under Chapter 13, the Logans would have to commit their disposable income to a plan for 36 months. 11 U.S.C. § 1325(b)(1). Over 36 months this disposable income would yield \$79,596.

The debtors have \$144,000 in secured car and home claims. As revealed on their amended Schedule J, they are paying their secured debt. The debtors have scheduled total unsecured debts of \$129,757.54. Using the above analysis, the debtors can pay significantly more than 50% of their debts to their unsecured creditors from future disposable income over 36 months. That ability to pay weighs for a dismissal.

Other Factors

Having considered the debtors' ability to fund a Chapter 13 plan, the court looks to the other factors outlined above to evaluate whether, under a totality of the circumstances, dismissal for substantial abuse is appropriate. The Logans both have steady income and good employment history. The Logans worked hard pre-petition to pay off their credit card debts. According to Randal's testimony he has not used credit cards since April 2002.

The Logans filed their bankruptcy petition on October 17, 2002. In March 2002 the Logans met with their bankruptcy attorney to contemplate filing a petition under Chapter 7. In April 2002 shortly before filing, the Logans withdrew funds to purchase a new Toyota truck, and surrendered their old vehicle. Regina testified that they sold stock given to them by her or Randal's mother, originally intended to go to their retirement, and used the proceeds to purchase the new truck. At the hearing, the Logans rationalized the purchase of this new truck by stating that Randal needed a new truck for his long commute from Mesquite to work in Terrell, that their old car required higher monthly payments and that they were concerned with post-petition credit. The Logans opted not to use the truck funds to pay their creditors.

They had been paying \$530 per month for the old vehicle. If the debtors did not spend the \$24,000 on a new truck, they would have ended up paying approximately \$23,000 (7,200 x 3) in vehicle payments on their old vehicle--approximately the same amount that was spent on the new truck. Thus, while the new truck transaction appears problematic, the appearance problem pragmatically cancels with the court's analysis of the debtors ability to pay their creditors over 36 months. Furthermore, there are no factors beyond the debtors' control to offset their ability to pay.

The Logans further assert that they have a constitutional right to benefit from federal income tax deductions in addition to receiving protection under the Bankruptcy Code. The Logans cannot have it both ways. The Logans cannot expect a federal court to impose a permanent injunction on creditor collection efforts while the Logans shield income from both taxes and creditors. There is no equal protection issue. The Logans have been given a choice. If they need a discharge, they can delay their 401(K) contributions for 36 months while they fund a Chapter 13 plan. If they are more concerned with current retirement planning, they can deal with their creditors outside bankruptcy. If they want to pursue a constitutional challenge to this court's application of § 707(b), the court invites them to present their issue to an Article III court.

Under the totality of the circumstances, the court concludes that the United States Trustee has established the "substantial abuse" of § 707(b). Although the debtors dealt in good faith with their creditors pre-petition, they have an ability to pay their creditors through a Chapter 13 plan and have a stable source of future income. They are eligible to be Chapter 13 debtors. There is not any compelling factor to continue in Chapter 7. Accordingly, the case will be dismissed unless the debtors file a notice converting the case to a case under Chapter 13 of the Bankruptcy Code within ten days following the entry of this memorandum opinion and order.

Based on the foregoing,

IT IS ORDERED that the motion of the United States Trustee to dismiss this case under 11 U.S.C. § 707(b) is **GRANTED** and the case shall be dismissed unless the debtors file a notice to convert the case to a case under Chapter 13 of the Bankruptcy Code within business 10 days following the entry of this order.

Signed this 16th day of June, 2003.



Steven A. Felsenthal
United States Bankruptcy Judge