**UNITED STATES BANKRUPTCY COURT**
**CENTRAL DISTRICT OF ILLINOIS**

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| **IN RE:** | ) | |
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| **MICHAEL W. BURNS** | ) | **No. 99-81972** |
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**O P I N I O N**

Before the Court is the motion filed by the UNITED STATES TRUSTEE (U.S. TRUSTEE) to dismiss the Chapter 7 case filed by the Debtor, MICHAEL W. BURNS (DEBTOR), under § 707(b) of the Bankruptcy Code, 11 U.S.C. § 707(b).

The DEBTOR filed a Chapter 7 petition in Bankruptcy on June 17, 1999. The DEBTOR is divorced and has a fourteen-year-old daughter, for whom he pays child support of $723.00 per month. The DEBTOR is a market manager for Pennzoil Quaker State, and has been so employed for eleven years. The DEBTOR listed his monthly gross wages as $5,111.00, from which payroll taxes, social security and insurance are deducted in the amount of $1,404.00. In addition to a contribution to a 401(k) plan in the amount of $51.00, a deduction in the amount of $543.00 is also taken from the DEBTOR's wages to repay a loan from his pension fund. The DEBTOR's monthly take-home pay is $2,390.00.

The DEBTOR currently pays $650.00 in rent, $320.00 in utilities, $300.00 for food, $250.00 for clothing and laundry expenses, $25.00 for medical and dental expenses, $80.00 for transportation expenses, $75.00 for recreation and $100.00 for insurance. The DEBTOR allots $25.00 for home maintenance and $100.00 for miscellaneous expenses. The DEBTOR's monthly expenses total $1,925.00, leaving him with $465.00 per month for discretionary spending.

The DEBTOR does not own any real estate nor does he own a vehicle. At the time the

bankruptcy was filed the DEBTOR had $500.00 in his savings account and was due an income tax refund in the amount of $200.00. The value of his interest in the 401(k) plan was listed as $20,000.00. The DEBTOR listed nine unsecured creditors, all appearing to be credit card debt, totaling $42,845.98. The DEBTOR has no secured creditors or unsecured creditors holding priority claims.

The U. S. TRUSTEE filed a motion to dismiss pursuant to § 707(b) of the Bankruptcy Code, 11 U.S.C. § 707(b), claiming that granting the DEBTOR a Chapter 7 discharge would constitute a substantial abuse of the provisions of Chapter 7. At the hearing on the motion, the parties presented a stipulation of facts. The parties agree that the DEBTOR's petition accurately sets forth his debts, income and expenses. The U.S. TRUSTEE does not claim that the DEBTOR has acted in bad faith or that there are any other aggravating factors warranting dismissal under § 707(b). The matter was taken under advisement.

Central to a § 707(b) determination is an evaluation of the debtor's financial position in a hypothetical Chapter 13 proceeding. The first step in this process is to determine the debtor's disposable income, a task simplified in the present case by the parties' stipulation.[1] At issue here is the part the DEBTOR's loan repayment plays in this analysis. The U.S. TRUSTEE contends that both the amount of the DEBTOR's 401(k) savings deduction and the amount of his loan repayment must be added back to his net monthly income in determining his ability to fund a Chapter 13 plan. In support of his position, the U.S. TRUSTEE relies on cases decided under Chapter 13 which deny confirmation of plans which propose to pay less than 100% to unsecured

[1] Thankfully, the parties' stipulation eliminates this Court's need to pass upon the propriety of the DEBTOR's expense budget. A cursory review of the cases discloses that courts have spent an inordinate amount of time in deciding just what is a reasonable food budget or what sum is a reasonable amount to spend on utilities. The results are inconsistent and no consensus has been reached. *See* n. 6, *infra.*

creditors while repaying loans to retirement accounts. Nearly all courts addressing the issue of whether a debtor's repayment of a retirement loan have held that such payments constitute disposable income, where repayment is not a condition of continued employment.[2] This Court has followed that rule, as have other bankruptcy judges in this district.[3] The reason for this rule is simple and grounded in fairness – a debtor should not be permitted to repay himself as a priority creditor at the expense of his unsecured creditors. Making that adjustment in the present case, the DEBTOR would have $32,699.52 available for plan payments over the life of a 36-month plan.[4]

The DEBTOR contends, and the U.S. TRUSTEE concedes, that the calculation of the DEBTOR's ability to fund a plan is complicated, if not rendered uncertain, by the tax consequences resulting from the DEBTOR's failure to make the loan repayments to the 401(k) plan. The parties stipulate that the Administrator of the DEBTOR's 401(k) plan might be permitted to declare a taxable distribution in the amount of $18,460.00, resulting in an income tax of $5,168.80 and a penalty of $1,846.00 for early withdrawal. While acknowledging that the DEBTOR could modify his Chapter 13 plan to provide for full payment of the additional tax as a priority claim, the U.S. TRUSTEE suggests that the tax penalty could be separately classified and subordinated to the claims of general unsecured creditors. In the absence of any support for his suggestion that the penalty "might" be subordinated, this Court concludes that for purposes of this proceeding, the penalty must be included in determining the percentage to be paid to

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[2] *In re Anes,* 195 F.3d 177 (3d Cir. 1999); *In re Harshbarger,* 66 F.3d 775 (6th Cir. 1995); *In re Davis,* 241 B.R. 704 (Bkrtcy.D. Mont. 1999); *In re Johnson,* 241 B.R. 394 (Bkrtcy.E.D.Texas 1999).

[3] *In re Jensen*, Case No. 97-82592 (J. Altenberger, Sept. 22, 1997); *In re Courson,* Case No. 94-80291 (J. Altenberger, Sept. 23, 1994).

[4] The parties have stipulated to this figure.

creditors.[5] Not only must the penalty be included in this hypothetical computation, it must come ahead of prepetition unsecured creditors. It would not be appropriate to ignore this consequence of freeing up funds to repay the DEBTOR's other creditors. If the DEBTOR completed payments under a Chapter 13 plan, this obligation would not be discharged. Accordingly, after accounting for priority treatment for both the potential tax and penalty claims, the DEBTOR's remaining disposable income over a 36-month period is $25,684.72. After factoring in the 6.5% fees due the Chapter 13 Trustee, the sum of $23,562.66 is available to pay general unsecured claims of $42,845.98, resulting in a dividend of 55%. This calculation fails to take into consideration additional attorney's fees which would be incurred in the conversion of the case to Chapter 13, which would further reduce the dividend to unsecured creditors to 53%.

Having made this calculation, the Court turns to the determination of whether the DEBTOR's ability to pay approximately 50% of his unsecured debts over a period of 36 months in a Chapter 13 plan, constitutes substantial abuse under § 707(b). 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

[5]At this stage, the Internal Revenue Service is not involved and it would be inappropriate for this Court to speculate how the IRS would respond to a suggestion of subordination and what the result of a ruling on that issue might be. It can be said, however, that it is this Court's experience that the IRS vigorously pursues the collection of taxes and does not ordinarily acquiesce in a postponement of payments.

> 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).

The Bankruptcy Code does not define "substantial abuse" and its interpretation has been the subject of much debate. Direction has been provided to this Court, however, by the District Court for the Central District of Illinois, in *In re Pilgrim,* 135 B.R. 314 (C.D.Ill. 1992), and in *In re Ontiveros,* 198 B.R. 284 (C.D.Ill. 1996). In *Pilgrim,* Judge Mihm embraced the "totality of circumstances" test established by the Fourth Circuit Court of Appeals in *In re Green,* 934 F.2d 568 (4th Cir.1991), stating:

> When assessing "substantial abuse" under § 707(b), the court must first consider the primary factor, the debtor's ability to pay his debts, and then any mitigating factor which may temper this ability to pay or any relevant factor independent of the debtor's ability to pay, such as bad faith. On a case-by-case basis, the court must assess whether this debtor is the dishonest or non-needy debtor whose case is intended to be dismissed under § 707(b).

In *Ontiveros,* Judge McDade, after examining the various approaches taken by the circuit courts and clarifying Judge Mihm's decision in *Pilgrim,* adopted the test set forth by the Sixth Circuit in *In re Krohn,* 886 F.2d 123 (6th Cir. 1989). Setting forth the three-step test, Judge McDade stated:

> First, the Court will consider the debtor's ability to pay as the primary, and possibly dispositive, factor. Second, a totality of the circumstances test should be employed to determine whether any mitigating factors affect the debtor's ability to pay or whether any aggravating factors show his bad faith. (Citation). In evaluating these factors, the focus should not be so much on how the debt was acquired (which goes to a good faith inquiry) but rather on the debtor's ability to repay the debt now. (Citation). Finally, the Court must determine whether the debtor is so dishonest or non-needy as to warrant dismissal under § 707(b).

Interpreting that standard in *In re Sawatzki*, Case No. 97-1327 (J. Mihm, Dec. 24, 1997),

Judge Mihm noted that a debtor's ability to pay creditors does not mandate dismissal under § 707(b). Rather, the bankruptcy court should focus upon any aggravating or mitigating factors and decide each case on an individual basis.

Relying upon these decisions, the U.S. TRUSTEE focuses upon the gross dollars available to fund the plans in those cases and the gross dollars available to fund a plan in this case. Acknowledging that in both *Sawatzki* and *Ontiveros* the debtors could pay 100% of their creditors, the U.S. TRUSTEE takes the position that in determining whether a debtor has the ability to fund a substantial plan, it is the dollars available and not the percentage payment to creditors which is significant. Otherwise, he asserts, a debtor is encouraged to run up debt on the eve of bankruptcy. Under this view, the debtor with the savvy to load up on expenses before filing would find a safe harbor in Chapter 7, whereas the debtor who gradually slides into bankruptcy would be denied relief, or, as symbolized by the court in *In re Wegner,* 91 B.R. 854 (Bkrtcy.D.Minn. 1988), "[P]igs are put on a diet but hogs are set free."[6]

This Court finds the position of the U.S. TRUSTEE to be untenable. "Substantial abuse" cannot be defined in terms of dollars alone. If Congress had intended that result, it could have easily included such a threshold in the statute. There is absolutely no basis in the decisions issued by the District Court to support that contention. Each of those cases involved debtors who could pay their unsecured creditors in full, and the court in no way implied that the amounts of

[6] The U.S. TRUSTEE's position is not entirely without support. In *In re Coleman*, 231 B.R. 760 (Bkrtcy.D.Neb. 1999), the court determined that the appropriate test is whether a debtor can make substantial payments to creditors over a three-year period and concluded that substantial abuse exists where a debtor can make monthly payments of $250-$350, regardless of whether such payments payoff 10% or 80% of the claims of the debtor's unsecured creditors. In implementing this rule, the debtor's lifestyle becomes the focus, necessitating an item-by-item examination of the budget and requiring the bankruptcy court to sit in judgment over specific individual expenses. In *In re Attanasio,* 218 B.R. 180, 201( Bkrtcy.N.D.Ala. 1998), at footnote 30, for almost seven pages, the court chronicles various decisions reviewing expenses ranging from charitable donations to cigarettes. This Court does not believe that is an appropriate role for a bankruptcy court to play.

disposable income in those cases were in and of themselves sufficient to trigger dismissal under § 707(b). In *Ontiveros*, Judge McDade framed the test as whether a debtor "has the ability to live comfortably and to pay off a substantial portion of his unsecured debts". This Court, for purposes of Chapter 13, has long considered as a yardstick of a substantial, or meaningful payment to creditors under a Chapter 13 plan, a distribution of at least 70% to unsecured creditors.[7] While this Court need not determine whether that standard will be strictly adhered to under § 707(b), it holds with certainty that a finding that the debtor could pay only half of his debts over a period of 36 months does not warrant a finding of substantial abuse. If that would be so, it is a small step to determining that a debtor who can pay 40%, then 30%, then only 20% of their debts under a Chapter 13, is not entitled to Chapter 7 relief.[8] The historic purpose of Chapter 7 bankruptcy is to give "the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt". *Local Loan Co. v. Hunt,* 292 U.S. 234, 244, 54 S.Ct. 695, 699, 78 L.Ed. 1230 (1934). There is no indication in the legislative history of § 707(b) that Congress intended to effect a fundamental change in this fresh start policy. Although that legislative history is complex, this Court agrees with those courts that have concluded that Congress did not intend to target the debtor who earns the wages of an ordinary working person, but rather the debtor who earns a

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[7] A Chapter 13 debtor may not extend a plan beyond 36 months under § 1322(d), unless cause is shown. A plan proposing a substantial distribution to creditors has been considered "cause" within this provision. In *In re Frank,* 69 B.R. 129 (Bkrtcy.C.D.Ill. 1986), this Court adopted the 70% rule, holding that a debtor could not propose a plan exceeding 36 months unless the plan provides that unsecured creditors are to receive at least 70% of their claims.

[8] For instance, the court in *In re Carlton,* 211 B.R. 468 (Bkrtcy.W.D.N.Y. 1997), in determining that the debtors' Chapter 7 filing constituted a substantial abuse, noted that the debtors' ability to pay 17% over a 36-month period made for a distribution in excess of that proposed by "many" of the Chapter 13 plans confirmed by the court. It is this line of reasoning that this Court perceives may ultimately lead to a distortion or loss of the fundamental goal of bankruptcy of providing the debtor with a new opportunity in life, and result in mandatory Chapter 13s.

significant sum of money and has simply chosen not to pay creditors. *In re Attanasio,* 218 B.R. 180 (Bkrtcy.N.D.Ala. 1998).

Rejecting the U.S. TRUSTEE's contention that substantial abuse be defined in terms of a debtor's ability to make a substantial payment, this Court reaffirms that the debtor's ability to fund a Chapter 13 plan is a "determination necessarily subject to an infinite variety of circumstantial factors depending on a given debtor and the debtor's particular financial condition". *In re Makinen,* 239 B.R. 532, 534 (Bkrtcy.D.Minn. 1999). It is precisely these diverse possibilities which defy a dollar threshold and require a court to consider the totality of the circumstances, as directed by Judge Mihm in *Sawatzki*. This Court finds that the DEBTOR's ability to pay only 50% of his unsecured creditors over a 36-month period, a far cry from paying his creditors in full, does not constitute substantial abuse.

This Opinion is to serve as Findings of Fact and Conclusions of Law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure.

See written Order.

DATED: April 25, 2000.

WILLIAM V. ALTENBERGER
UNITED STATES BANKRUPTCY JUDGE

COPIES TO:
MR. CHARLES E. COVEY
700 Commerce Bank Building
Peoria, Illinois 61601
Attorney for Debtor

MR. GARY T. RAFOOL
Rafool & Bourne
1600 First Financial Plaza
411 Hamilton Blvd.
Peoria, Illinois 61602
Trustee

U.S. TRUSTEE
401 Main Street, Suite 1100
Peoria, Illinois 61602

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**O R D E R**

For the reasons stated in an Opinion filed this day, IT IS ORDERED that the motion of the U. S. TRUSTEE to dismiss the case pursuant to § 707(b) is hereby DENIED.

Dated: April 25, 2000.

WILLIAM V. ALTENBERGER
UNITED STATES BANKRUPTCY JUDGE

Copies to:
Mr. Charles E. Covey
Mr. Gary T. Rafool
U.S. Trustee