UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
ALBANY DIVISION

IN RE:	)	CHAPTER 7
	)	CASE NO. 04-12403-JDW
BOBBY L. PAYNE, SR. and	)	
ALICE R. PAYNE,	)	
	)	
DEBTORS.	)	

BEFORE

JAMES D. WALKER, JR.

UNITED STATES BANKRUPTCY JUDGE

<u>COUNSEL</u>

For Debtors: F. Anthony Blakey
Post Office Box 70879
Albany, Georgia 31708

For U.S. Trustee: Elizabeth A. Hardy
433 Cherry Street, #510
Macon, Georgia 31201

MEMORANDUM OPINION

This matter comes before the Court on the United States Trustee's motion to dismiss pursuant to § 707(b). This is a core matter within the meaning of 28 U.S.C. § 157(b)(2)(A). After considering the pleadings, the evidence, and the applicable authorities, the Court enters the following findings of fact and conclusions of law in conformance with Federal Rule of Bankruptcy Procedure 7052.

Findings of Fact

Debtors Bobby and Alice Payne are married and have one son. Mr. Payne works as a foreman, and Ms. Payne is self-employed as a beautician. They filed a joint Chapter 7 petition on October 14, 2004. On January 24, 2005, the United States Trustee filed a motion to dismiss for substantial abuse on the ground that Debtors have sufficient disposable income to pay a significant portion of their debts through a Chapter 13 plan. The Trustee made this determination by examining Debtors' schedules and several past tax returns.

There are some discrepancies between Debtors' bankruptcy schedules and their 2004 federal income tax returns, particularly with respect to Ms. Payne's business expenses. Certain expenses were excluded from the tax return–most notably an estimated tax payment of $460 per month and maintenance expenses of $100 per month. Nevertheless, Trustee's analysis of current and past tax returns yielded a higher figure for business expenses than Debtors' bankruptcy schedules. The differences in these figures as well as the income figures seem to be more a result of different methods of analysis than significant differences in actual numbers. Parsing every discrepancy is not productive in that it will not yield any useful information. The Court finds that the numbers used in the bankruptcy schedules are an accurate–if not precise–representation of Debtors' financial condition.

According to Schedule I, Debtors have a combined monthly income of $6,133.74, after payroll deductions for taxes and insurance. Schedule J reports monthly expenses of $6,221, including $2,090 in business expenses. Personal expenses totaling $4,131 are as follows:

Rent: $618
Electricity: $150
Telephone: $70
Cable: $45
Cellular phone: $70
Garbage: $15
Home maintenance: $75
Food: $400
Clothing: $100
Medical and dental expenses: $200
Transportation (excluding car payments): $250
Charitable contributions: $100
Homeowner's insurance: $30
Life insurance: $21
Auto insurance: $110
Repayment of past due federal income taxes: $275
Property taxes: $170
Jaguar payment: $675
Timeshare property: $180
Van lease: $527
School expenses: $50

Because Debtors introduced no evidence of making regular charitable contributions of $100 per month, the Court will reduce that expense. The trustee presented evidence that Debtors' average monthly charitable contributions are approximately $30. Therefore, the Court finds that Debtors' actual charitable contribution expense is $30. The schedules also do not reflect a monthly expense of $332 for a whole life insurance policy.[1] Taking into account these two corrections, personal expenses plus business expenses total $6,483. In addition, the schedules do not reflect a monthly 401(k) loan repayment deducted from Mr. Payne's paycheck of $160. As a result, Debtors' monthly income is reduced to $5,973.74.

One item of concern among Debtors' expenses is the Jaguar. In 2001, Debtors entered into a 3-year lease on a new S type Jaguar, but converted the lease to a loan in June of 2004. To facilitate this conversion, they borrowed $5,000 from Mr. Payne's 401(k) as a down payment. The total amount of the car loan exceeded $21,000 at an interest rate of 21 percent. According to Ms. Payne, they purchased the Jaguar at the end of the lease because they were unable to obtain financing to purchase a different car. However, she stated that they did not try to buy a used car priced at $5,000 or less with the 401(k) money because it did not occur to them to do so.

Also in the summer of 2004, Mr. Payne stopped making 401(k) contributions and purchased a whole life insurance policy. He testified that he did so because the 401(k) had been losing money, and he had been advised that the insurance policy would be a safer investment. He had been making payments of approximately $220 per month on the 401(k) for several years. Currently, according to his testimony and his checking account statement, he is making a payment of $332 per month for the whole life policy. Basically, prior to filing for bankruptcy, Debtors' replaced a $220 per month retirement contribution with a $332 per month contribution.

[1] The $21 life insurance payment listed on Schedule J is apparently for one or both of Debtors' term life policies.

Debtors have unpaid federal income tax liability for the years 2001, 2002, and 2003 of $16,598, including penalties and interest, according to Schedule E. They have additional liability of $4,966 for 2004. They paid no taxes for these years. In 2002, they entered into an agreement with the IRS to repay past due taxes, including taxes that may have been due prior to 2001. The payment has changed over the years and currently is $275 per month.

Mr. Payne testified that Debtors knew they were in financial trouble by 2002, and at that time, they stopped making charges on their credit cards and entered into the plan to repay their past due taxes. They sought credit counseling and repaid approximately $15,000 in debt through Consumer Credit Counseling Service between February 2002 and August 2004. They also unsuccessfully tried to take out home equity loans to pay off the debt. Despite their repayment efforts, a creditor sued them for $2,600. That suit compelled Debtors to consult a bankruptcy attorney and subsequently file this case.

The creditor's suit represents a small fraction of Debtors' total debt. They scheduled $118,753 in secured claims, including the timeshare and the Jaguar; $16,598 in priority claims, all held by the IRS; and $53,637 in general unsecured claims. The liens on two secured claims for $2,613 and $4,705 have been avoided, increasing general unsecured claims to $60,955. In addition, Debtors' 2004 income tax liability of $4,966 increases priority claims to $21,564.

The Court held a hearing on the Trustee's motion to dismiss on April 19, 2005, and, for the following reasons, will grant the motion.

Conclusions of Law

Section 707(b) of the Bankruptcy Code authorizes the Court to "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." 11 U.S.C.A. § 707(b) (West 2004). Debtors concede that their debts are primarily consumer. Thus, the only question is whether granting relief would be a substantial abuse. The Code does not define "substantial abuse," so its interpretation has fallen to the courts, which have generated numerous opinions. Unfortunately, the Eleventh Circuit Court of Appeals is not among them. Nevertheless, virtually all courts to consider the issue look at the totality of the circumstances. Green v. Staples (In re Green), 934 F.2d 568, 572-73 (4th Cir. 1991); In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989). Although such a test involves a range of factors,[2] "[t]he primary factor in determining whether substantial abuse exists is the ability

---

[2] Factors courts have considered in the totality of circumstances analysis are varied and include the following: (1) whether the debtor filed his bankruptcy petition in good faith; (2) whether the filing was precipitated by an unseen catastrophic event, such as sudden illness or unemployment; (3) whether the schedules reasonably and accurately reflect the debtor's financial condition; (4) whether the debtor made significant purchases on the eve of bankruptcy; (5) whether the debtor incurred cash advances or made consumer purchases far exceeding his ability to repay them; (6) the period of time over which the debts were incurred; (7) whether the debtor's proposed budget is excessive or unreasonable; (8) the impact of the bankruptcy filing on the debtor's standard of living; (9) the debtor's age, health, number of dependents, and family responsibilities; (10) whether the debtor made any efforts to repay the debts or negotiate with creditors; (11) whether the debtor could provide a meaningful distribution in a Chapter 13 case; (12) whether the debtor's expenses could be reduced significantly without depriving him and his dependents of necessities. See Krohn, 886 F.2d at 126-27; Green, 934 F.2d at 572; Turner v. Johnson (In re Johnson), 318 B.R. 907, 916-17 (Bankr. N.D. Ga. 2005); In re Rogers, 168 B.R. 806, 808 (Bankr. M.D. Ga. 1993); In re Woodhall, 104 B.R. 544, 546 (Bankr. M.D. Ga. 1989).

of the debtor to repay the debts out of future disposable income." In re Rogers, 168 B.R. 806, 809 (Bankr. M.D. Ga. 1993) (Laney, J.).

In Rogers, the court found substantial abuse when the debtor had sufficient disposable income to pay its unsecured debts in full within 34 months. Id. at 810. Similarly, in In re Woodhall, 104 B.R. 544 (Bankr. M.D. Ga. 1989) (Hershner, C.J.), the court found substantial abuse when, in addition to other factors, the debtor could repay 100 percent of his priority and unsecured debts within four years. Id. at 546. Likewise, the court in Walton v. Smith (In re Smith), 229 B.R. 895 (Bankr. S.D. Ga. 1997) (Dalis, C.J.), found substantial abuse when–after reducing some expenses–the debtor could pay his priority creditors in full and his general unsecured creditors a dividend of 84.8 percent over three years. Id. at 899.

In Smith, Judge Dalis raises an issue argued by the Trustee in this case, namely that the Court can, in projecting the debtor's ability to repay under Chapter 13, reduce expenses it deems unreasonable. The court in Smith made the reductions without considering the propriety of doing so. The court in Turner v. Johnson (In re Johnson), 318 B.R. 907 (Bankr. N.D. Ga. 2005), took a different approach. In that case, the debtor's mortgage accounted for 73.84 percent of her total debt, and the monthly payment accounted for 66.3 percent of her income. Id. at 910. The trustee argued that ability to repay debts was a "dispositive" factor in the substantial abuse analysis, and that in determining the debtor's disposable income the court was "not bound by the Debtor's actual expenses." Id. at 914-15. The court disagreed with both arguments, stating that "if the Court followed the Trustee's recommendation, the Court goes beyond merely reducing expenses, and, in essence, forces the Debtor to make significant lifestyle changes by surrendering, selling, or abandoning property...." Id. at 916. By rewriting the debtor's expenses the court would effectively be imposing its personal value judgments on the debtor's lifestyle. Id. at 919. For those reasons, the court refused to reduce the debtor's housing expense for purposes of projecting her disposable income in a Chapter 13 plan. Id. Instead, the court focused on those circumstances tending to show whether or not the debtor was of the "honest but unfortunate" variety. Id. at 919-20. Because the only evidence of dishonesty was the size of the debtor's mortgage, the court found no substantial abuse. Id. at 920.

The Court tends to agree with Johnson that, as a general rule, it should not arbitrarily reduce Debtors' actual expenses for the purposes of projecting disposable income based on vague considerations of reasonableness, especially when surrender of property would necessarily follow from the reduction. However, the Court cannot simply ignore the facts surrounding the creation of certain expenses, such as the Jaguar loan and the whole life insurance policy. While they will factor into the totality of the circumstances, they may also justify reducing Debtors' expenses solely for analytical purposes.

The Court has found that Debtors have income of $5,973.74 and expenses of $6,483. In a Chapter 13, Debtors assert that they would surrender the timeshare and pay the IRS and Jaguar through the plan. Thus, their monthly expenses can be reduced by $180, $275, and $675 respectively for each item, leaving total expenses of $5,353. Relying on these numbers, without any inquiry into the reasonableness of the expenses, Debtors would have $620.74 per month available to fund a 57 month plan. Allowing 8 percent or $49.66 for administrative costs, the remaining $571.08 would be insufficient to pay the secured and priority claims in full. Over the life of a 57 month plan, this formula would generate total payments of $32,551.56. The Jaguar alone, based on 12 percent interest, would require total payments of approximately $27,417. That leaves only $5,134.56 to pay priority debts that total $21,564 and nothing for general unsecured creditors.

The only way to provide any dividend to general unsecured creditors is to force Debtors to cut their budget. The analysis advanced by the trustee allows no income accommodation for the 401(k) loan repayment ($160) and no expense for the whole life policy ($332). It also eliminates the secured claim for the Jaguar (thereby freeing up a significant portion of the plan payment), but adds $350 to Debtors' monthly expenses to provide for a replacement vehicle. Making these adjustments, Debtors would have monthly income of $6,133.74 and expenses of $5,341, leaving $792.74 available to fund a plan. Subtracting $63.42 for fees, leaves $729.32 or $41,571.24 for creditors over the life of a 57 month plan. Of that, $21,564 would go to the IRS, leaving $20,007.24 for general unsecured creditors, which represents a dividend of 32.8 percent. Although the cases cited earlier in this opinion provided dividends of near or at 100 percent over a shorter time frame, the Court does not consider $20,000 to be a trivial or insignificant payment.

The trustee has also argued that Debtors have engaged in a pattern of choosing themselves over their creditors. This is demonstrated by (1) their consistent failure to pay income taxes as they came due in previous years, (2) their decision to lease a Jaguar at a time when they were not paying their income taxes, (3) their decision to convert the Jaguar lease to a loan rather than purchasing a less expensive car, (4) their decision to switch from a 401(k) plan to the greater expense of a whole life insurance policy as their primary retirement vehicle, and (5) incurring $50,000 in credit card debt. Not specifically listed, but also among the trustee's concerns is the continuing expense of the timeshare. The trustee argues that these choices are not merely the result of bad judgment, but instead are acts of recklessness that are indicia of Debtors' bad faith in dealings with their creditors.

The court in Krohn said that "a court should ascertain from the totality of the circumstances whether [the debtor] is merely seeking an advantage over his creditors, or instead is 'honest,' in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is 'needy' in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets." 886 F.2d at 126. See also Johnson, 318 B.R. at 919-20.

Debtors' actions here seem to cut both ways. In fact, this case presents a combination of excessive spending, honest efforts to rectify past problems, and extraordinarily bad judgment. On one hand, Debtors lived beyond their means by running up credit card debt and purchasing luxuries such as the timeshare and Jaguar. In addition, as the trustee pointed out, they did all this while ignoring their income tax obligations. In contesting the motion to dismiss, they have used their IRS liability as a reason that they cannot fund a Chapter 13 plan; once the priority debts are paid, there is no money left for the general unsecured creditors. The irony of this argument is not lost on the Court.

The timeshare poses a special problem. In analyzing their ability to fund a hypothetical Chapter 13, Debtors consented to surrender the timeshare. However, they have made no similar concession if their Chapter 7 case survives dismissal. Currently, their statement of intention indicates that the debt will be reaffirmed. They have not amended the statement of intention or otherwise assured the Court that they are prepared to surrender the property. Keeping a vacation property while unsecured creditors go unpaid weighs in favor of a finding of substantial abuse.

The Jaguar is another matter. Reliable transportation is not merely a luxury. It is necessary to the ability to earn a living and care for children. The problem with the car, aside from the fact that it is a luxury vehicle, is the circumstances under which the loan was obtained. Debtors' had two options: (A) use the $5,000 from the 401(k) as a down payment and take out a loan for $21,000 at 21 percent interest; or (B) buy a $5,000 car and not incur any further debt. Debtors claim that they simply did not recognize (B) as an option. They testified that by this time they understood that they were in serious financial trouble. Yet it never occurred to them to use the money to buy a more modest used car. It is difficult for the Court to reconcile these facts, even taking into account bad judgment. Ultimately, this also tends to show substantial abuse.

The purchase of the whole life policy essentially as a replacement for Mr. Payne's 401(k) does seem to be the result of simple bad judgment based on bad financial advice. Even so, contributing to any retirement vehicle while creditors, including the IRS, go unpaid does not paint a favorable picture.

On the other side of the equation, Debtors have engaged in certain behavior that should be encouraged–ceasing to use their credit cards, repaying a significant amount of debt through a credit counseling service, and repaying past due income taxes. But, even these actions are undermined by the attendant circumstances. From 2002 through 2004, while Debtors were in credit counseling and while they were repaying back taxes, they let their current income tax liability go unpaid. In this case, Debtors' good behavior simply cannot surmount the numerous factors that weigh in favor of finding substantial abuse. The Court does not doubt Debtors' sincerity in trying to remedy their financial troubles. However, their unwillingness to make sacrifices in their lifestyle in the process cannot be overlooked.

After considering the totality of the circumstances, the Court finds that granting Debtors a discharge would be a substantial abuse of Chapter 7. Therefore, the Court will grant the trustee's motion and dismiss this case.

Debtors have not indicated they wanted to convert this case to Chapter 13 in the event of an adverse decision. Understanding Debtors may have preferred to avoid any appearance of doubt as to the viability of their defense to the U.S. Trustee's motion, the Court would welcome a timely filed motion for reconsideration to delay the effective date of this order for the purpose of filing such a conversion.

An Order in accordance with this Opinion will be entered on this date.

Dated this 10th day of June, 2005.

James D. Walker, Jr.
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
ALBANY DIVISION

IN RE:	)	CHAPTER 7
	)	CASE NO. 04-12403-JDW
BOBBY L. PAYNE, SR. and	)	
ALICE R. PAYNE,	)	
	)	
DEBTORS.	)	

ORDER

In accordance with the Memorandum Opinion entered on this date, the Court hereby GRANTS the motion of the United States Trustee to dismiss the above-captioned case.

So ORDERED, this 10th day of June, 2005.

James D. Walker, Jr.
United States Bankruptcy Judge