UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In re: **DENNIS STEVEN FREEMAN and** **LAURA L. FREEMAN,** **Debtors.**	: : : : : :	**Case No. 01-06490-CH** **Chapter 7**

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ORDER—TRUSTEE'S MOTION TO DISMISS CASE AND OBJECTION THERETO

On April 17, 2002, a hearing was held on the United States Trustee's Motion to Dismiss Case and Debtor's Objection Thereto. David A. Morse represented Debtors Dennis Freeman and Laura Freeman. Assistant United States Trustee James L. Snyder represented the United States Trustee for Region 12, Habbo Fokkena. At the conclusion of the hearing, the court took the matter under advisement. The court considers the matter fully submitted.

The court has jurisdiction of these matters pursuant to 28 U.S.C. §§ 157(b)(1) & 1334 and order of the United States District Court for the Southern District of Iowa pursuant to 28 U.S.C. § 157(a). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O). Upon review of the pleadings, evidence, and arguments of counsel, the court now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 9014 and 7052.

FINDINGS OF FACT

1. Dennis Freeman and Laura Freeman (hereinafter collectively, Debtors) filed a joint voluntary petition for chapter 7 bankruptcy relief on December 19, 2001.

2. Debtors scheduled six secured creditors in Schedule D holding $145,601 in claims. These debts consist of first and second mortgages against Debtors' homestead and loans against debtors' thrift savings plans.

3. Schedule F lists 26 unsecured creditors holding $50,232.26 in unsecured claims.

4. Debtors' scheduled claims are primarily consumer in nature.

5. Debtors statement of intention states that they intend to reaffirm all debts described in Schedule D.

6. Debtors' Schedule I - Current Income shows that Dennis earns gross monthly income of $3,560.03 for a yearly amount of approximately $42,720.00. From this amount, $884.65 is withheld for payroll taxes and social security; $161.40 for insurance; $37.14 for union dues; and $1,104.23 for his "pension."

7. Debtors' schedule of current income shows that Laura earned gross monthly income of $3,571.71 for a yearly amount of approximately $42,860.52. From this amount, $940.46 is withheld for payroll taxes and social security; $32.93 for insurance; $37.14 for union dues; and $1,448.10 for her "pension."

8. Debtors' scheduled their total combined monthly income as $2,617.69. Debtors' schedule of current expenses indicates monthly expenses totaling $3,294.87.

9. Debtors' statement of financial affairs indicates that Debtors' income for 1999 was $91,859.36. Their joint income for 2000 was $103,392.79 and for 2001 was $89,985.21.

10. Debtors identify two dependents, a daughter age 14 years, and a daughter age 18 years.

11. Debtors have scheduled the following amounts as direct payments for the cost of their home: house payment - $1,098.71; utilities - $242.00; water and sewer - $100.00; and, home maintenance - $50.00; for a total of $1,490.71.

12. Debtors scheduled wage deductions of $2,552, primarily to fund contributions to Debtors' retirement plan and repayment of loans from Debtors' retirement plan.

13. Debtors work in the Des Moines area, both employed with the United States Postal Union. Debtors' live in Altoona, Iowa.

14. Debtors are providing insurance for their daughter, and the schedule reflects this amount.

15. On March 4, 2002, the United States Trustee for Region 12 (hereinafter UST) filed a motion to dismiss based on the reasonableness and accuracy of Debtors' schedules pursuant to § 707(b).

16. Debtors filed a response to the motion to dismiss and attached various documents to support their position. They included billing statements, letters, paycheck stubs, and a copy of their 1999 federal income tax return. They did not include a copy of their 2000 or 2001 tax return.

DISCUSSION

UST filed a motion to dismiss Debtors' bankruptcy case pursuant to 11 U.S.C. §707(b), and contends that allowing Debtors to proceed under chapter 7 would result in a substantial abuse of the provisions of the chapter. UST argues that Debtors have understated their income by including deductions for pension contributions and pension loan repayments. UST also contended that Debtors have overstated their expenses and offers specific alterations to their expense schedule. If

said deductions are included and the expenses modified, Debtors have sufficient disposable income to repay their unsecured consumer debt. In the motion, UST calculates that in a hypothetical chapter 13, Debtors could pay $76,500.00 over the course of a 36-month plan resulting in the payment of 152.29% of their unsecured debt, and $127,500.00 or 253.82% of their unsecured debt in 60-month plan.

Debtors dispute UST's conclusions and calculations. They argue that the Trustee's motion failed to take into consideration the financial ramifications of eliminating the pension contributions and loan repayments, and its impact on the money available to the Debtors upon retirement as well as the severe negative adverse tax consequences to the Debtors. Debtors maintain that their pension deductions are necessary expenses whose removal would severely limit the amount available to them at time of retirement. They state that their disposable income should not include their voluntary contribution to their retirement plan or their retirement loan repayment, and according to them relief under chapter 7 would not be an abuse of its provisions.

Section 707(b) was enacted in 1984 in response to Congress's perception that an increasing number of unneedy debtors were using chapter 7 to escape paying consumer debts. In re Walton, 866 F.2d 981, 982-83 (8th Cir. 1989). After amendments in 1986 and 1998, § 707(b) provides:

> (b) 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) (2001).

In order to prevail on a motion to dismiss, UST must show that Debtors' debts are primarily consumer in nature, and that granting chapter 7 relief would result in substantial abuse of the provisions of the chapter. In re Praleikas, 248 B.R. 140, 143 (Bankr. W.D. Mo. 2000).

The Bankruptcy Code does not define "substantial abuse." In interpreting the term, the Eighth Circuit holds that the essential inquiry is "whether the debtor's ability to repay creditors with future income is sufficient to make the Chapter 7 liquidating bankruptcy a substantial abuse of the Code." Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992). See also U.S. Trustee v. Harris, 960 F.2d 74, 77 (8th Cir. 1992); In re Walton, 866 F.2d at 984-85. While the Eighth Circuit does not adopt a wide ranging "totality of the circumstances test," Harris, 960 F.2d at 77, the court may consider a variety of factors. See In re Walton, 866 F.2d at 983- 85 (courts not foreclosed *inter alia* from considering future income and inability to pay alone might not shield a debtor from dismissal under § 707(b)); see also In re Woodward, 265 B.R. 179, 187-88 (Bankr. S.D. Iowa 2001) (courts may consider additional relevant factors to determine that § 707(b) dismissal is proper). However, a debtors' ability to fund a chapter 13 plan is the primary factor to be considered. In re Walton, 866 F.2d at 985 (citing with approval the Ninth Circuit's analysis in Zolg v. Kelly (In re Kelly)), 841 F.2d 908, 914-15 (9th Cir. 1988).

The ability to fund a chapter 13 plan is determined by a calculation of the debtors' disposable income. Stuart v. Koch (In re Koch), 109 F.3d 1285, 1289 (8th Cir. 1997). "Disposable income" is defined as income not reasonably necessary for the support of the debtor, the debtor's dependents, or the debtor's business. Id. citing 11 U.S.C. § 1325(b)(2).

In this case, Debtors do not dispute UST's assertion that their debts are primarily consumer debts. No evidence was introduced at the hearing to indicate that any of the debts listed in the schedules were acquired for the purpose of obtaining a profit. Accordingly, the court finds that UST has met this element as required by § 707(b).

The court agrees that Debtors' deductions for pension contributions must be included in a calculation of disposable income under a hypothetical chapter 13 analysis. This court has consistently held that in determining disposable income, a debtor may not withhold amounts to be contributed to a retirement fund, absent compelling reasons. In re Ventling, Case No. 01-01153-CH slip op. at 7 (Bankr. S.D. Iowa June 6, 2002) (JH Dec. #363). The weight of case law supports this view. See In re Heffernan, 242 B.R. 812, 818 (Bankr. D. Conn. 1999) (payments to pension plan not reasonably necessary for debtor's support, therefore disposable income for § 707(b) analysis); In re Watkins, 216 B.R. 394, 396 (Bankr. W.D. Tex.1997) (same); see also, In re Festner, 54 B.R. 532, 533 (Bankr. E.D.N.C. 1985) (voluntary contributions to a pension may be prudent, but they cannot be made at the expense of unpaid creditors); In re Fountain, 142 B.R. 135, 137 (Bankr. E.D. Va. 1992) (pension contributions are not necessary for maintenance and support of the debtor, and therefore, constitute disposable income); In re Cavanaugh, 175 B.R. 369, 373 (Bankr. D. Idaho 1994) (voluntary contributions to retirement plans are disposable income); In Re Cornelius, 195 B.R. 831, 835 (Bankr. N.D.N.Y. 1995) (same); Feldman v. Feldman (In re Feldman), 220 B.R. 138, 146 (Bankr. N.D. Ga. 1998) (voluntary contribution to 401k not necessary living expense in calculation of disposable income for § 523(a)(15) purposes). But see, In re Mills, 246 B.R. 395, 402 (Bankr. S.D. Cal. 2000)

(holding no per se rule that pension contributions are not reasonably necessary for debtor's support and must be included as disposable income in § 707(b) analysis) and The New York City Employees' Retirement System v. Sapir (In re Taylor), 243 F.3d 124, 129-30 (2d Cir. 2001) (approving a "flexible solution" which relies on the bankruptcy court's discretion in considering various factors in the totality of circumstances to determine whether the contribution or any expense is reasonably necessary).

Debtors argue that the amounts that are withheld from their pay checks for the repayment of pension loans should not be included in the disposable income calculation. Debtors are both employed by the United States Postal Service and take part in a thrift savings plan (TSP). A TSP is a plan in which federal employees may participate as part of the retirement system created by Congress and the Federal Employees Retirement System Act of 1986 (FERSA). 100 Stat. 514; codified 5 U.S.C. §§8401-8479. All sums contributed to the TSP by the employee are held in trust for the employee in an individual account identified by the participant's name and social security number. 5 U.S.C §8437(g). When an employee receives a loan from the retirement plan, the funds received are amounts the employee him or herself has contributed to and are not taken from a TSP pool. If a TSP participant fails to repay a loan in full, the participant's TSP retirement benefits are reduced in the like amount, and the unpaid portion is reported to the Internal Revenue Service as a taxable distribution. The employee may then be liable for taxes and penalty for early withdrawal.

Debtors argue that TSP accounts are not part of the bankruptcy estate because of the anti-alienation provision in the retirement plan required by 5 U.S.C. § 8437(e). See Patterson v. Shumate, 504 U.S. 753 (1992) (holding that the anti-alienation provision under the Employee

Retirement Security Act of 1974 constitutes an enforceable restriction on the transfer of a beneficial interest of a debtor in a trust under 11 U.S.C. § 541(c) thereby excluding the interest from the bankruptcy estate). Therefore, the loans that they received from their TSP accounts are not claims as defined by the Bankruptcy Code, and the bankruptcy court lacks jurisdiction over the loans and cannot order their repayment provisions modified. See New York City Employees Retirement System v. Villarie (In re Villarie), 648 F.2d 810, 812 (2d Cir. 1981); but see In re MacDonald, 222 B.R. 69, 76-77 (Bankr. E.D. Pa. 1998) (finding that In re Buchferer, 216 B.R. 332 (Bankr. E.D.N.Y. 1997), a decision arising out of the Second Circuit, "holds that the broad definition of 'claim' recognized by the Supreme court in Johnson v. Home State Bank, 501 U.S. 78 (1991)," effectively overrules Villarie). The United States Trustee does not dispute this contention.

However, the court need not address the issue of jurisdiction over the pension funds or the loans arising from them because it is irrelevant to the court's analysis. For purposes of a § 707(b), the ability to maintain a hypothetical chapter 13 plan is measured by evaluating the debtor's financial condition. In re Koch, 109 F.3d at 1288. "The fact that a pension is exempt from the reach of creditors does not preclude a bankruptcy court from finding that the pension is also disposable income for purposes of [c]hapter 13." Taylor v. United States (In re Taylor), 212 F.3d 395 (8th Cir. 2000). "The essential inquiry is whether the debtor's ability to repay creditors with future income is sufficient to make the [c]hapter 7 liquidating bankruptcy a substantial abuse of the Code." Fonder v. United States, 974 F.2d 996, 999 (8th Cir. 1992).

Many other courts have held that repayment of pension loans and contribution to pension

plans should be included in the calculation for disposable income. See e.g. In re Harshbarger, 66 F.3d 775, 777 (6th Cir.1995) (pension plan repayments should be included "as part of the disposable income in the bankruptcy estate" to satisfy 11 U.S.C. § 1325(b).); In re Anes, 216 B.R. 514 (Bankr. M.D. Pa. 1998) *affd*, 195 F.3d 177, 179 (3d Cir. 1999) (same); In re Estes, 254 B.R. 261, 263-266 (Bankr. D. Idaho 2000) (repayment of a 401K retirement fund is voluntary and not reasonably necessary for the maintenance and support of the debtor); In re Davis, 241 B.R. 704, 707-709 (Bankr. D. Mont. 1999) (concerning a Montana provision similar to ERISA, that mandatory deductions for retirement contributions are to be included in projected disposable income); In re Gilliam, 227 B.R. 849, 851 (Bankr. S.D. Ind. 1998) (repayment of pension loans included in projected disposable income and is not reasonably necessary for the support of the debtor); In re Johnson, 241 B.R. 394, 401 & 403 (Bankr. E.D. Tex. 1999) (chapter 13 debtor's proposal to repay a loan to a pension plan violated §1325(b)).

Further, the fact that a debtor might suffer adverse tax consequences as a result of failing to repay the pension loan does not alter this conclusion. See In re Scott, 142 B.R. 126, 135 (Bankr. E.D. Va. 1992) ("Court finds that the debtor may not avoid such [tax] liability and hardship to the detriment of his creditors."); In re Estes, 54 B.R. at 266-67 (Bankr. D. Idaho 2000) (tax "penalties are not sufficient to make these payments "mandatory" and therefore excluded from the calculation of disposable income").

In this case, Dennis Freeman's deduction of $1,104.00 and Laura Freeman's deduction of $1,448.00 (amounts rounded down to a whole dollar) from their monthly incomes for pension contributions and pension loan payments must be included in a calculation of disposable income.

Accordingly, Dennis Freeman's monthly total income for a hypothetical chapter 13 analysis is $2,608.00 ($1,504.00 + $1,104.00 = $2608.00), and Laura Freeman's monthly total income is $2,561.00 ($1,113.00 + $1,448.00 = $2,561.00). Their combined total monthly income is $5,169.00.

Debtors scheduled monthly expenditures of $3,295.00 (rounded up to the next dollar). UST argues that Debtors have overstated their expenses and suggest adjustments amounting to $269.00 per month. Even if the court ignores the UST's proposed adjustments and uses Debtors' scheduled expenses, Debtors have disposable monthly income of $1,874.00 ($5,169.00 – $3,295.00 = $1874.00). Said disposable income would generate $69,464.00 over the course of three years and $112,440 over five years. Consequently, Debtors are capable of repaying their unsecured debts in full in either scenario. The court additionally notes that Debtors claimed federal tax refunds $5,500.00 and $5,467.00 in 1999 and 2000 respectively. In the same years, Debtors' state returns showed them owing $18.00 and $398.00. Debtors estimated a federal tax refund of $5,500.00 for the 2001 tax year. Said refund would constitute reportable income and subject to turnover to the trustee in a hypothetical chapter 13.

Accordingly, the court finds that UST has overcome the statutory presumption for granting the requested relief. The court finds that Debtors have sufficient disposable income to fund a chapter 13 plan. Allowing them to proceed with their chapter 7 case will result in a substantial abuse of the provisions of this chapter. UST's motion to dismiss will be granted. However, the court will stay the execution of its order for fifteen days to provide the Debtors with the opportunity to convert their case if they so choose.

ORDER

IT IS ACCORDINGLY ORDERED as follows:

1) The United States Trustee's Motion to Dismiss is SUSTAINED.

2) The court will stay the execution of the order dismissing the case for fifteen (15) days from the date of the entry of this order to permit Debtors to take such actions as required to convert their case to another chapter, should they so choose.

3) Failure on the part of Debtors to take affirmative action within said fifteen (15) day period of time will cause the order dismissing the case to be entered without further notice and hearing.

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RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE