UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

LINDA S. SMITH, dba
Mark Smith Standard Service,

Debtor.

Case No. 87-2145-W

C.R. HANNAN, Trustee

Plaintiff,

V.

LINDA S. SMITH, dba
Mark Smith Standard Service,

Defendant.

Adv. Pro. No. 87-0263

Chapter 7

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MEMORANDUM OF DECISION

On May 3, 1988 a hearing on defendant's motion to dismiss the adversary proceeding in this Chapter 7 case was held in Council Bluffs, Iowa. C.R. Hannan, trustee, appeared. David J. McCann appeared on behalf of the defendant. Charles C. Smith appeared on behalf of City National Bank of Shenandoah. The issue before the court is whether the debtor should be denied a discharge under 11 U.S.C. section 727(a)(2)(A). At the hearing the court denied the debtor's motion to dismiss and stated it would address the merits of the complaint based on the present record and arguments of counsel. Much of the record is derived from proceedings concerning the trustee's objection to exemptions and application to compel

debtor to turn over property.

This is a core proceeding pursuant to 28 U.S.C. section 157(b)(2)(I). Based on the record and arguments of counsel and being fully advised in the premises, the court makes the following findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052.

FACTS

The debtor and her late husband, Mark L. Smith, operated a gasoline and service station in Shenandoah, Iowa. Mark L. Smith died on July 23, 1986. Beginning in the fall of 1986, the debtor discussed purchasing a life insurance policy with three different life insurance agents. The debtor's attorney advised the debtor to sell a 1969 Chevrolet Camaro and a 1952 Chevrolet and to apply the proceeds toward the purchase of a life insurance policy. The debtor sold the two vehicles for $7,000.00 and used this money to purchase a single premium life insurance policy on August 17, 1987. The debtor stated she purchased the policy to protect her two sons. At the time the debtor purchased the policy, unmatured life insurance policies were exempt from execution under Iowa law. Iowa Code section 627.6(6)- [1]

[1] In 1988 the Iowa Legislature extensively amended Iowa Code section 627.6(6). Section 4 of House File 649 (to be codified at Iowa Code section 627.6(6)). Among other things, the amendments place a $10,000.00 limit on the exemption for insurance acquired within two years of the date execution is issued or exemptions are claimed. These changes have no bearing on the issue before the court.

Leak Specialists is in the business of inspecting underground fuel tanks for leaks. Leak Specialists inspected the debtor's gasoline tanks in April of 1987 and charged $750.00 for its services. The debtor did not pay the bill. In August of 1987 a representative of Leak Specialists telephoned the debtor about the overdue bill. The representative asked when payment could be expected. The debtor replied she would try to make payments from sums she expected from accounts receivable. At that time the gas station held $3,439.71 in accounts receivable. The debtor stated in a deposition that she intended to collect the receivables and pay Leak Specialists.

Later in August, the debtor's attorney advised her not to collect the accounts because once she filed bankruptcy she would be required to turn over to the trustee any amounts received. The debtor filed for relief under Chapter 7 on August 27, 1987.

DISCUSSION

The trustee argues that the debtor's representation to Leak Specialists that payment on the bill would be made after collecting on accounts receivable was false. The trustee alleges that the debtor intended to cause Leak Specialists to take no collection action until she filed bankruptcy. The trustee points to the fact that the debtor's business bank account contained sufficient funds from which to pay Leak Specialists. Additionally the trustee notes

that at the time the debtor made the representations to Leak Specialists she sold the vehicles for $7,000.00 and used the amount to purchase a life insurance policy.

The trustee's cause of action is based on 11 U.S.C. section 727(a)(2)(A) which reads:

> (a) The court shall grant the debtor a discharge, unless--
>
> ....
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an office of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
> (A) property of the debtor, within one year before the date of filing the petition;

An action brought under section 727 is the most serious non-criminal action that a creditor can bring against a debtor in bankruptcy. In re Schermer, 59 B.R. 924 (Bankr. W.D. Ky. 1986). Discharge under section 727 "is the heart of the fresh start provisions of the bankruptcy law". In re Nye, 64 B.R. 759, 762 (Bankr. E.D. N.C. 1986) quoting H.R. Rep. No. 595, 95th Cong., lst Sess. 384 (1977), U.S. CODE CONG. & ADMIN. NEWS 1978, pp. 5787, 6340. Consequently, objections to discharge are to be construed liberally in favor of debtors and strictly against the objecting creditor. In re Schmit, 71 B.R. 587, 590 (Bankr. D. Minn. 1987); In re Usoskin, 56 B.R. 805, 813 (Bankr. E.D. N.Y. 1985).

The burden of proof-in objecting to discharge rests with the objecting creditor. Bankruptcy Rule 4005. The four elements the trustee must prove under section 727(a) (2)(A) are:

> 1. A transfer of property has occurred;
>
> 2. It was property of the debtor;
>
> 3. The transfer was within one year of the date of filing the petition; and
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> 4. The defendant had, at the time of the transfer, the intent to hinder, delay or defraud a creditor.

In re Ford, 53 B.R. 444, 446 (W.D. Vir. 1983), aff'd 773 F.2d 52 (9th Cir. 1985).

The first three elements are not challenged. The debtor owned the vehicles. The sale of the vehicles in August of 1987 constituted a transfer within one year of the debtor's bankruptcy filing. The dispute in this case is whether Linda S. Smith possessed the intent to hinder, delay or defraud a creditor. Rarely will debtors testify they acted with the requisite intent that would warrant denial of discharge. Therefore courts may rely on all the facts and circumstances of a case to infer intent. In re Devers, 759 F.2d 751, 754 (9th Cir. 1985).

The debtor's eve of bankruptcy conversion of non-exempt property into exempt property alone does not justify denial of discharge. Hanson v. First National Bank in Brookings, No. 87-5314, slip on. at 5 (8th Cir., filed June 2, 1988). Forsberg v. Security State Bank, 15 F.2d 499, 501 (8th Cir.

1926). However, where other facts exist showing fraudulent intent, a denial of discharge is warranted. Norwest Bank Nebraska, N.A. et al. v. Tveten, No. 87-5312, slip op. at 9 (8th Cir., filed June 2, 1988).

In Tveten a physician, suffering from severe financial setbacks, liquidated most of his non-exempt assets worth approximately $700,000.00 and converted the assets into exempt property. Tveten later filed for protection under Chapter 11 and a creditor objected to discharge on the ground that Tveten intended to defraud, delay and hinder his creditors by converting the assets. The Eighth Circuit affirmed the district court's affirmance of the bankruptcy court's finding that there was extrinsic evidence to show that Tveten transferred the property with the intent to defraud. In doing so, the Eighth Circuit was influenced by a number of factors. First was Tveten's admission that his purpose in making the transfers was to shield assets from creditors. Secondly, the exemption to which Tveten transferred the non-exempt assets--life insurance and annuity contracts payable by a fraternal benefit association--had no monetary limit. The court found that unlimited exemptions had the potential for unlimited abuse. The court clearly was concerned with the amount of money Tveten attempted to protect in relation to the purposes behind exemption laws, namely protecting a family from impoverishment and providing debtors the means with which to survive during times of

little or no income. The court declared:

> [T]his case presents a situation in which the debtor liquidated almost his entire net worth of $700,000.00 and converted it to non-exempt property in seventeen transfers on the eve of bankruptcy while his creditors, to whom he owed close to $19,000,000, would be left to divide the little that remained in his estate. Borrowing the phrase used by another court, Tveten 'did not want a mere fresh start, he wanted a head start.' His attempt to shield property worth approximately $700,000.00 goes well beyond the purpose for which exemptions are permitted.

Id. at 12 (citation omitted)(emphasis in original). Finally, the Eighth Circuit agreed with the bankruptcy court's finding that Tveten's entire pattern of conduct evidenced fraudulent intent.

Consideration of the Tveten factors leads the court to conclude that the trustee has failed to meet his burden in this case. Although the life insurance exemption utilized by the debtor had no monetary limit, there is no evidence that the debtor abused the exemption. The $7,000.00 in proceeds the debtor put into life insurance is exceedingly modest in comparison to the sums involved in the Tveten case. Further, the amounts involved here are fully consistent with the beneficial policies underlying Iowa's exemption statute. In no way do the amounts exceed what is necessary and reasonable to further those policies. Finally, the trustee has not established a "pattern of conduct" demonstrating intent to hinder, delay or defraud. Rather, the

court finds credible the debtor's testimony that her purpose in transferring the property was to protect her sons.

CONCLUSION

WHEREFORE, for the reasons expressed above, the court finds that the debtor did not sell the vehicles and apply the proceeds to the purchase of a life insurance policy with the intent to hinder, delay or defraud her creditors.

THEREFORE, a denial of discharge the trustee seeks is not warranted. An order of dismissal of this adversary proceeding will be entered.

Dated this 3rd day of August, 1988.

LEE M. JACKWIG
CHIEF U.S. BANKRUPTCY JUDGE