

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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May 8, 2002

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Subject: *In re Kevin G. and Cathy J. Cap,*
Chapter 7; Bankr. No. 01-41239

Dear Counsel:

The matter before the Court is the Motion for Judgment on the Pleadings and brief filed by the United States Trustee on April 11, 2002, and Debtors' response and brief filed April 22, 2002. This is a core proceeding under 11 U.S.C. § 152(b)(2). This letter decision and accompanying order shall constitute the Court's findings and conclusions under Fed.R.Bankr.P. 7052 and 9014. As set forth below, the Court concludes that the Motion will be denied and that an evidentiary hearing will be held promptly, as needed.

Summary. Kevin G. and Cathy J. Cap ("Debtors") filed a Chapter 7 petition on November 2, 2001. According to their schedules I and J, Debtors had monthly net income of just over \$3,000 and monthly expenses of just over \$3,574.

Under 11 U.S.C. § 707(b), the United States Trustee moved to dismiss the case for substantial abuse. The United States Trustee argued that Debtors had understated their monthly income available to pay creditors because their expenses had included voluntary retirement fund contributions and because Debtors were having too much income withheld for federal taxes. Based on their calculation, the United States Trustee argued that Debtors' actual monthly net income is \$3,977. The United States Trustee further argued that Debtors' monthly expense for housing and related

Re: Kevin G. & Cathy J. Cap
May 8, 2002
Page 2

utilities were excessive. When their calculated net income of \$3,977 was compared to the calculated reasonable expenses, the United States Trustee argued that Debtors had available income of \$1,233 per month to make Chapter 13 plan payments and that with this monthly sum they could pay all their unsecured creditors nearly in full over three years. The United States Trustee further noted that at the meeting of creditors, Debtors disclosed that they are receiving another \$200 in income per month from a contract for deed (this income had not been set forth on their Schedule J). The additional \$200 per month would further improve Debtors' ability to fund a Chapter 13 plan, the United States Trustee argued.

In their response, Debtors stated that Debtor Kevin Cap's employer estimated that Debtor Kevin Cap's net monthly income in 2002 would be only \$3,259.28. Debtors also argued that payroll deductions for Debtor Kevin Cap were standard for income taxes, Social Security, and Medicare.¹ Later the employer filed an affidavit regarding Debtor Kevin Cap's income for 2002. The employer estimated that Debtor Kevin Cap's net monthly income would be \$3,078. Attached were recent payroll statements for Debtor Kevin Cap.

The United States Trustee moved for a judgment on the pleadings based on that office's review of the payroll statements attached to Debtor Kevin Cap's employer's affidavit. The United States Trustee calculated that Debtor Kevin Cap was actually receiving monthly net income of \$3,540.60 per month in 2002. Further, the United States Trustee argued that Debtors had not refuted that their monthly housing expenses (mortgage and utilities) exceeded the I.R.S.'s housing allowance for their home county by about \$1,000 and that if their housing expenses were reduced, that Debtors would be able to fund a Chapter 13 plan. Even recognizing that the \$200 monthly contract for deed payments will end in 11 months, the United States Trustee calculated that Debtors would still have over \$600 a month in disposable income to fund a Chapter 13 plan.

¹ Debtors' response also stated that a pre-petition claim by their attorney of \$800 had been left off Schedule J. That debt, however, would be discharged under Chapter 7. Under Chapter 13, it would be an administrative claim if the pre-petition legal services were bankruptcy related.

Re: Kevin G. & Cathy J. Cap
May 8, 2002
Page 3

In their response, Debtors still maintained that Debtor Kevin Cap's net monthly income was presently only \$3,078; they did not address the calculation error raised by the United States Trustee. Further, Debtors argued that they should not be forced to sell their home in an effort to reduce their monthly housing expenses because sale costs would eat up some of their equity, which would be entirely exempt as their homestead.

Applicable law. Section 707(b) of the Bankruptcy Code permits the dismissal of a Chapter 7 case upon a showing that granting the debtor relief would be a substantial abuse of the Bankruptcy Code. The section is intended to promote fairness to creditors and prevent the use of Chapter 7 by non needy debtors. *Stuart v. Koch (In re Koch)*, 109 F.3d 1285, 1288 (8th Cir. 1997).

"Substantial abuse" is not defined within the Bankruptcy Code. In interpreting the section, the Court of Appeals for the Eighth Circuit has held that the primary inquiry is whether the debtor has the ability to pay creditors under a Chapter 13 plan. *Id.* (citing *In re Walton*, 866 F.2d 981, 983 (8th Cir. 1989)); *Nelson v. Siouxland Federal Credit Union (In re Nelson)*, 223 B.R. 349, 353 (B.A.P. 8th Cir. 1998). A debtor's ability to pay is measured by evaluating the debtor's financial condition in a hypothetical Chapter 13 case. *Id.* The analysis includes the expectation that the debtor will put forth his best effort in a Chapter 13 plan. *In re Shelley*, 231 B.R. 317, 319 (Bankr. D. Neb. 1999); *In re Beauchamp*, Bankr. No. 97-50487, slip op. at 6 (Bankr. D.S.D. May 28, 1998) (citing *Hagel v. Drummond (In re Hagel)*, 184 B.R. 793, 798 (B.A.P. 9th Cir. 1995), and *In re Schnabel*, 153 B.R. 809, 818 (Bankr. N.D. Ill. 1993)).

Discussion. Were the Court to rely on Debtors' Schedules I and J as originally filed, it is clear that Debtors have the ability to fund a Chapter 13 plan. Based on those schedules, Debtors could use the \$528 that Debtor Kevin Cap was contributing to a 401k account and he could cut his federal income tax withholding by at least a few hundred dollars per month. With this disposable income of at least \$700, Debtors could repay a substantial portion of their unsecured debt through a Chapter 13 plan. Debtors have, however, amended their schedules and the changes are significant. Such significant changes alone warrant further inquiry because the Court and the United States Trustee should both be able to fully rely on a debtor's original schedules.

Re: Kevin G. & Cathy J. Cap
May 8, 2002
Page 4

Based on Debtors' amended schedules, the first issue is Debtor Kevin Cap's monthly net income. In their response to the United States Trustee's Motion for Judgment on the Pleadings, Debtors did not identify any error in the United States Trustee's calculations based on the attachments to the employer's affidavit. Thus, unless Debtors can supply better evidence, the Court will find that Debtor Kevin Cap's monthly net income is \$3,540.60.

To be further addressed is whether the amount withheld from Debtor Kevin Cap's salary for federal income taxes is appropriate, that is, the taxes on his income are paid in full by the year's end, but there is also no large excess to be refunded by the government. If the parties cannot quickly settle this issue, an evidentiary hearing will be held or the matter can be submitted on briefs.

The second issue is the reasonableness of Debtors' expenses, especially their housing expenses. In their original Schedule J, Debtors stated that their mortgage payments were \$1,432 and that this sum included taxes and insurance. They also stated that their utilities (electricity and/or heating fuel, water and sewer, and telephone) totaled \$405, and that their monthly maintenance costs were \$50. Thus, their housing expenses totaled \$1,887, and all their expenses, including housing, totaled \$3,574. In their amended Schedule J, filed contemporaneously with their response to the United States Trustee's Motion for Judgment on the Pleadings, Debtors stated that their mortgage payments were \$1,042 per month, their utilities were \$350 per month, their monthly maintenance expenses were \$50, their homeowner's and mortgage insurance were \$90 per month, and their real estate taxes were \$220 per month for a total of \$1,752. Under their amended Schedule J, all their expenses, including housing, totaled \$3,424, which, surprisingly, was the exact total net monthly income that Debtors set forth on their amended Schedule I.

If Debtors only had a single purchase money mortgage on their home, their housing costs would be more in line with the I.R.S.'s housing allowance for their county. Since neither of the two mortgage payments can be altered under a Chapter 13 plan, it does not appear that Debtors' housing expense can be appreciably reduced in a Chapter 13 proceeding without Debtors selling their home and moving to less expensive quarters. Absent evidence that Debtors' house is more than they reasonably need for a family of four based on their present income and the size, location, and amenities of

Re: Kevin G. & Cathy J. Cap
May 8, 2002
Page 5

the house, or that their other housing related expenses are inflated, the Court will not presume a lower housing cost is appropriate when making a Chapter 13 analysis.

Since the Court cannot resolve the federal income tax withholding issue based on the present record, the United States Trustee's Motion for Judgment on the Pleadings will not be granted. Within ten days from entry of this Order, the parties shall advise the Court whether an evidentiary hearing is needed on that issue. The United States Trustee also needs to advise the Court on whether that office has evidence to present on the appropriateness of Debtors' housing costs, as discussed above.

An order will be entered denying the United States Trustee's Motion for Judgment on the Pleadings.

Sincerely,



Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: case file (docket original; serve parties in interest)

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

MAY - 8 2002

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By 

NOTICE OF ENTRY
Under F.R. Bankr.P. 9022(a)
Entered

MAY - 8 2002

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

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