

IN THE UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION

FILED  
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U.S. BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO  
CLEVELAND

**In re:**

**In Proceedings Under Chapter 7**

**GOLDEN REY and  
REBECCA REY**

**Case No.:10-15399**

**Debtors.**

**JUDGE RANDOLPH BAXTER**

**MEMORANDUM OF OPINION AND ORDER**

This matter is before the Court on the Motion to Dismiss Case Pursuant to 11 U.S.C. § 707(b)(1) and (b)(3) (the “Motion”) filed by the United States Trustee for Region 9 (the “UST”) over the objection of Golden and Rebecca Rey (the “Debtors”). This Court acquires core subject matter jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a), (b)(1), 28 U.S.C. § 1334 and General Order No. 84 of the District. After the conclusion of a duly noticed evidentiary hearing, an examination of the evidence admitted and a review of the record, generally, the following factual findings and conclusions of law are hereby rendered:

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On June 3, 2010, the Debtors filed a voluntary petition for relief under Chapter 7 of Title 11 of the United States Code (the “Bankruptcy Code”). Debtor, Golden Rey, has been employed in IT support for the past six years, and Rebecca Rey has been employed as a secretary for the past twelve years. They earn a combined annual gross income of approximately \$74,000.00. The Debtors are married and have one adult child. Debtors’ Schedule B indicates that their personal property is valued at \$82,396.64. They list \$221,273.81 in secured debt on Schedule D, \$150.00 in priority unsecured debt on Schedule E, and \$25,308.75 in general unsecured debt on Schedule F. This petition is their only bankruptcy filing.

Concurrently with their bankruptcy petition, Debtors filed their Form 22A Means Test (the “Means Test”). They listed a household size of three. The median family income for a family of three in Ohio is \$61,522.00. See [www.usdoj.gov/ust](http://www.usdoj.gov/ust) for median income for a family of three in Ohio. Thusly, the Debtors are above-median income debtors. The Debtors indicated on their Means Test that the presumption of abuse does not arise.

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The UST asserts that the Debtors’ case should be dismissed because, under the totality of the circumstances, granting the Debtors a Chapter 7 discharge would be an abuse under 11 U.S.C. § 707(b)(3). The UST contends that the Debtors are making 401(k) contributions and repaying 401(k) loans with funds that could be used to repay creditors. He asserts that the Debtors are retaining rental property, which they are incurring expenses for but not receiving rental income. The UST further notes that the Debtors received a 2009 federal tax refund of \$3,264.00, which could have been used to repay creditors.

The Debtors contend that the arguments offered by the UST are not sufficient to dismiss their case as abusive under the totality of the circumstances test. They argue that, although they are making 401(k) contributions and repaying 401(k) loans, they did not deduct those amounts in determining their available disposable income either on their schedules or their Means Test. They argue that, although they do not have a tenant in their rental property, the mortgage payment is so minimal that if they were no longer paying it they would still have negative disposable income. They further assert that they do not know whether they will have large tax refunds in the future, because some credits may not be available going forward.

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The dispositive issue before this Court is whether the Debtor's petition for relief constitutes an abusive filing.

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Section 707 of the Bankruptcy Code provides for dismissal of a Chapter 7 case or conversion to a case under Chapter 11 or Chapter 13. A case warrants dismissal where a court finds that the granting of relief would constitute an abuse of the Chapter 7 provisions.

Title 11 U.S.C. § 707(b) states the following:

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, *may dismiss* a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, *or, with the debtor's consent, convert* such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. 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)).

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of—

(I) 25 percent of the debtor's nonpriority unsecured claims in the case, or \$7,025, whichever is greater; or

(II) \$11,725.

(Emphasis added.)

Sections 707(b)(2)(A)(ii), (iii) and (iv) describe the applicable and actual expenses that a

debtor may claim.

If the presumption of abuse does not arise or is rebutted, then the court considers the totality of the circumstances under 11 U.S.C. § 707(b)(3).

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(I) of such paragraph does not arise or is rebutted, the court shall consider--

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

Section 707(b)(2)(A) of the Bankruptcy Code sets forth the criteria for a presumption of abuse and constitutes the means test for a debtor's ability to repay his debts. The means test presents a statement of the debtor's current monthly income and shows whether a presumption of abuse arises as a consequence of identifying monthly disposable income in excess of the limits described under Section 707(b)(2)(A)(ii), (iii) and (iv). A debtor's monthly disposable income is determined by deducting certain allowances and other expenses from the debtor's current monthly income. A presumption of abuse arises and the debtor fails the means test if the debtor's 60-month disposable income is greater than the amounts calculated under Section 707(b)(2)(A)(i)(I) and (II).

The standard expense allowances determined by the Internal Revenue Service ("IRS") for use in completing bankruptcy forms are posted at: <http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm>. There are standards listed for allowable living expenses including food, housekeeping supplies, apparel & services, personal care products & services, and miscellaneous items. The standards are

based upon the number of members in the household and their gross monthly income.

The inquiry for a motion to dismiss pursuant to § 707(b) of the Bankruptcy Code does not end with the determination of whether the presumption of abuse arises. Section 707(b)(3) grants a court the authority to dismiss a Chapter 7 case, where the presumption of abuse does not arise, for either bad faith or the totality of the circumstances if the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3).

The Bankruptcy Code does not define the term "totality of the circumstances." Notwithstanding, two Sixth Circuit Court of Appeals decisions, *Behlke v. Eisen (In re Behlke)*, 358 F.3d 429 (6th Cir.2004) and *In re Krohn*, 886 F.2d 123 (6th Cir.1989), provide guidance on the totality of the circumstances test for dismissal under § 707(b). Among the factors to be considered in deciding whether the totality of the circumstances warranted a dismissal of the debtor's case under § 707(b), the *Krohn* court opined:

A court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.

*In re Krohn*, 886 F.2d at 126; accord *Behlke v. Eisen*, 358 F.3d at 435.

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To meet the burden established in 11 U.S.C. § 707(b) for dismissal, the UST must prove by a preponderance of the evidence standard that granting relief would constitute abuse. *In re Browne*,

253 B.R. 854, 856-7 (Bankr. N.D. Ohio 2000).

The Debtors' Means Test indicates that the presumption of abuse does not arise, and the UST does not dispute that assertion. Rather, the UST is seeking to dismiss the Debtors' case pursuant to Section 707(b)(3). Since the UST has not alleged the Debtors acted in bad faith, this Court renders its decision herein on the basis of the totality of the circumstances.

In the present case, the Debtors are gainfully employed and have been so employed for a number of years. They earn an above-median income for their family size and geographical location. Debtors' Schedule I indicates that their combined monthly net income is \$4,743.64 per month. Their Schedule J indicates monthly expenses totaling \$5,142.51, reflecting a negative monthly disposable income of \$398.87.

The Debtors' Means Test, as filed, indicates the presumption of abuse does not arise in their case. UST Ex. D-52. The Debtors listed a 60-month disposable income amount of \$10,334.40 on line 51 of the Means Test. UST Ex. D-52. They listed the threshold debt payment amount on line 54 as \$10,417.45. UST Ex. D-52. The presumption of abuse does not arise if a debtor's 60-month disposable income is less than the threshold debt payment amount. The amounts on Debtors' Means Test narrowly avoid raising the presumption of abuse in this case. Furthermore, the Means Test permits deductions for taxes *actually incurred* on line 25. Catherine Lowman, a bankruptcy analyst from the UST's office, offered credible testimony. She testified that the amount on line 25 of Debtors' Means Test is overstated based on her review of the Debtors' 2009 federal tax return. (Lowman, C., Direct). She further stated that, by virtue of receiving a refund, the Debtors were not actually incurring the tax expense on line 25, but were actually incurring a smaller amount. (*Id.*). She conceded on cross examination, however, that the UST's office did not request the Debtors' tax

returns, and that it was unclear whether the overstatement on line 25 based on Debtors' federal tax refund would be offset by taxes owed to state and local agencies. (Lowman, C., Cross). Thusly, her testimony in this particular regard was conclusory and without substantiation.

#### 401(k) Contributions and Loan Repayments

Mr. Rey testified that he and his wife make monthly 401(k) contributions of \$305.90 and monthly 401(k) loan repayments of \$324.70, based on their biweekly pay deductions. (Rey, G., Cross). His testimony was credible. The Sixth Circuit Court of Appeals has held that loan repayments for these types of accounts cannot be deducted from the debtor's disposable income because "it would be unfair to the creditors to allow the [d]ebtors ... to commit part of their earnings to the payment of their own retirement fund while at the same time paying their creditors less than a 100% dividend." *Behlke v. Eisen (In re Behlke)*, 358 F.3d at 435. The Debtors contend that, although they are in fact incurring payroll deductions for 401(k) contributions and loan repayments, they have not included these amounts in calculating their disposable income, either on Schedules I and J or their Means Test.

The fact that the Debtors correctly did not deduct their 401(k) deductions from their disposable income does not exclude those payments from the Court's consideration. Although the amount of Debtors' 401(k) deductions is not considered in determining Debtors' current available disposable income, the amount of a debtor's disposable income is one of many factors that a court considers in evaluating a motion to dismiss under totality of the circumstances. *In re Krohn*, 886 F.2d at 126. 401(k) loans are generally repaid within a five year term to avoid being a taxable distribution under the Internal Revenue Code. *Patrick v. Commissioner of Internal Revenue*, 1998 WL 24194 at \*3, 26 U.S.C. § 72(p). Debtors will therefore generally complete repayment of 401(k) loans within

the time period they are committed under a Chapter 13 plan, funds from which will then be available to distribute to unsecured creditors. *In re Lenton*, 358 B.R. 651, 660 (Bankr. E.D. Pa. 2006). Furthermore, the fact that the 401(k) deductions were excluded from the Debtors' disposable income calculation does not change the policy behind disallowing 401(k) deductions: that it is "unfair to allow the Debtors to commit part of their earnings to the payment of their own retirement fund while at the same time paying their creditors less than a 100% dividend." *In re Felske*, 385 B.R. 649, 659 (Bankr. N.D. Ohio 2008).

Debtors are retaining a rental property for which they are incurring monthly expenses but are receiving no income. The Debtors' Statement of Intention indicates that they wish to retain the property, and they did not claim an exemption for the property on Schedule C. Although Debtors assert that the mortgage payment on the rental property, \$315.00 per month, is not large enough to provide positive disposable income if they were not paying it, Mr. Rey testified at trial that they incur approximately \$200 per month in additional expenses for insurance and utilities on the property. (Rey, G., Cross). Thus, the Debtors are essentially paying \$515.00 per month to retain their rental property. Given that the Debtors listed negative disposable income of \$398.87 on their Schedule J, excluding these two expenses yields a positive disposable income.

Mr. Rey also testified that the property would need work to make it suitable for renting. (Rey, G., *Id.*). Notwithstanding their desire to keep the property, he stated that they had not made a mortgage payment on the property for approximately three to four months, as a result of being behind on other bills. (Rey, G., *Id.*). He admitted that they have had no contact with the lender about retaining the property, other than signing a form granting the lender permission to discuss it with them. (Rey, G., *Id.*). It is therefore unclear whether the Debtors would even be able to keep this



property, given their current delinquency. The Debtors should not be permitted to retain a rental property with a negative cash flow while offering no distribution to their unsecured creditors. *See In re Blankenship*, 398 B.R. 457, 462 (Bankr. N.D. Ohio 2008).

Debtors also received a 2009 federal tax refund of \$3,264.00. The Debtors argued that part of the refund was a result of the Making Work Pay tax credit, which would not be available the following year, and that Mr. Rey's income had decreased from the previous year. Ms. Lowman testified that, according to the Internal Revenue Service website, the Making Work Pay credit would be available through the 2010 tax year, at a minimum. (Lowman, C., Direct). Such testimony was unrefuted. She also testified that the Debtors would still be eligible for deductions for mortgage interest, and would likely still receive a refund the following year. (Lowman, C., *Id.*). This testimony was also unrefuted. During cross examination, Ms. Lowman stated that if the Debtors were no longer receiving deductions for rental property, she estimated the reduction to their refund to be approximately \$1,000.00. (Lowman, C., Cross). Although speculative, her testimony was not refuted by any persuasive testimony to the contrary.

The Debtors enjoy a stable source of future income, earning greater than the median family income for a family of three in Ohio. If Debtors' 401(k) loans complete during a Chapter 13 plan period, the amounts used to repay these loans could be devoted to repaying unsecured creditors. If Debtors were no longer incurring the expenses for their rental property, they would have positive disposable income based on the figure listed on Schedule J.

Given the totality of Debtor's financial circumstances, it is hereby determined that granting the Debtor relief under Chapter 7 would constitute abuse pursuant to § 707(b)(3) of the Bankruptcy Code. Dismissal of a case under § 707(b)(3) is discretionary, however. There are mitigating factors

in this case, such as a lack of bad faith on the part of the Debtors, the fact that Debtors do not incur lavish expenses, and, although they are above-median debtors, their income is not such that they significantly exceed the median income for their family size. Based on these factors, the Debtors are provided fifteen (15) days from entry of this Order to cease payments on the rental property, including maintenance expenses, and cease 401(k) deductions (contributions and loan repayments), and provide certification to the Court and UST that such payments have ceased. Their petition schedules are to be amended, accordingly, or their case will be dismissed forthwith upon certification from the U.S. Trustee.

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Accordingly, the UST's motion to dismiss pursuant to 11 U.S.C. § 707(b)(1) and (b)(3) is hereby granted, provisionally. The Debtors are provided fifteen (15) days from entry of this order and judgment to certify that they have ceased payments on the subject rental property and 401(k)s. Their failure to do so within the allotted time period will result in the granting of the U.S. Trustee's Motion to Dismiss. Each party is to bear its respective costs.

**IT IS SO ORDERED.**

Dated this 4<sup>th</sup> day  
of November, 2010

  
**JUDGE RANDOLPH BAXTER**  
**UNITED STATES BANKRUPTCY COURT**