United States Bankruptcy Court
District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
THOMAS E. SMITH and
BETTY O. SMITH,
Debtors. No. 13-00-12422 SR

and

In re:
JOSE SERNA and
LINDA SERNA,
Debtors. No. 13-00-12595 SA

MEMORANDUM OPINION ON CONFIRMATION

These matters came before the Court to consider confirmation of the debtors' chapter 13 plans. In both cases the debtors are represented by Bill Gordon & Associates. One case (Smith) involves the reasonableness of a "contingency fund" in the budget being accumulated for a child's college education and an automobile for her. Both cases were argued as if they involved the issue of whether the debtors' voluntary contributions to retirement plans are reasonably necessary expenses for the maintenance or support of the debtors or their dependents. However, because the Serna debtors' agreement at confirmation to contribute an additional $179.26 to the plan payments results in payment in full of the unsecured claims and the arrearages, and because the Smith plan, as confirmed by this Court, has much the same result,

the Court does not address the issue of whether the debtors' voluntary contributions to retirement plans are reasonably necessary expenses for the maintenance or support of the debtors or their dependents. This is a core proceeding. 28 U.S.C. § 157(b)(2)(L).

SERNA FACTS

Debtors Serna filed their Chapter 13 petition on May 10, 2000. All assets are over encumbered or exempt and it appears that there would be no distribution to unsecured creditors in a hypothetical chapter 7 case. Ms. Serna is in her fifties; Mr. Serna's is 50. The debtors have one dependent, age 15. The debtors have $26,417.00 in retirement savings.

The Schedule I listed gross income of $4,506.38, payroll deductions of $1,884.53 (including "Stock/401k" of $196.67 and "Cash Balance Loan" to employer of $179.26) for a monthly net take home pay of $2,621.85. The $196.67 payment represents approximately 6.3% of Mr. Serna's gross wages, and approximately 4.2% of Mr. and Ms. Serna's combined gross wages. Debtors listed $222.00 as income from daughter's payment for a 1997 Nissan (basically a pass through because debtors list $222 for this as an expense also; the vehicle is not written down in or paid through the plan and no arrearages are scheduled for payment under the plan). Debtors also

listed $57.00 as a prorated amount of estimated income tax returns for total combined monthly income of $2,900.85. Monthly expenses were listed on Schedule J in the amount of $2,464.00, resulting in projected excess income of $436.85 per month. The monthly expenses are reasonable.

The issue presented by the parties in this case is whether $196.67 for Mr. Serna's current stock/401(k) contribution is reasonably necessary for the support or maintenance of the debtors or their dependents.

SMITH FACTS

Debtors Smith filed their Chapter 13 petition on May 1, 2000. All assets are over encumbered or exempt and it appears that there would be no distribution to unsecured creditors in a hypothetical chapter 7 case. The debtors are 52 and 49 years old. They have one dependent, age 15. The debtors have $8,394 in retirement savings. The debtors have a loan from the 401(k) plan; the debtors have not listed this loan in their schedules, but Mr. Smith testified that it was about $3,800. Mr. Smith testified that if he failed to repay this loan there would be adverse tax consequences.

The original Schedule I listed gross income of $3,485.63, payroll deductions of $1,102.60 (including "401k/401k loan repayment" of $229.66) for a monthly net take home pay of

$2,383.03. Debtors listed $465.00 as income from operation of a business. Debtors also listed $400 income from a rental house and $67.00 as a prorated amount of estimated income tax returns for total combined monthly income of $3,315.03. Monthly expenses were listed on Schedule J in the amount of $2,889.38, resulting in projected excess income of $425.65 per month. The monthly expenses are reasonable.

On January 23, 2001, debtors filed amended Schedules I and J. Amended I shows that the business terminated and Ms. Smith is now employed with wages of $1,405.39, payroll deductions of $293.04, and net take home pay of $1,112.35. The 401(k) payment was reduced to $151.34. Debtor testified that about $90.00 is for repayment of the 401(k) loan and about $60.00 is the current 401(k) contribution. The $60.00 payment appears to represent approximately 1.6% of Mr. Serna's gross wages, and approximately 1.1% of Mr. and Ms. Smith's combined gross wages. Rental income had increased by $25.00. The combined monthly income was now $4,026.80. Amended Schedule J contained some relatively small changes (e.g. mortgage payments, utilities) that debtors explained at confirmation. Amended J showed an increase in medical expenses of $380, explained to the Court's satisfaction by testimony at confirmation. The "Other: Work and School Meals"

category increased, which was reasonable in light of Ms. Smith's new job. The Smiths also added a category of "Other: Contingency Fund" expense in the amount of $335.00. Debtors testified that they are putting money away for their teenage daughter's college education and saving for a third car because their daughter now drives.

The Smith's Chapter 13 plan (doc. 5) called for 60 monthly payments of $425 ($22,500). After payment of Trustee fees ($2,250) and attorney fees ($1,587) the plan pays $14,643 of secured claims at 10% interest with the balance to unsecured creditors. Debtor's amended Schedule J increases the plan payments to $600. The plan, as amended, would not pay unsecured creditors 100% of their claims. The issues presented by the parties for decision in this case are as follows: (1) is the $335 "contingency fund" reasonably necessary for the support or maintenance of the debtors or their dependents, and (2) is $90.00 for repayment of a 401(k) loan reasonably necessary, and (3) is $60.00 for Mr. Smith's current 401(k) contribution reasonably necessary?

SERNA CONCLUSIONS

The issue presented by the parties in this case is whether $196.67 for Mr. Serna's current stock/401(k) contribution is reasonably necessary for the support or

maintenance of the debtors or their dependents. However, the Court's analysis of the numbers, together with some minor assumptions, leads to the conclusion that the 401(k) issue need not be decided in the Sernas' case.

The Serna's Chapter 13 plan (doc. 6) calls for 60 payments of $435 ($26,100). At confirmation the debtors said they would stop the $179.26 deduction that was paying Bank of America (Ms. Serna's employer), which deduction in any event was only going to run for 12 more months. Rounding up the $179.26 to $180 and assuming that the $180 would go to pay creditors each month during the 60-month plan, the debtors will be paying a total of $36,900 ($615 x 60 months). Subtract from that $3,690 (trustee fee), $1,587 (attorney fee), $4,413 at 0% interest (Charter Bank arrears provided for in plan), and $8,960 (comprised of the total $6,800 schedule F debt plus an estimated $2,160 [$180 x 12, which is probably high, since the Court suspects that the $179.26 included interest] for the Bank of America debt), and $18,250 remains, which presumably is sufficient to pay off the NM Educators FCU and Sears debts of $12,350 and $500 respectively at 10% interest. Thus the plan, as amended at confirmation, would pay all creditors, including unsecured creditors, 100% of their claims. See 11 U.S.C. §1325(b)(1)(A). The issue of

whether the debtors should be allowed to continue their 401(k) deductions does not present itself in the Sernas' case.

SMITH CONCLUSIONS

The $335 in the "contingency fund" as used by the debtors in this case is not necessary for the support or maintenance of the debtors. To begin with, the fund is not really a "contingency" fund. This Court has already ruled that a contingency fund is designed as a cushion for unanticipated expenses such as uninsured medical expenses, vehicle breakdowns, etc.; that is, what may be called "life's unexpectancies".[1] Saving for a child's college education and the purchase of a car are exactly the opposite of "contingencies" used in that sense. In the future, debtors and their counsel should more accurately describe the proposed expenditures in the budget.

With respect to the actual purposes of the proposed expenditures, the Court finds that neither of them is "reasonably necessary" for the support of the debtors or their dependent, on the facts presented in this case. With respect

[1] In re Leon-Guerrero, No. 13-99-12568, United States Bankruptcy Court, District of New Mexico, Memorandum Opinion on Confirmation of Debtors' Chapter 13 Plan, at 11-13 (October 19, 2000) (Doc. 32). The complete text of the decision is available at the Court's chambers' web page, which can be found at the District of New Mexico United States Courts website at www.nmcourt.fed.us.

to the vehicle, there has been no showing that the debtor's 16-year-old dependent is unable to get to school and other required destinations without a vehicle, nor any evidence that she cannot find employment to be able to purchase a vehicle herself.[2]

The savings fund for the college education is more problematic. See, e.g., In re Gonzales, 157 B.R. 604, 610 (Bankr. E.D. Mi. 1993)("[J]ust as society accepts as reasonable an adult child's assumption of the moral obligation to support an aged or infirm parent, it now accepts as reasonable a parent's own feeling of the moral imperative of assisting a willing child to obtain a higher education.") Nevertheless, the Court finds in this case that the future college expenses of a dependent do not fall into the same class as food, shelter, utilities and similar expenditures. Again, there has been no showing that this dependent cannot, or will not in the future be able to, earn money, obtain Pell grants, etc. In so ruling, the Court is not suggesting that a college education is not important for the dependent's future, and the Court is certainly not encouraging the incursion of the large student loans that the Court periodically sees in

[2] Of course, the purchase price of the car may pale in comparison to the cost of insuring the car and driver.

hardship discharge cases. Rather, the Court is merely ruling that, in the circumstances presented by this case, the dependent can begin saving for college herself, and her parents can join her in that effort at the conclusion of their chapter 13 case, which is now over a year old.

Of the $335, however, the debtors should be entitled to set aside a portion as a genuine contingency fund. A figure of $150 a month would be reasonable for this purpose, again given the circumstances of this case.[3] Therefore, the Court finds that there is an additional $185 of projected disposable income that must be devoted to the plan.

At $785 per month for 60 months ($600 plus $185), the debtors will have paid the trustee $47,100. If one subtracts $4,710 (trustee fee), $1,587 (attorney fees), and $643 at 0% interest for the Norwest mortgage arrearage, the remaining sum is $40,160, a sum insufficient to pay in full the secured debt to be paid in the plan of $14,000 at 10% interest plus the schedule F debt of $30,029.

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[3] At the end of three years, at $150 a month, the debtors will have accumulated a total contingency fund of $5,400, assuming no depletions in the meantime. That is certainly not an extravagant amount to have available as a savings account to meet emergencies. At the end of five years, the amount would be $9,000, also not an extravagant amount for that time and in their circumstances.

The schedules do not disclose how much of the Schedule I deduction for "401K/401K Loan Repayment" is for repayment and how much for a new contribution.[4] At trial, however, Mr. Smith testified (in round numbers) that $90 a month goes to repayment of the loan and $60 a month to a new contribution.

Without consideration of whether the $90 repayment of the 401(k) loan is reasonably necessary for the support or maintenance of the debtors or a dependent (and to the extent that a 401(k) loan repayment represents an actual debt), the plan's repayment of the $3,800 debt at $90 per month would constitute a treatment problem under 11 U.S.C. §1322(a)(3) or a classification problem under 11 U.S.C. § 1322(b)(1) for which debtors have presented no justification.[5] This $90 must also be devoted to the plan.

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[4] To the extent that the 401(k) loan is a debt, it should have been listed in Schedule D or F. Schedule B (and C) show a 401(k) account worth $1,200 and a "pension" account worth $7,194. Mr. Smith testified that the amount of the loan is $3,800.

[5] 11 U.S.C. §1322(a)(3) provides that "[t]he plan shall...if the plan classifies claims, provide the same treatment for each claim within a particular class." Section 1322(b)(1) provides in relevant part that "[s]ubject to subsections (a) and (c) of this section, the plan may...designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated;..." The $3,800 401(k) loan is not classified at all in the plan.

In so requiring, the Court recognizes that failure to repay a pension plan loan is likely to be treated as a premature withdrawal, thereby causing the imposition of an excise tax. See In re Marvin, No. 7-99-11150, United States Bankruptcy Court, District of New Mexico, Order Granting the United States Trustee's Motion to Dismiss Under 11 U.S.C. §707(b) with Leave to Convert, at 3 n.3 (February 16, 2000) (doc. 15) (accounting for an Internal Revenue Service tax penalty of 10% for early withdrawal). Mr. Smith testified that the tax consequence would be 40% on the amount not repaid.[6] But the $5,400 ($90 loan repayments x 60), when added to the $40,160, results in a figure of $45,560 of total plan payments. That figure exceeds $44,029, which is the total of the $3,800 (401k loan balance) plus $14,000 (which is, however, subject to a 10% interest rate) plus the $30,029 of schedule F debt. Thus, there should be little if any unpaid balance on the 401(k) loan, and therefore little if any tax consequence, even at a 40% rate. And, since the plan as

[6] On cross examination, Mr. Smith said that the source of the 40% figure was not a tax professional but different people he had talked with who had experienced the same problem. No other testimony on the issue was provided. It appears, however, that this figure is probably close. Debtors' marginal tax rate appears to be 28% (see 26 U.S.C. § 1(a)(1)), and there is a 10% penalty for early withdrawal. The Court is not asking the parties to supplement the record on this issue.

amended by this ruling results in, practically speaking, paying all the claims against the estate, there is no reason to consider the reasonable necessity of the $60 a month 401(k) contribution which the debtors are making.

SUMMARY

The Court will confirm the Serna plan as amended at the confirmation hearing (to pay $615 per month), and will confirm the Smith plan if debtors increase the monthly payment by $275 to a monthly total of $875. Since both plans are sixty-month plans rather than 36-month plans, the confirmation orders will be without prejudice to the debtors to move to modify their respective plans in light of the rulings and non-rulings in this memorandum. See In re Marvin, at 3-4 ("As long as [all of Debtors' projected disposable income...for a three-year period] is contributed to the plan, the exact amount of the plan payments and the terms of the plan can be at Debtors' discretion. Debtors can propose a plan of any length which puts this total into the hands of the Trustee for distribution.").

The Court will enter Orders in the two respective Chapter 13 cases reflecting the above rulings.

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on July 10, 2001, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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