UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

NORMAN L. KERCHER and BARBARA KERCHER d/b/a DECK THE WALLS, **Joint Case No. 97-20114-K**

Chapter 7

Debtors.

MORRIS E. AND DONNA NORSWORTHY,

Plaintiffs,

v. **Adv. Proc. No. 97-0992**

NORMAN L. KERCHER and BARBARA KERCHER d/b/a DECK THE WALLS,

Defendants.

MEMORANDUM AND ORDER RE "COMPLAINT OBJECTING TO DISCHARGE" COMBINED WITH NOTICE OF THE ENTRY THEREOF

Introduction

This adversary proceeding arises out of a complaint filed by the plaintiffs, Morris E. and Donna Norsworthy, seeking a denial of the general discharges of the defendants, Norman L. Kercher and Barbara Kercher dba Deck the Walls, the above-named chapter 7 debtors ("Debtors"), under 11 U.S.C. § 727 (a)(2)(A), (a)(4)(A) and (a)(5).

By virtue of 28 U.S.C. § 157 (b)(2)(J) this is a core proceeding. The court has jurisdiction of this action under 28 U.S.C. §§ 1334 (a)-(b) and 157(a) and Miscellaneous District Court Order No. 84-30 entered on July 11, 1984. Based on the pleadings, statements of counsel,

the sworn testimony adduced at the trial, the trial exhibits, and consideration of the entire case record as a whole, the court renders the following findings of fact and conclusions of law in accordance with FED. R. BANKR. P. 7052.

BACKGROUND FACTS

The relevant background facts may be briefly summarized as follows: In 1982, the plaintiffs purchased and thereafter managed and operated *Deck the Walls*, a retail framing business located in the Mall of Memphis in Memphis, Tennessee. In March 1988, the debtors purchased the plaintiffs' *Deck the Walls* for a total purchase price of $500,000. Plaintiffs received $375,000 in cash at the closing along with a promissory note for $125,000 secured by a junior lien upon the assets of the business, which note was payable in full in 18 months. The first lien was held by the First American Bank.

In October 1990, the debtors filed their first petition under chapter 7 of the Bankruptcy Code, being joint Case No. 90-29472-B. Debtors thereafter received discharges, but nonetheless reaffirmed their debts to both First American Bank and the plaintiffs, the first and second lien holders on the business assets. Subsequently, on January 6, 1997, the debtors filed a second chapter 7 case, being joint Case No. 97-20114-K herein. Plaintiffs thereafter filed this adversary proceeding objecting to the debtors' general discharges.

Important here, the debtors' *Schedule B - Personal Property* indicated that they had no property as contemplated in Question 17 - *Other liquidated debts owing debtor including tax refunds. Give particulars.* (emphasis added.) Likewise, the debtors indicated that they had no property as contemplated in *Schedule B - Personal Property, Question 20 - Other contingent*

and unliquidated claims of every nature, including tax refunds, counterclaims of the debtors, and rights to setoff claims. Give estimated value of each. (emphasis added.)

The parties have stipulated to the following relevant background facts regarding and surrounding the debtors' 1996 tax refund check:

1. Debtors filed this joint chapter 7 case on January 6, 1997.

2. Debtors filed their 1996 Internal Revenue Service Form 1040 on or about February 23, 1997, which reflected a refund due them of $11,009.20.

3. The Internal Revenue Service ("IRS") later issued a tax refund check to the debtors, being Check No. 2300 64825376, dated June 20, 1997, in the amount of $11,009.20.

4. Trial counsel for the debtors delivered the tax refund check to the Chapter 7 trustee herein on or about March 2, 1998, although the original counsel for the debtors and the Chapter 7 trustee had discussed the refund check for some months prior to this date as evidenced by the November 11, 1997 letter from the Chapter 7 trustee to counsel for the debtors.

5. Christopher L. Nearn, Esquire, trial counsel for the debtors, first learned of the existence of the IRS refund check either at the debtors' Rule 2004 examination, which took place on August 21, 1997, or shortly prior thereto.[1]

[1]See "Stipulation of Facts Regarding Income Tax Refund" filed on October 6, 1998.

Plaintiffs contend, inter alia, that the debtors knowingly and fraudulently, in or in connection with this bankruptcy case, made a false oath or account by omitting various and material assets, including the $11,009.02 tax refund check from the Schedule B. Accordingly, the plaintiffs assert that "the omission of any non-exempt asset from Debtors' original 'no-asset' filing gives rise to virtually irrefutable inference..." that the debtors' general discharges should be denied. See *Oldendorf v. Buckman*, 173 B.R. 99, 105 (E.D. LA 1994). Plaintiffs further state that the debtors still have not amended their schedules to reflect the omitted 1996 tax refund check. FED. R. BANKR. P. 1009.

In response, the debtors contend, in relevant part here, that the omission of the tax refund check was inadvertent.

On September 1, 1998, the court conducted a trial on the merits and took the matter under advisement for careful consideration. This Memorandum and Order results.

CONCLUSIONS OF LAW

Plaintiffs seek to have the debtors' general discharges denied under section 727(a)(2)(A), (a)(4)(A), and (a)(5) of the Bankruptcy Code. Specifically, section 727(a) provides in relevant part that an individual debtor shall be granted a discharge, unless –

> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer 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--
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> (A) property of the debtor, within one year before the date of the filing of the petition;
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> * * *
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> (4) the debtor knowingly and fraudulently, in or in connection with the case--
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> (A) made a false oath or account;
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> * * *
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> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet

the debtor's liabilities.

11 U.S.C. § 727 (a)(2)(A), (a)(4)(A), and (a)(5).

The statutory elements of a section 727 discharge action must be demonstrated by a preponderance of the evidence by the plaintiff. FED. R. BANKR. P. 4005; *In re Adams*, 31 F.3d 389 (6th Cir. 1994).

The court will first address the plaintiffs' concerns and allegations under 11 U.S.C. § 727(a)(4)(A) which center around the failure of the debtors to originally disclose the 1996 tax refund check. During the course of a bankruptcy case, there are instances when the debtor is required to make statements or give testimony under oath. See, for example, 11 U.S.C. § 521 and FED. R. BANKR. P. 4002(1)-(2). A debtor's schedules and statements either must be verified or must contain an unsworn statement under penalty of perjury in lieu of verification. FED. R. BANKR. P. 1008. Likewise, at the section 341(a) meeting of creditors or at a Rule 2004(a) examination, the debtor must submit to an examination under oath. See 11 U.S.C. § 343; FED. R. BANKR. P. 2004(a).

If a debtor intentionally makes a false statement under oath or penalty of perjury, whether in the petition, schedules, statements, or testimony, the debtor may later find that a general discharge will not be granted. See *In re Semel*, 479 F.2d 1269 (3rd Cir. 1973), cert. denied 415 U.S. 931 (1973), for an illustration of a general denial of discharge based on false testimony concerning the debtor's assets. See also *In re Braymer*, 126 B.R. 449, 501 (N.D. Tex. 1991), where the bankruptcy court based its denial of a general discharge on the fact that the original schedules had failed to list certain assets and creditors, even though the debtor subsequently filed

amendments that were "an obvious attempt to belatedly respond to [the objector's] complaints."

Because a debtor is required to attest to the completeness and accuracy of the bankruptcy schedules, an intentional omission of any property or debt also may result in a bar to the general discharge. The seriousness of the oath is illustrated in *In re Gugliada,* 20 B.R. 524 (S.D.N.Y. 1982), where a discharge was denied because the debtor signed a statement attesting to the completeness of the schedules when in fact he had failed to list what the court found to be equitable interests the debtor had in his wife's bank account, in the home to which his wife had title, and in the corporation of which the debtor had management control but in which he did not own stock. See also *In re Silverstein*, 151 B.R. 657 (E.D.N.Y. 1993).

It is said that although a knowing and fraudulent false oath or account may bar a discharge under section 727(a)(4)(A), an honest mistake will not. See, for example, *In re Arcuri*, 116 B.R. 883 (S.D.N.Y. 1990). It is important to understand, however, that a debtor who has made a misrepresentation in the schedules has the burden of proving that it was the result of an honest mistake. Once it appears that the oath is false, the burden falls upon the debtor to come forward with evidence to prove that it was not an intentional misrepresentation. *In re Sears*, 225 B.R. 270 (Bankr. D. R.I. 1998). Otherwise, the court may infer fraudulent intent from the unexplained false statement. See, among others, *In re Mascolo,* 505 F.2d 274, 276 (1st Cir. 1974); see also *In re Tully*, 818 F.2d 106, 111 (1st Cir. 1987)(reckless indifference to the truth is the equivalent of fraud; "a debtor cannot, merely by playing ostrich and burying his head deeply enough in the sand, disclaim all responsibility for statements which he has made under oath"); *In re Johnson*, 82 B.R. 801, 805 (E.D.N.C. 1988)("the court may infer such intent from circumstantial evidence including a pattern of nondisclosure").

Accordingly, section 727(a)(4)(A) of the Bankruptcy Code extends to the debtor's statements made in the petition, schedules, and statement of affairs as well as oral testimony at the section 341(a) meeting of creditors or at a Rule 2004 examination -- all of which are made under oath or penalty of perjury. 3 NORTON BANKR. L. & PRAC. 2D § 74:11 (1998). In order to deny a debtor's general discharge under section 727 (a)(4)(A), the plaintiff must show that the debtor made a false statement under oath; that the debtor acted with knowledge and with the requisite intent as contemplated under the statute; and that the false statement was materially related to the debtor's bankruptcy case. *In re Hoflund,* 163 B.R. 879 (Bankr. N.D. Fla. 1993); *In re Sears,* supra. In accordance with the Official Bankruptcy Forms, the debtor is required to verify the completeness and accuracy of any schedule of assets and debts or statement of financial affairs filed in a case. 3 NORTON BANKR. L. & PRAC. 2D § 74:11 (1998). As noted earlier, where there is a knowing failure to list and disclose an asset, an inference of fraudulent intent may be drawn in the absence of mitigating circumstances. *In re Hoflund* at 883. The failure to amend the schedules to include omitted information concerning assets may constitute a reckless indifference to the truth, which is equivalent to fraud. *In re Sofro,* 110 B.R. 989 (Bankr. S.D. Fla. 1990).

The Sixth Circuit Court of Appeals addressed section 727(a)(4)(A) in the case of *In re Millsaps*, 774 F.2d 1163 (6th Cir. 1985). The crucial question in the *Millsaps* case was whether a chapter 7 debtor's nondisclosure of a tax refund in the amount of $2,338 was in bad faith or fraudulent. The Sixth Circuit stated that "it is particularly within the province of the finder of fact to determine credibility and whether there was intent to conceal the existence of a sizeable tax refund from their schedule of assets." *Id.* at 1163. Such intent may be properly inferred from

the circumstances of the case. *In re Turpin,* 142 B.R. 491, 495 (Bankr. M.D. Fla. 1992).

In *Millsaps,* the debtor did not include any amount for an impending tax return on his schedule of assets, and in response to question *To what tax refunds (income or other), if any, are you or may you be entitled?,*" the debtor answered "unknown." Neither did the debtor claim the tax refund in his original exemption schedule, nor did he mention a refund at the subsequent meeting of creditors. The Sixth Circuit noted that while "the debtor did not at either time have his tax return prepared, he could well have been found to know that he was due to receive one, and he failed to mention this to his own attorney." *Id.* The Court emphasized that even after he learned about the tax refund, of $2,338, the debtor contacted no one about its existence until the IRS notified the debtor that the refund would be mailed directly to the bankruptcy trustee. Consequently, the trial court in the *Millsaps* case questioned the debtor's explanation for his failure to notify anyone about his impending tax refund. Debtor contended that since he was a blue collar work with no legal or accounting background, he could not have anticipated a tax refund. The Court replied, however, that "this debtor had sufficient tax knowledge to argue that he knew the IRS generally offsets tax refunds against alleged tax deficiencies and knew it would be unreasonable to claim the refund as exempt, when he owed outstanding tax deficiencies." *Id.* The Sixth Circuit heavily relied upon the trial judge's determination of the debtor's credibility in concluding that the debtor's discharge should be denied. *Id.*

According to the sworn testimony at trial in the instant adversary proceeding, the debtors received prior tax refunds in the approximate amounts of $7,200 for the 1992 tax year, $5,500 for 1993, $5,400 for 1994, and $10,894 for 1995. Admittedly, the debtors had not filed their 1996 tax return until on or about February 23, 1997, more than a month after the filing of their

joint chapter 7 case.[2] It is emphasized, however, that the debtors typically received these sizeable past tax refunds as their *Deck the Walls*' business losses increased annually. As previously mentioned, the debtors merely assert that the 1996 anticipated tax refund was inadvertently omitted from their schedule of assets.

[2]Id.

The fresh start afforded by the discharge of a debtor's personal liability for prepetition debts is a rudimentary principle of the Bankruptcy Code. *Grogan v. Garner*, 498 U.S. 279, 286 (1991). The federal bankruptcy laws fresh start policy is reserved solely for "honest, but unfortunate" debtors. *Id.* (citing *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934)). In the instant proceeding, the court cannot (and should not) ignore the fact that the debtors are highly sophisticated and articulate business people and should have anticipated receiving a sizeable tax refund for 1996. Debtor, Mr. Kercher, has a Bachelor of Arts in Economic Sociology and Business Administration and served as Vice President of Sales, Retail Division of Schering-Plough in Memphis, Tennessee. Debtors jointly managed the financial affairs of and managed *Deck the Walls*. As evident in the years prior to the filing of this chapter 7 petition, the debtors were aware, or should have been aware, as sophisticated business people, that they would receive a tax refund for the 1996 tax year. As stipulated to by the parties, the debtors' trial attorney, Christopher Nearn, Esquire, was not even aware of the 1996 tax refund until on or about August 21, 1997.[3]

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[3]Debtor, Mr. Kercher, testified at the Rule 2004 examination that the 1996 tax refund was

spent. At the trial, Mr. Kercher asserted that he testified at the Rule 2004 examination that the tax refund was "earmarked" to be spent. Mr. Kercher testified that upon receipt of the tax refund check in March 1997, the debtors' attorney of record, Robert E. Rose, Esquire, later told him to "hold on to the check."

Considering a totality of the particular facts and circumstances, the court finds that the debtors' explanation of the omission of the 1996 tax refund is less than satisfactory. At the least, it represents an impermissible reckless indifference. Although the debtors did not have their 1996 tax return prepared when this case was commenced, they knew or should have known that they were due to receive one based on prior years. The past tax refunds and the 1996 tax refund were sizeable in amounts.

This court strongly believes that the existing federal bankruptcy laws are intended to be "a sturdy bridge over the financially troubled waters by means of which 'the honest but unfortunate debtor' may reach 'a new opportunity in life and clear for future effort, unhampered by the pressure and discouragement of pre-existing debt.'"[4] Yet, here, the debtors' explanation of the omission of their anticipated 1996 tax refund check from their schedule of assets is unacceptable under the circumstances. They should be held to a higher standard and be held accountable for their acts and omissions regarding the 1996 tax refund check.

After carefully reviewing the debtors' schedules, excerpts from both the transcript of debtors' Rule 2004 examinations, and their testimony at the trial, and further considering the course of conduct between the parties, the court finds that the debtors' general discharges should be denied under section 727(a)(4)(A). The court finds that the debtors made false statements which were materially related to their chapter 7 case (i.e., the omission of the 1996 tax refund check from Schedule B). Additionally, the court finds that the statutory intent required under section 727(a)(4)(A) should be inferred under a totality of the circumstances due to, at the least,

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[4] *In re Jones*, 490 F.2d 452, 457 (5th Cir. 1994)(quoting *Local Loan Co. v. Hunt*, 292 U.S. 23, 244 (1934)).

the debtors' reckless indifference. Plaintiffs have minimally, but sufficiently, carried the required burden of proof by a preponderance of the evidence. The court notes, however, that the result here probably would have been different if the standard of proof under section 727(a) were by clear and convincing evidence. *In re Adams*, 31 F.3d 389 (6th Cir. 1994).

Based on these findings, the court concludes that the debtors' general discharges should be denied under 11 U.S.C.§ 727(a)(4)(A). Having concluded that the debtors' general discharges should be denied under section 727(a)(4)(A), there is no need for the court to additionally address the plaintiffs' other concerns and allegations contained in their original and amended complaint objecting to the debtors' general discharges.

ORDER DENYING DEBTORS' GENERAL DISCHARGES AND NOTICE OF THE ENTRY THEREOF

After a trial on the merits of the original and amended section 727(a)(4)(A) complaint filed by the plaintiffs, Morris E. and Donna Norsworthy, objecting to the general discharges of the defendant-debtors, Norman L. Kercher and Barbara Kercher, and the matter having been taken under advisement for a final decision; now, upon the evidence adduced at the trial, and, in accordance with the foregoing findings of fact and conclusions of law,

IT IS ORDERED AND NOTICE IS HEREBY GIVEN THAT:

1. The section 727(a)(4)(A) complaint of the plaintiffs, Morris E. and Donna Norsworthy, is hereby sustained.

2. The defendant-debtors, Norman L. Kercher and Barbara Kercher, be and they are hereby denied a general discharge from their debts by virtue of 11 U.S.C. § 727(a)(4)(A).

3. The Bankruptcy Court Clerk shall promptly send copies of the this Memorandum and Order to the following:

Henry C. Shelton, III, Esquire
Rachel L. Hotze, Esquire
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Christopher L. Nearn, Esquire
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Ellen B. Vergos, Esquire
United States Trustee
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Memphis, TN 38103

Richard T. Doughtie, III, Esquire
Chapter 7 Trustee
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4. Pursuant to FED. R. BANKR. P. 4006, the Bankruptcy Court Clerk, after this Order becomes final, shall promptly give notice of the denial of the defendant-debtors' discharges in the manner provided in FED. R. BANKR. P. 2002(f)(6).

BY THE COURT:

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DAVID S. KENNEDY
CHIEF U. S. BANKRUPTCY JUDGE

DATE: November 16, 1998