American Bankruptcy Institute

Means Test:
Its Latest Meaning (or Meanings...)

Hon. Eugene R. Wedoff
U.S. Bankruptcy Court, N.D. Ill.; Chicago

MEMORANDUM

TO: Advisory Committee on Bankruptcy Rules

FROM: Gene Wedoff

RE: Forms 22A and C: National and Local Standard expense allowances based on "household size"

DATE: August 14, 2008

Following the last meeting of the Advisory Committee in March of this year, the Subcommittee on Consumer Issues has considered whether there should be a change in the instruction in Lines 19A, 19B, and 20B of Form 22A and Lines 24A, 24B, and 25B of Form 22C. In each of these lines, the debtor is instructed to deduct from income a National or Local Standard expense allowance determined, in part, by the debtor's "household size." The subcommittee has determined that this instruction is not the best reflection of the statutory language.

In March 2007, the Advisory Committee agreed to change "family size" to "household size" in several lines of Forms 22A and 22C. In one area—determining the state median income that applied to the debtor's case—this change was clearly appropriate. Section 707(b)(7) provides the safe harbor from means test presumption and Section 1325(b)(3) and (4) contains provisions bearing on the method of calculating disposable income and the length of the applicable commitment period, all based on a comparison of the number of persons in the debtor's "household" to the "median family income of the applicable State" of a particular size or type. The debtor's "household" size is therefore the relevant consideration by the terms of the Code itself.

However, where means test deductions are required to be stated, there is another, distinct use of "family" or "household" size—it determines the amount of certain National and Local Standard expense allowances for general expenses, health care, and housing. Here, the statutory language is not dispositive. Section 707(b)(2)(I) simply provides that "[t]he debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards . . . for the debtor, the dependents or the debtor, and the spouse of the debtor in a joint case if the spouse is not otherwise a dependent.." Since the National and Local standards are those set out in the Internal Revenue Manual, the Advisory Committee has generally sought to apply them—in the absence of a statutory provision to the contrary—in the manner that they are applied in the Manual itself. For example, we have carefully tracked the language of the Manual in describing the "Other Necessary Expense" allowances that are similarly provided for in § 707(b)(2)(I). The IRS sets out its National Standards according to "number of persons," without referencing either "family" or "household" size. See the set of general expense allowances listed at http://www.irs.gov/businesses/small/article/0,,id=104627,00.html and the health care costs listed at http://www.irs.gov/businesses/small/article/0,,id=173385,00.html. For the Local Standard housing allowances, the IRS provides differing amounts depending on "family" size. See, e.g., the allowances for the District of Columbia listed at http://www.irs.gov/businesses/small/article/0,,id=104741,00.html.

However, for all three sets of allowances, the IRS indicates that the number of persons or family size is determined according to the number of dependents that the debtor claims. In the web page cited above for the general National Standard allowances, the IRS states: "Generally, the total number of persons allowed for National Standards should be the same as those allowed

as exemptions on the taxpayer's most recent year income tax return." The health care web page states: "Taxpayers and their dependents are allowed the standard amount monthly on a per person basis . . . ." And the housing web pages, as reflected in the D.C. example cited above, repeat the direction from the general National Standards list: "Generally, the total number of persons allowed for determining family size should be the same as those allowed as exemptions on the taxpayer's most recent year income tax return."

The Internal Revenue Manual itself is consistent with the dependent-focused instructions accompanying the lists of deduction amounts, as reflected in the following excerpts:

> § 5.15.1.7.8. Generally, the total number of persons allowed for national standard expenses should be the same as those allowed as exemptions on the taxpayer's current year income tax return. Verify that exemptions claimed on the taxpayer's income tax return meet the dependency requirements of the IRC. There may be reasonable exceptions. Fully document the reasons for any exceptions. For example, foster children or children for whom adoption is pending.
>
> § 5.15.1.8.7. Taxpayers and their dependents are allowed the [out-of-pocket health care] standard amount monthly on a per person basis, without questioning the amounts they actually spend.
>
> § 5.15.1.9.1.A. Generally the total number of persons allowed for determining family size [for Local Housing and Utilities allowances] should be the same as those allowed as exemptions on the taxpayer's most recent year tax return. There may be reasonable exceptions, such as foster children or children for whom adoption is pending.

Forms 22A and 22C deviate from the dependent-focused application of the National and Local Standards by directing the debtor to use "household" size without regard to whether the members of the debtor's household are dependents of the debtor. This can result in both under- an over-inclusiveness compared to the IRS instructions. The forms are under-inclusive in situations where a debtor has dependents who are not members of the debtor's household (for example, a dependent child living in a residential-care facility or with a former spouse). The forms are over-inclusive in situations where the members of the debtor's household are not

dependents of the debtor (for example, the self-sufficient parents of an adult debtor who lives in their home).

The subcommittee proposes making the forms reflective of the IRS application of the National and Local Standards by making the following changes in the forms.

• In Line 19A of Form 22A and Line 24A of Form 22C: “"Enter in Line 19A [24A] the “Total” amount from IRS National Standards for Food, Clothing and Other Items for the applicable number of persons. (This information is available at www.usdoj.gov/ust/ or from the clerk of the bankruptcy court.) The applicable number of persons is the number that would currently be allowed as exemptions on your federal income tax return, plus the number of any additional dependents whom you support."

• In Line 19B of Form 22A and Line 24B of Form 22C: “Enter in Line b1 the applicable number of persons who are under 65 years of age, and enter in Line b2 the applicable number of persons who are 65 years of age or older. (The applicable number of persons in each age category is the number in that category that would currently be allowed as exemptions on your federal income tax return, plus the number of any additional dependents whom you support.) Multiply Line a1 by Line b1 to obtain a total amount for persons under 65, and enter the result in Line c1. Multiply Line a2 by Line b2 to obtain a total amount for persons 65 and older, and enter the result in Line c2.”

• In Line 20A of Form 22A and Line 25A of Form 22C: “Enter the amount of the IRS Housing and Utilities Standards; non-mortgage expenses for the applicable county and family size. (The applicable family size consists of the number that would currently be allowed as exemptions on your federal income tax return, plus the number of any additional dependents whom you support.)”

MEMORANDUM

TO: Subcommittee on Consumer Issues

FROM: Elizabeth Gibson, Assistant Reporter

RE: Form 22C and Deduction of Business Expenses

DATE: May 19, 2008

One of the issues for the Subcommittee's consideration during its conference call on May 22 is presented by a recent Ninth Circuit BAP decision. In Drummand v. Wiegand (In re Wiegand), 386 B.R. 238 (9th Cir. BAP 2008), the court held that a chapter 13 debtor engaged in business may not subtract business expenses from gross receipts in determining his current monthly income. That conclusion led the court to declare that Form 22C, by instructing the debtor to make such a deduction, is inconsistent with § 1325(b)(2). The *Wiegand* case reached the same conclusion as the earlier decision in In re Arnold, 376 B.R. 652 (Bankr. M.D. Tenn. 2007).

As part of the report of income, item 3 of Form 22C requires a chapter 13 debtor to list gross receipts from the operation of a business, profession, or farm and from that figure to subtract ordinary and necessary business expenses. The resulting figure is listed as the debtor's business income and is added to other reported income to determine the debtor's current monthly income. Form 22C then uses the current monthly income figure for three purposes: (1) to determine the applicable commitment period; (2) to determine the appropriate method for calculating disposable income; and (3) to calculate the disposable income of an above-median-family-income debtor. The applicable commitment period is determined by comparing the debtor's annualized current monthly income to the applicable median family income, a figure

calculated by the U.S. Census Bureau. If the debtor's income is less than the applicable median family income, the commitment period is three years; otherwise, it is five years. Above-median-family-income debtors must calculate their disposable income by deducting from current monthly income expenses authorized by the IRS national and local standards and certain "other necessary expenses" designated by the IRS, as well as additional expenses specified by the Bankruptcy Code.

The *Wiegand* and *Arnold* courts concluded that Form 22C is inconsistent with § 1325(b)(2) of the Code. Section 1325(b)(2)(B) provides with respect to a debtor engaged in business that disposable income is calculated by deducting from current monthly income "expenditures necessary for the continuation, preservation, and operation of [the debtor's] business." According to *Wiegand*, this provision "plainly and unambiguously requires a debtor to deduct business expenses from current monthly income." The court reasoned that "[i]f business expenses are deducted from gross receipts to determine a chapter 13 debtor's current monthly income, then there would be no need for § 1325(b)(2)(B), which provides for the same deductions."

The point at which business expenses are deducted – to calculate current monthly income or disposable income – is significant for the determination of the applicable commitment period. If these expenses are deducted in determining current monthly income, a debtor's annualized current monthly income is more likely to fall below the median family income and thus qualify the debtor for the shorter commitment period. The point at which the deduction takes place may also affect whether the debtor's disposable income is calculated pursuant to § 1325(b)(3), using the IRS standards for expenses, or under § 1325(b)(2), using actual expenses.

Judge Wedoff has indicated that this issue was thoroughly discussed in the course of drafting Form 22C. There were at least a couple of reasons that the decision was made to include the business expense deduction in the calculation of current monthly income rather than disposable income. First, the Census Bureau uses net, rather than gross, income in computing median family incomes. *See* http://www.census.gov/acs/www/Downloads/2006/usedata/Subject_Definitions.pdf (pp. 47-48). Since those are the figures to which the debtor's annualized current monthly income must be compared under § 1325(b), it makes sense to calculate current monthly income in the same manner. Second, the use of gross receipts for self-employed debtors would lead to distinctions in the calculation of current monthly income based merely on the business form under which the debtor has chosen to operate. Under the *Wiegand* approach, a self-employed debtor with gross business receipts of $250,000 will be above the applicable median family income of any state, even if she has a net income of only $40,000. If that same debtor instead were operating her business as an LLC and taking a salary of $40,000, she would most likely be below her state's median family income. It is hard to imagine any reason that Congress would have intended to treat those two situations differently.[1] Thus the Advisory Committee, in approving Form 22C, chose to interpret "income" as used in § 101(10A)'s definition of "current monthly income" as net, rather than gross, business income.

An additional reason might be advanced for rejecting the *Wiegand* approach. If one follows the plain meaning approach it advocates, a plain meaning interpretation of § 1325(b)(3) and § 707(b)(2)(A) and (B) would result in an above-median-family-income debtor who is self-

[1] Although not addressing this specific argument, the *Wiegand* court observed that the result it reached was not absurd "because the Code is replete with rules and requirements that impact sole proprietors differently than wage earners."

employed never being able to deduct most business expenses.[2] Section 1325(b)(3) requires an above-median-family-income debtor to determine "amounts reasonably necessary to be expended" according to "subparagraphs (A) and (B) of section 707(b)(2)." Those paragraphs of the means test require application of "the National Standards and Local standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service . . . ." All of those IRS standards and categories relate to personal and household, not general business, expenses. Permissible business expenses are included in another section of the IRS Financial Analysis Handbook. *See* http://www.irs.gov/irm/part5/ch15s01.html . Likewise, all of the other expenses expressly allowed to be deducted under § 707(b)(2)(A) and (B) are personal and household, not business, expenditures. Thus, as the Advisory Committee previously concluded in approving Form 22C, the only sensible interpretation of income for a self-employed debtor is net, not gross, income.[3]

Despite the logic of using net business income to determine a debtor's current monthly income, it is true that such an interpretation creates a redundancy with § 1325(b)(2)(B)'s instruction to subtract business expenses from current monthly income to calculate disposable income. That provision existed prior to the changes introduced by BAPCPA and was likely overlooked by Congress when it introduced the concept of "current monthly income" and the means test into § 1325(b). Form 22C deals with this problem for above-median-family-income debtors by instructing them not to deduct a second time any business expenses deducted in item

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2 The same result would also be true for any self-employed chapter 7 debtor.

3 The *Arnold* court suggested that an above-median-income, self-employed debtor could deduct business expenses as part of "other necessary expenses" in computing disposable income. It cited the IRS Financial Analysis Handbook § 5.15.1.10, which describes the allowable "other necessary expenses." Although that section imposes a necessity test that permits expenses "for the production of income," most of the expenses of running a business

3 to calculate business income. In the case of a chapter 13 debtor who is at or below the median family income, the same prohibition against double deductions should also apply. (This problem could arise in those courts that calculate disposable income based on current monthly income reported on Form 22C and expenses reported on Schedule J.)

would not fall within any of the "categories specified as Other Necessary Expenses" (*see* § 707(b)(2)(A)(ii)(I)).

In re _____
Debtor(s)

Case Number: _____
(If known)

According to the information required to be entered on this statement (check one box as directed in Part I, III, or VI of this statement):

☐ **The presumption arises.**
☐ **The presumption does not arise.**
☐ **The presumption is temporarily inapplicable.**

CHAPTER 7 STATEMENT OF CURRENT MONTHLY INCOME AND MEANS-TEST CALCULATION

In addition to Schedules I and J, this statement must be completed by every individual chapter 7 debtor, whether or not filing jointly. Unless the exclusion in Line 1C applies, joint debtors may complete a single statement. If the exclusion in Line 1C applies, each joint filer must complete a separate statement.

Part I. MILITARY AND NON-CONSUMER DEBTORS

1A	**Disabled Veterans.** If you are a disabled veteran described in the Declaration in this Part IA, (1) check the box at the beginning of the Declaration, (2) check the box for "The presumption does not arise" at the top of this statement, and (3) complete the verification in Part VIII. Do not complete any of the remaining parts of this statement. .☐ **Declaration of Disabled Veteran.** By checking this box, I declare under penalty of perjury that I am a disabled veteran (as defined in 38 U.S.C. § 3741(1)) whose indebtedness occurred primarily during a period in which I was on active duty (as defined in 10 U.S.C. § 101(d)(1)) or while I was performing a homeland defense activity (as defined in 32 U.S.C. §901(1)).
1B	**Non-consumer Debtors.** If your debts are not primarily consumer debts, check the box below and complete the verification in Part VIII. Do not complete any of the remaining parts of this statement. ☐ **Declaration of non-consumer debts.** By checking this box, I declare that my debts are not primarily consumer debts.
1C	**Reservists and National Guard Members; active duty or homeland defense activity.** Members of a reserve component of the Armed Forces and members of the National Guard who were called to active duty (as defined in 10 U.S.C. § 101(d)(1)) after September 11, 2001, for a period of at least 90 days, or who have performed homeland defense activity (as defined in 32 U.S.C. § 901(1)) for a period of at least 90 days, are excluded from all forms of means testing during the time of active duty or homeland defense activity and for 540 days thereafter (the "exclusion period"). If you qualify for this temporary exclusion, (1) check the appropriate boxes and complete any required information in the Declaration of Reservists and National Guard Members below, (2) check the box for "The presumption is temporarily inapplicable" at the top of this statement, and complete the verification in Part VIII. **During your exclusion period you are not required to complete the balance of this form, but you must complete the form no later than 14 days after the date on which your exclusion period ends, unless the time for filing a motion raising the means test presumption expires in your case before your exclusion period ends.** ☐ **Declaration of Reservists and National Guard Members.** By checking this box and making the appropriate entries below, I declare that I am eligible for a temporary exclusion from means testing because, as a member of a reserve component of the Armed Forces or the National Guard a. ☐ I was called to active duty after September 11, 2001, for a period of at least 90 days and ☐ I remain on active duty /or/ ☐ I was released from active duty on _____, which is less than 540 days before this bankruptcy case was filed; OR b. ☐ I am performing homeland defense activity for a period of at least 90 days /or/ ☐ I performed homeland defense activity for a period of at least 90 days, terminating on _____, which is less than 540 days before this bankruptcy case was filed.

Interim Rule 1007-I. Lists, Schedules, Statements, and Other Documents; Time Limits; Notice Regarding Temporary Exclusion from Means Testing

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(b) SCHEDULES, STATEMENTS, AND OTHER DOCUMENTS REQUIRED.

* * * * *

(4) Unless either

(A) § 707(b)(2)(D)(i) applies, or

(B) § 707(b)(2)(D)(ii) applies and the exclusion from means testing granted therein extends beyond the period specified by Rule 1017(e),

an individual debtor in a chapter 7 case shall file a statement of current monthly income prepared as prescribed by the appropriate Official Form, and, if the current monthly income exceeds the median family income for the applicable state and household size, the information, including calculations, required by § 707(b), prepared as prescribed by the appropriate Official Form.

* * * * *

(c) TIME LIMITS. In a voluntary case, the schedules, statements, and other documents required by subdivision (b)(1), (4), (5), and (6) shall be filed with the petition or within 15 days thereafter, except as otherwise provided in subdivisions (d), (e), (f),

~~and~~ (h), and (n) of this rule. In an involuntary case, the list in subdivision (a)(2), and the schedules, statements, and other documents required by subdivision (b)(1) shall be filed by the debtor within 15 days of the entry of the order for relief. In a voluntary case, the documents required by paragraphs (A), (C), and (D) of subdivision (b)(3) shall be filed with the petition. Unless the court orders otherwise, a debtor who has filed a statement under subdivision (b)(3)(B), shall file the documents required by subdivision (b)(3)(A) within 15 days of the order for relief. In a chapter 7 case, the debtor shall file the statement required by subdivision (b)(7) within 45 days after the first date set for the meeting of creditors under § 341 of the Code, and in a chapter 11 or 13 case no later than the date when the last payment was made by the debtor as required by the plan or the filing of a motion for a discharge under § 1141(d)(5)(B) or § 1328(b) of the Code. The court may, at any time and in its discretion, enlarge the time to file the statement required by subdivision (b)(7). The debtor shall file the statement required by subdivision (b)(8) no earlier than the date of the last payment made under the plan or the date of the filing of a motion for a discharge under §§ 1141(d)(5)(B), 1228(b), or 1328(b) of the Code. Lists, schedules, statements, and other documents filed prior to the conversion of a case to another chapter shall be deemed filed in the

converted case unless the court directs otherwise. Except as provided in § 1116(3), any extension of time to file schedules, statements, and other documents required under this rule may be granted only on motion for cause shown and on notice to the United States trustee, any committee elected under § 705 or appointed under § 1102 of the Code, trustee, examiner, or other party as the court may direct. Notice of an extension shall be given to the United States trustee and to any committee, trustee, or other party as the court may direct.

* * * * *

(n) TEMPORARY EXCLUSION FROM MEANS TESTING.

(1) An individual debtor who is temporarily excluded from means testing pursuant to § 707(b)(2)(D)(ii) shall file any statement and computation required by subdivision (b)(4) no later than14 days after the expiration of the temporary exclusion if the expiration occurs within the time specified by Rule 1017(e) for filing a motion pursuant to § 707(b)(2).

(2) If the temporary exclusion from means testing pursuant to § 707(b)(2)(D)(ii) terminates under the circumstances specified in subdivision (n)(1) and if the debtor has not previously filed a statement and computation required by subdivision (b)(4), the clerk shall forthwith give the debtor notice that any required statement and

computation must be filed within the time specified in subdivision (n)(1).

COMMITTEE NOTE

This rule is amended to take account of the enactment of the National Guard and Reservists Debt Relief Act of 2008, which amended § 707(b)(2)(D) to provide a temporary exclusion from the application of the means test for certain members of the National Guard and reserve components of the Armed Forces. This exclusion applies to qualifying debtors while they remain on active duty or are performing a homeland defense activity, and for a period of 540 days thereafter. For some debtors initially covered by the exclusion, the protection from means testing will expire while their chapter 7 cases are pending, and at a point that a timely motion to dismiss under § 707(b)(2) may still be filed. Under the amended rule such debtors are required to file the statement and computations required by subdivision (b)(4) no later than14 days after the expiration of their exclusion.

Subdivisions (b)(4) and (c) are amended to relieve debtors qualifying for an exclusion under § 707(b)(2)(D)(ii) from the obligation to file a statement of current monthly income and required calculations at the outset of their chapter 7 cases.

Subdivision (n) is added to provide for the filing of the information required by subdivision (b)(4) by a debtor who initially qualifies for the means test exclusion under § 707(b)(2)(D)(ii), but whose exclusion expires during the time that a motion to dismiss under § 707(b)(2) may still be made under Rule 1017(e). Such a debtor must file the statement and computations required by subdivision (b)(4) no later than14 days after the temporary exclusion expires. Under subdivision (n)(2) the clerk is required, upon the expiration of the temporary exclusion, to provide prompt notice to the debtor of the need to file the required statement and computations if the debtor has not already done so.

COMMITTEE NOTE

The chapter 7 form is amended to implement the temporary exclusion from means testing created by the National Guard and Reservists Debt Relief Act of 2008. That law amended § 707(b)(2)(D) for a period of three years by adding a new subsection (ii) to provide a temporary exclusion from the application of the means test for certain members of the National Guard and reserve components of the Armed Forces. The new temporary exclusion would last for the period that the qualifying debtor is on active duty or is performing a homeland defense activity, and for 540 days thereafter.

Because the exclusion for Reservists and National Guard members applies only for a defined period of time, it may expire during the course of the chapter 7 case filed by a debtor initially entitled to the exclusion. For that reason, a new check box is added to the top of the form that states that the "presumption is temporarily inapplicable." A debtor who is entitled to claim the Reservists and National Guard exclusion at the commencement of the chapter 7 case may check that box.

The new exclusion applies only to a debtor who satisfies all of the requirements of § 707(b)(2)(D)(ii), and its expiration date depends on facts specific to each debtor. Therefore, in a joint case in which the exclusion in part 1C is claimed by either or both filers, each joint filer must complete a separate statement. If only one joint debtor qualifies for the exclusion in part IC, the other joint debtor must complete the form.

Part 1C is added to the form to allow qualifying debtors to claim the temporary exclusion under § 707(b)(2)(D)(ii). Debtors who declare under penalty of perjury that they satisfy all of the requirements of that provision are directed to verify their declaration in Part VIII and to check the "temporary presumption" box at the beginning of the form. They are not required to complete the remaining parts of the form for so long as the exclusion remains applicable.

A debtor who is or has been a Reservist or a National Guard member may qualify for the exclusion described in part 1C by being called to active duty service after September 11, 2001, for a period of at least 90 days, or while performing homeland defense activity for a period of at least 90 days. After the debtor has been released from active duty or has ceased performing homeland defense activity, the exclusion applies for a period of 540 days

after the release date or cessation of homeland defense activity. Under those circumstances the debtor must state the date of release from active duty or the date on which the performance of homeland defense activity terminated.

If the Reservist and National Guard exclusion terminates during the course of a chapter 7 case – because of the expiration of the 540 day period following the release from active duty or the cessation of homeland defense activity – then the debtor may be required to complete the remaining parts of the form that are applicable to the debtor. If the exclusion terminates while a timely motion to dismiss under § 707(b)(2) may still be filed, Interim Rule 1007-I(n) requires that the debtor complete the remaining parts of the form no later than 14 days after the termination. If the obligation to complete the form arises in these circumstances and the debtor has not previously completed the form, the clerk is required to give the debtor notice of the obligation.