American Bankruptcy Institute

Disposable Income: Choosing a Chapter under the Means Test

Joseph E. Cohen
Cohen & Krol; Chicago

Keisha M. Hooks
The Office of the Chapter 13 Trustee; Chicago

Mark A. Redmiles
Deputy Director, Executive Office for U.S. Trustees; Washington, D.C.

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

THE MEANS TEST IN ILLINOIS BANKRUPTCY COURTS

I Cases interpreting "projected disposable income" and "applicable commitment period"

In re Demonica, 345 B.R. 895 (Bankr. N.D. Ill. 2006)

The Court denied confirmation based on the trustee's projected disposable income objection. The Court determined that projected disposable income must be based on actual monthly income, not Form 22C's historical figure. According to §1325(b)(2), projected disposable income is relevant to determining what unsecured creditors must receive, but "*projected* disposable income" is not defined in the Code. The term "disposable income" is defined by using pre-petition income. So in order to give meaning to every word in the statute, the Court concluded that "projected disposable income" is not synonymous with "disposable income." It also decided that the actual income, as disclosed on Schedule I, would be used to determine the debtor's projected disposable income.

The Court also held that reasonably necessary expenses for above the median debtors must be based on the expenses outlined in §707(b)(2)(A) and (B). Although the debtor's car was in his spouse's name, he had the expense of owning a car. Therefore, he was permitted to deduct the IRS standards for owning and operating a vehicle. The Court also noted that the debtor could not deduct an additional housing expense to account for the difference between his actual costs and the IRS allowance.

In re Greer, 388 B.R. 889 (Bankr. C.D. Ill. 2008)

The chapter 13 trustee objected to the confirmation of the debtors' plan because their disposable income was not based on the couples' "current monthly income." Instead, the debtors used their actual disposable income, which was lower due to a job loss. The Court sustained the trustee's objection and found that post-filing changes to income cannot be considered. According to the Bankruptcy Code, the projected disposable income calculation must begin with the debtors' six-month, pre-petition average, not their actual income.

In re Fuller, 346 B.R. 472 (Bankr. S.D. Ill. 2006)

The chapter 13 trustee opposed the debtors' plan because they were not committing all of their disposable income as calculated by Form 22C. The debtors, whose current income was lower than the six-month average, argued that Schedules I and J should be used to determine their projected disposable income. The Court articulated its formula for determining projected disposable income, which combined elements of both parties' arguments.

The Court accepted the debtors' argument that Form 22C is not the sole determinor of projected income, and that Schedule I should be considered since projected disposable income is a forward-looking concept. The Court also agreed with the trustee that expenses for above median debtors must be determined by §707(b)(2)(A) and (B). The Court further noted that Schedule J still is used to determine reasonable expenses for below median debtors.

In re Nance, 371 B.R. 358 (Bankr. S.D. Ill. 2007)

The chapter 13 trustee objected to five plans proposed by above median debtors. The trustee argued that the debtors were either not committing all of their disposable income, as defined by Schedules I and J, or the debtors' plans were not lasting for the required five year commitment period.

By finding that projected disposable income must be determined by Form 22C only, the Court adopted a mechanical approach to calculating income. The Court also found that above the median debtors must commit to five-year plan, or pay unsecured creditors in full, even if their projected disposable income is a negative number. While recognizing the split in authority, the Nance court decided that §1325(b)(4)(b) requires above the median debtors to remain in chapter 13 for sixty months if creditors are not being paid in full.

In re Mathis, 367 B.R. 629 (Bankr. N.D. Ill. 2007)

The Court confirmed the above the median debtors' 36-month plan over the trustee's objection. The Court accepted the debtors' argument that the means test determines "projected disposable income", which is the amount of money unsecured creditors must receive. In addition, "applicable commitment period" is not a length of time, but a factor to be multiplied by projected disposable income. Since the debtors had negative projected disposable income, non-priority unsecured creditors were not required to receive any payments. Therefore, the Court reasoned that a 60-month plan was not necessary.

II Cases interpreting controversial means test deductions

In re Saffrin, 380 B.R. 191 (Bankr. N.D. Ill. 2007)

The chapter 13 trustee objected to confirmation on the ground that the debtors were not committing all of their disposable income to unsecured creditors. The above median debtors deducted a $1,000 monthly expense for their 18-year old daughter's college expenses. The Court reasoned that the debtors were not permitted to deduct the expenses as educational expenses under section 707(b)(2)(A)(ii)(IV) since the child was over 18, and the expense was for college tuition, not elementary or secondary school. The Court also rejected the debtors' argument that college tuition can be deducted as a necessary expense under section 707(b)(2)(A)(ii)(I) of the Bankruptcy Code. After reviewing the Internal Revenue Manual, the Court concluded that college tuition is not necessary since it is neither a condition for employment nor is it being spent for a child who is mentally or physically challenged. As a result, the trustee's objection was sustained.

In re Farrar-Johnson, 353 B.R. 224 (Bankr. N.D. Ill. 2006)

The chapter 13 trustee objected to the debtors' plan because the couple was not committing all of their disposable income. The trustee argued that the debtors' reasonably necessary expenses must be based on Schedule J and not §707(b)(2)(A) and (B). In the trustee's opinion, Schedule J included excessive and unreasonable expenses. Therefore, the plan could not be confirmed unless the budget and plan were amended to pay a higher dividend to

unsecured creditors. The Court overruled this objection holding that Schedule J does not apply to above the median debtors since §1325(b)(3) mandates the use of the expenses outlined in §707(b)(2)(A) and (B).

The trustee also argued that the debtors' $1,233 housing deduction on Form 22C was improper since they lived on a military base and had no actual housing expense. After analyzing the language in §707(b)(2)(A)(ii)(I), the Court disagreed with the trustee. The Court recognized that deductions according to the IRS "Local and National Standards", which include housing expenses, only had to be "applicable" while "Other Necessary Expenses" had to be "actual." Therefore, the debtors were entitled to the housing expense that applied to their household size and county of residence.

The trustee's final argument was that the debtors' disposable income calculation was evidence that they proposed the plan in bad faith. The Court found that good faith is not an element of §1325(b)(2)'s disposable income test. The only standard that expenses must satisfy is whether they are reasonably necessary. Therefore, good faith cannot be considered when scrutinizing disposable income. For above median debtors, expenses that are properly deducted under §707(b)(2)(A) and (B) are considered reasonably necessary as a matter of law. Therefore, the Court had to accept the debtors' disposable income calculation, and the trustee's objection was overruled.

In re Barrett, 371 B.R. 855 (Bankr. S.D. Ill. 2007)

Unsecured creditor eCast objected to several of the debtor's means test deductions. First, eCast opposed the debtor's deduction for housing and automobile ownership expenses. eCast argued that the debtor is not entitled to deduct the IRS Standards because her actual costs were lower than the IRS allowances. In addition, eCast objected to the automobile ownership deduction for her second vehicle, which was an unencumbered motorcycle. Lastly, the creditor argued that the debtor's plan payment should increase when the note on her direct-pay automobile is satisfied.

The Court overruled eCast's objection and found that the IRS standards are permitted irrespective of the debtor's actual expenses. The Court's decision rested on the distinction made in §707(b)(2)(A)(ii)(I) between "applicable monthly expenses" and "actual monthly expenses." The debtor's actual costs are not relevant when deducting National and Local Standards, i.e housing and transportation expenses. Despite eCast's argument, the Court declined to consult the Internal Revenue Manual for guidance since Congress did not include that directive in the statute.

In addition, the Court held that the debtor, who was single and had no dependents, could deduct the ownership expense for both vehicles, even though the second vehicle was not necessary and had no actual ownership cost. The Court also found that an increase in the plan payment was not required when her automobile loan was paid in full. In accordance with the Nance decision, projected disposable income is determined exclusively by Form 22C. A graduated payment would give consideration to the debtor's actual projected disposable income, which the Court expressly prohibited for above the median debtors. Therefore, the debtor's plan ultimately was confirmed over eCast's objection.

In re Burmeister, 378 B.R. 227 (Bankr. N.D. Ill. 2007)

The chapter 13 trustee opposed the debtors' deduction of mortgage payments for real estate they intended to surrender. In the objection to confirmation, the trustee argued that the debtors should not be permitted to deduct the payment for the surrendered property since the debtors would not have the expense once the plan is confirmed. The Court rejected the trustee's argument that the effective date of the plan determined the appropriateness of the deduction. Instead of relying on §1325(b)(1), the Court decided that if the payments were "contractually due" at the time of filing, then §§707(b)(2)(A)(iii)(I) and 1325(b)(3) permit the deduction of the expense.

The trustee also argued that, by including this mortgage payment, the debtors had not proposed the plan in good faith. The Court responded by holding that a good faith attack cannot be raised when disposable income is at issue. There is no relationship between the two concepts since the disposable income test is found in §1325(b) while the issue of good faith arises under §1325(a)(3). Since §1325(b) defines reasonable and necessary expenses, good faith is not a consideration. As a result, the trustee's objection was overruled, and the plan was confirmed.

In re Randle, 358 B.R. 360 (Bankr. N.D. Ill. 2006)

The Court found in favor of the debtor when asked to decide whether a chapter 7 debtor's case should be dismissed as abusive. The United States Trustee argued that the debtor should not be permitted to deduct the mortgage payment for real estate she intends to surrender. The Court denied the Trustee's motion by relying on the language in §707(b)(2)(A)(iii), which in pertinent part, states that the secured debt must be " scheduled as contractually due...in each month of the 60 months following the date of the petition." The Court found that the inquiry does not extend beyond whether the secured debt was due at the time of filing. Contrary to the United States Trustee's argument, the provision does not allow for the consideration of the debtor's schedules or post-filing intentions. The Court asserted that the statute limits its examination to the debtor's contractual obligations at the time of filing and denied the Trustee's motion to dismiss.

Authored by:
Keisha M. Hooks, Esq,
Office of the Chapter 13 Trustee, Marilyn O. Marshall

A DEBTOR'S GUIDE TO CHAPTER 7 & CHAPTER 13

JOSEPH E. COHEN

Cohen & Krol
Chicago & Waukegan

A DEBTOR'S GUIDE TO CHAPTERS 7 & 13

JOSEPH E. COHEN
COHEN & KROL
105 West Madison Street
Suite 1100
Chicago, IL 60602
312/368-0300
jcohen@cohenandkrol.com

I. WHO MAY BE A DEBTOR UNDER CHAPTER 7

A. Person Who Resides, Has Domicile Or Place Of Business Or Property In U.S.

– must be a person which includes individuals, corporations and partnerships

– cannot be railroads, domestic & foreign insurance companies, banks, savings and loans, land trusts, municipalities

– no requirement that Debtor be insolvent

B. Important Provision Of '109

– cannot be Debtor if Debtor has been Debtor at any time in preceding 180 days, and

– case dismissed by Court for willful failure of Debtor to abide by orders of the Court or to appear before the Court in proper prosecution of the case, or

– if Debtor requested and obtained dismissal following the filing of a request for relief from the automatic stay

II. WHO MAY BE A DEBTOR UNDER CHAPTER 13

A. Chapter 13 Eligibility Requirements

– for cases filed after April 1, 2007 only an individual with regular income who

on the date of the filing of the case has noncontingent, liquidated unsecured debts of $336,900.00 and noncontingent, liquidated secured debts of $1,010,650.00 are eligible to file for Chapter 13.

B. Other Considerations

– There cannot be an involuntary Chapter 13 proceeding. A Chapter 13 can only be filed by a Debtor and not by a third party. Chapter 13's cannot be filed for a partnership or a corporation. However, a debtor operating a business as a sole proprietorship is eligible to file for Chapter 13 protection.

III. CREDIT COUNSELING REQUIREMENT FOR CHAPTERS 7 & 13

Pursuant to Section 109 (h) an individual may not be a debtor unless such individual has during the 180-day period preceding the date of the filing of the Chapter 7 or Chapter 13, received from an approved nonprofit budget and credit counseling agency an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

IV. COMMENCEMENT OF CASE

A. Commencement of Case

Almost every consumer Chapter 7 will be initiated by an entity that may be a debtor filing with the Bankruptcy Court a petition seeking relief under Chapter 7 of the Code. It is important to note that the filing of a voluntary petition constitutes an order for relief. ' 301. No motions or further pleadings are necessary to obtain the order for relief.

B. Venue of Case

The venue requirements for filing a voluntary Chapter 7 or 13 petition are identified in 28 U.S.C. ' 1408. This section states that a case may be commenced in the district where

the debtor had his domicile, residence or principal place of business in the United States for the one hundred and eighty (180) days immediately proceeding the commencement of the case or for the longer portion of the one hundred and eighty day period. For example, if the debtor had resided in Madison, Wisconsin from January of 2007 through June of 2008, a total of six months, then moved to Waukegan, Illinois and filed a Chapter 7 in August of 2008, the proper venue would reside in Madison, Wisconsin. However, if the debtor waited until the middle of September of 2008, then more than ninety one (91) days of the one hundred and eighty day period would fall within the Illinois residency period. The proper venue would then be the Illinois Bankruptcy Court and not the Wisconsin Bankruptcy Court.

C. Joint Cases

The filing of a joint case may be commenced by the filing of a single petition. Only an individual debtor and his spouse may file a joint case with a single petition. The joint case can still be filed for a wife and husband even if a divorce action is pending as long as a Judgment for Dissolution of Marriage is not entered prior to the filing of the petition. Fathers and sons cannot file a joint case as well as partners in a business that has failed.

The filing of a joint case does not result in the debtor's estates being consolidated. The Court, if necessary, will determine the extent, if any, to which the husband's estate and the wife's estate shall be consolidated. In a typical consumer no-asset proceeding, this determination will not be necessary. The rules governing the consolidation or joint administration of joint cases are located in Rule 1015, Rules of Bankruptcy Procedure. The filing fee for a joint case is the same as the fee for an individual case being filed.

V. PROCEDURE FOR COMMENCING CASE

A. Caption of Voluntary Petition

The caption of the voluntary petition you are filing should contain the following items. Rule 1005.

1. Name of the Court.

2. Title of the case which includes

   a. name and address of debtor(s),

   b. social security number of debtor(s), (only last 4 digits)

   c. all other names used by debtor within eight years prior to filing of petition.

B. Required Documents for Commencing Case

The debtor, in a voluntary case, in addition to the Voluntary Petition, must file a list of all creditors, including names and addresses. The requirement of a list of creditors is waived if the debtors file a schedule of liabilities (schedules D, E, F, G and H) when the case is commenced.

The following documents will have to be filed to commence the Chapter 7 or Chapter 13 proceeding. The listed documents are identified by their official names with a statement as to when they must be filed with the Clerk of the Bankruptcy Court.

1. Voluntary Petition - must be filed at commencement of case.

2. List of Creditors - must be filed at commencement of case. This requirement is waived if a schedule of liabilities is filed. Rule 1007.

3. Notice to Individual Consumer Debtor(s) - must be filed at commencement of case.

4. Credit Counseling Certificate or Waiver. An individual debtor must file a statement of Compliance with the credit counseling requirements which must also be filed at the commencement of case. Interim Rule 1007(b)(3).

5. Declaration Regarding Electronic Filing - must be filed at commencement of case.

6. Disclosure of Compensation Under 11 U.S.C. '329 and Bankruptcy Rule 2016(b) - must be filed within 15 days of filing of petition.

7. Chapter 7 Debtor's Statement of Intention - must be filed within 30 days of filing of petition. Section 521(a).

8. Schedule of Current Income (Schedule I) and Current Expenditures for Individual Debtor (Schedule J) - must be filed within 15 days of filing of petition.

9. Schedules of Liabilities and Assets - must be filed within 15 days of filing of petition. Rule 1007.

10. Statement of Financial Affairs - must be filed within 15 days of filing of petition. Rule 1007.

C. Means Testing

1. In a Chapter 7 proceeding, an individual debt with primarily consumer debts shall file a statement of current monthly income using Official Form B 22A. Therefore if the debtor has primarily business debts, Form B 22A does not have to be completed. This Form must be filed within 15 days of filing of petition.

2. In a Chapter 13 proceeding, an individual debt with any type of debts shall file a statement of current monthly income using Official Form B 22C. This Form will very likely

determine the amount to be made pursuant to the Chapter 13 Model Plan. This Form must be filed within 15 days of filing of petition.

D. List of Creditors, Schedules and Statement of Affairs

The schedules, together with the statement of affairs are the heart and soul of a Chapter 7 bankruptcy. It is extremely important that these documents are accurately filled out and filed on a timely basis. The failure to accurately complete these documents can result in several things occurring:

1. The Debtor can be forced to amend his schedules or statement of affairs. This costs time and money for all parties involved.

2. The Trustee, United States Trustee or other party can file a '727 Objection to Discharge complaint. These are typically filed if the Debtor knowingly or fraudulently made a false oath and account on his schedules.

3. The Court on its own motion or by motion of the U. S. Trustee, Chapter 7 or Chapter 13 Trustee can attempt to dismiss the case on the basis of "abuse". '707(b).

Many times, debtor's attorneys and/or their clients will not schedule certain assets and liabilities through neglect. The assets and liabilities most frequently neglected are as follows:

1. Life insurance policies, cash surrender value and beneficiaries.

2. Pension or retirement plans at work.

3. Profit sharing plans.

4. Personal injury, malpractice or contract actions.

5. Workman Compensation actions.

6. Income tax refunds.

7. Individual Retirement Accounts (IRA) and related plans.

8. Contingent liabilities.

9. Prepetition sale of assets.

10. Payments to creditors within ninety (90) days or one year prior to filing of petition.

11. Transfer of assets in the past two years.

It only takes a few more minutes to accurately complete the schedules, statement of affairs and schedule of current income and expenses. A trouble free case is the result of the additional time and effort.

E. Verification of Pleadings

Rule 1008 states that all petitions, lists, schedules, statement of affairs, etc., be verified or, in the alternative, contain an unsworn declaration. This is accomplished when filing electronically through CM/ECF by filing an executed Declaration Regarding Electronic Filing. Please review the Administrative Procedures For The Case Management/Electronic Case Filing System (CM/ECF) found on the Courts website, www.ilnb.uscourts.gov.

Rule 9011, regarding signing and verification of papers, has to be of utmost concern to all practitioners. This rule states that if an attorney or a party signs a document, that signature means certain things, i.e.:

1. That the signatory has read the document.

2. That to the best of the signatory's knowledge, information or belief formed after reasonable inquiry, the document is well grounded in fact.

3. That the pleading is not interposed for any improper purpose, such as to harass, to cause delay or to increase the cost of litigation.

The penalty for violation of Rule 9011 can be the striking of pleadings or monetary sanctions being imposed against the attorney or party who signed the purported document.

F. Filing Fees

At the present time, the filing fee for a Chapter 7 proceeding is $299.00. Normally this is paid in full at the filing of the case. This fee of $299.00 is the same for individual cases or joint cases between husband and wife. The filing fee for a Chapter 13 is $274.00.

The Code does provide that the $299.00 or $274.00 filing fee can be paid in installments. This requires an application signed by the debtor stating that the debtor is unable to pay the fee except in installments. It is important to note, that the debtor can not request an installment fee if the debtor has paid any money or transferred any property to the debtor's attorney for services rendered in connection with the case. The practitioner is not allowed to receive any compensation prior to payment in full of all installments owed by the debtor to the Court. The number of installments cannot exceed four and the final installment must be paid within 120 days of the filing of the petition.

G. Death and Insanity

Rule 1016 of the Rules of Bankruptcy Procedure governs the effect that the death or insanity of a debtor has upon the administration of the bankruptcy estate. The rule states that the death or insanity of a debtor will not stop a liquidation of the debtor's assets by a Trustee in a Chapter 7 proceeding. This will be true in an asset case where the Debtor has appeared at the Section 341 First Meeting of Creditors. However, in a no asset case, the

Trustee will typically dismiss the case rather than proceed with the administration.

VI. AUTOMATIC STAY PROVISIONS - ' 362 of Code

A. Upon Filing Of Voluntary Or Involuntary Petition, Automatic Stay Is Created

- stay is automatic upon filing of case
- do not have to make motion to obtain stay
- stays commencement or continuation of action proceeding against Debtor
- stays enforcement against Debtor or property of the estate of a pre-petition judgment
- stops acts to obtain possession of property or to exercise control of property of the estate
- prohibits any act to create, effect or enforce any lien against property of the estate except for mechanics liens

B. Exceptions to Automatic Stay

- doesn't apply to criminal proceedings
- collection of alimony, maintenance or support from property not property of the estate not stayed
- doesn't prohibit commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental units police or regulatory power
- no co-debtor stay for consumer debts in Chapter 7, only Chapter 13.

C. Modification or Lifting of Automatic Stay

- stay may be modified for cause, including lack of adequate protection of an interest in property, or
- of Debtor doesn't have an equity in such property and is not necessary to an effective reorganization
- cause not defined in Code

– adequate protection determined on a case by case basis

– normally only secured creditors or lessors will seek to modify stay

– stay will be modified to allow plaintiff to proceed where personal injury action pending and other defendants or insurance exist

D. Automatic Stay Can Terminate Automatically

– will terminate upon dismissal of bankruptcy

– entry of discharge of Debtor will terminate stay as to Debtor or if Trustee has abandoned property

E. Things to Remember

– burden of proof on all issues except Debtor's equity in property on party opposing relief

– willful violation of stay entitles party injured to recover actual damages and sometimes punitive damages

F. How Is Stay Modified

– by motion with $150.00 fee

– stay will be terminated after 30 days from request unless Court, after notice and hearing, continues stay pending conclusion of final or preliminary hearing.

– Court shall order stay if opposing party, usually Debtor, shows there is reasonable likelihood that party opposing relief will be successful

– if first hearing is preliminary hearing, then final hearing has to be commenced no later than 30 days after conclusion of preliminary hearing but can be waived by the parties

VII. FIRST MEETING OF CREDITORS IN CHAPTERS 7 & 13

A. Conducted by Interim Trustee.
– In Cook County, Chapter 7 cases are held at Office of the United States Trustee

– In other counties locations vary

– Chapter 13 cases are always heard by the Office of the Chapter 13 Trustee assigned to the case. In Cook County the 341 first meetings are held at the Office of the Chapter 13 Trustee and not the Office of the United States Trustee. In the suburbs the locations vary.

B. Usually Held Within 40 Days Of Filing Of Petition

C. 20-Day Notice Sent To All By The Court

D. Creditors Invited To Attend But Not Mandatory For Them, Just Debtor

VIII. DISCHARGE AND DISCHARGEABILITY IN CHAPTER 7

A. This Is Entire Goal Of Chapter 7 Proceeding

B. Creditors' Options

- can file objection to discharge ('727) or complaint to determine dischargeability of a particular debt ('523)
- must file within 60 days of original first meeting date unless extended by Court order prior to expiration of 60-day period
- either '523 or '727 action must be commenced by the filing of an adversary complaint

C. Chapter 7 Trustee Can Only File Objection To Discharge ('727)

- under prior case law, Trustee cannot move to extend the time to file objections to discharge and complaints to determine dischargeability for other parties, only for him or herself but this appears to be changing

D. Grounds For Debt To Be Determined Non Dischargeable Pursuant To '523 Of Code

- for taxes or custom duties
- all trust fund taxes not dischargeable including withholding and sales tax (ROT taxes)
- some income tax liability is dischargeable

– debt not dischargeable if money, property, services or extension or renewal obtained by false pretenses, false representation or actual fraud

– false financial statement

– consumer debts to a single creditors more than $550.00 for luxury goods or services incurred within 90 days

– cash advances aggregating more than $825.00 obtained by an individual debtor with 70 days before the order for relief

– if debt not scheduled

– for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny

– for a domestic support obligation

– debts of the kind incurred by the debtor in the course of a divorce or separation agreement

– willful and malicious injury by the Debtor to another entity or property of an entity

– student loans unless undue hardship

– for death or personal injury caused by the debtor=s operation of a motor vehicle because of intoxication from alcohol, drugs or other substances.

– debts previously denied a discharge in a bankruptcy proceeding

– for fees and assessments that become due after the Order for Relief for condos or co-ops

E. Grounds for Objection to Discharge ('727)

– Debtor must be an individual, not a corporation

– Debtor with intent has transferred, removed, destroyed, mutilated or concealed property of the Debtor within one year of filing or post-petition

– concealed, destroyed or failed to keep books and records

- Debtor knowingly made a false oath or used a false claim
- Debtor knowingly withheld information from officer of the estate
- Debtor has failed to explain satisfactorily loss of assets
- Debtor has refused to obey lawful order of Court
- additional grounds

IX. DISCHARGE AND DISCHARGEABILITY IN CHAPTER 13

A. Dischargeability Pursuant To Section 523

- The comments made in Section D above, Grounds For Debt To Be Determined Non Dischargeable Pursuant To '523 Of Code, also apply to Chapter 13 cases.

B. Grounds for Objection to Discharge ('727)

- Creditors cannot file an Objection to Discharge ('727) in a Chapter 13

X. ADVANTAGES OF CHAPTER 7 FILING

A. Automatic Stay Stops All Actions Against Debtor

B. Trustee Is Appointed. His Job Is To Liquidate All Non-Exempt Assets And Distribute Pursuant To '507 Of The Code

C. '507 Distribution In Following Order

- allowed unsecured claims for domestic support obligations
- administrative expenses, usually Trustee and Attorney for Trustee fees
- unsecured '502)(f) claims
- unsecured claims for wages, salaries or commissions including vacation, severance and sick leave pay incurred within 180 days of case or cessation of business up to $10,000.00
- allowed unsecured claims for contributions to employee benefit plan

- allowed unsecured claims of persons engaged in production or raising of grain
- allowed unsecured claims of individuals for $2,425.00 for purchase, lease or rental of property or services
- tax claims
- certain entities that subrogate to the rights of a holder of a claim lose priority

D. Provides Convenient Forum For Trustee And/Or Debtor To Adjudicate Lien Claims

E. Pursuant To '522(F), Debtor Can Avoid Lien On A Non-Possessory, Non-Purchase Money Security Interest

F. Pursuant To '722, Debtor Can Redeem Personal Property By Paying Holder Of Lien The Value Of The Secured Claim

G. Can Reject Executory Contracts

H. Can Recover Preferential Transfers And Fraudulent Conveyances

I. Can Claim Property Exempt

1. Homestead of $15,000.00 per person
2. $2,400.00 equity in motor vehicle
3. $4,000.00 of personal property
4. Unlimited wearing apparel
5. $750.00 tools of the trade
6. $7,500.00 personal injury action
7. Pension plan, retirement plans, IRA-s, 401(k)-s
8. Life insurance
9. Workers compensation

J. Can Reaffirm On Secured Debt

K. Debtor Can File Complaints To Determine Dischargeability Of Tax Claims

L. Can Determine Amount Of Secured Claim Or Lien

M. Debtor Has Protection Against Discriminatory Treatment

N. Can Force Turnover Of Property Being Held By Third Party Or Custodian

O. Limited Authority For Trustee To Operate Business To Maximize Liquidation Of Assets

P. Creditor Or Trustee Must Object To Claim Of Exemption Within 30 Days Of Concluded First Meeting

Q. Debtor Can Obtain True Fresh Start After Discharge

R. Debtor Has Absolute Right To Convert To Chapter 13 Or 11

S. Dismissal Of Action Requires 20-Day Notice Unlike Chapter 13

XI. DISADVANTAGES OF FILING CHAPTER 7

A. Trustee Is Appointed. He/She Controls Liquidation Of Assets Instead Of Debtor

B. Creditors Can File '523 Dischargeability Complaints And Trustee Or Creditors Can File '727 Objection To Discharge

C. Not All Debts Discharged

D. Court, U. S. Trustee or Chapter 7 Trustee Can Bring Motion Pursuant To '707 For Abuse

E. Only Entitled To A Chapter 7 Discharge Every 8 Years

F. Pursuant To Rule 2004 And Powers Given To Trustee And Creditors, Affairs Of Debtor Can Be Investigated In Great Detail

G. Must Surrender All Non-Exempt Assets To The Trustee

H. Discharge Can Be Revoked If Certain Criteria Proven

I. Student Loans Not Dischargeable Unless Undue Hardship

J. Only 60 Days To Assume Or Reject Leases Or Executory Contracts

K. Corporations Do Not Get Discharge In Chapter 7

XII. ADVANTAGES OF CHAPTER 13 FILING

A. A Chapter 13 Debtor gets all of the advantages listed in the Section on

Advantages Of Chapter 7 Filing except for paragraphs B, J, O and S.

B. The Debtor Must File A Chapter 13 Model Plan

- The Plan allows a mortgage arrearage or any arrearage on a secured debt to be paid over a maximum period of 60 months but not less than 36 months

- Any unsecured priority claims such as taxes or domestic support obligations can be paid without interest over a maximum period of 60 months

- Chapter 13 plan must run between 3 to 5 years

- The filing of a Chapter 13 stops any pending foreclosure actions or any other collection activity against the debtor

- Stops the repossession of a motor vehicle and can even allow for the return of a vehicle that has been repossessed prior to the filing of the case

C. No Chapter 7 Trustee Is Appointed To Liquidate The Debtors Assets

D. Chapter 13 Trustee Acts Like A Disbursing Agent For Creditors

E. Many Times Debtors Can Lower Their Total Monthly Payments

F. The Co-Debtor Of A Consumer Debt Is Also Stayed By The Filing Of The Debtors Chapter 13

G. Debtors Who Have High Monthly Income And Do Not Qualify For A Chapter 7 Under The Means Test Have A Way To Satisfy Their Debts

XIII. DISADVANTAGES OF FILING CHAPTER 13

A. The Debtors Pay Their Debts Out Of Their Disposable Income Which Effectively Ties Up Their Cash Flow During The Term Of The Chapter 13 Plan.

B. Some Debts Are Nondischargeable In A Chapter 13 And Will Still Be Owed After The Chapter 13 Is Competed. A Good Example Of This Are Student Loans

C. Attorney Fees In A Chapter 13 Are Typically Higher Than Those Charged In A Chapter 7

D. The Debt Limitations Described Previously Prohibits Some Deserving Debtors From Being Eligible To File For Chapter 13. They Must File A Personal Chapter 11 Instead

E. It Takes Normally 3 To 5 Years To Obtain A Discharge In Chapter 13. In A Chapter 7 A Debtor Typically Gets Discharged 5 Months After The Filing Of The Petition

F. Creditors Can Still File '523 Dischargeability Complaints

G. Pursuant To Rule 2004 And Powers Given To Trustee And Creditors, Affairs Of Debtor Can Be Investigated In Great Detail

H. Many Chapter 13 Cases Are Dismissed For Failure Of The Debtor To Make The Monthly Trustee Payments.

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

---

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

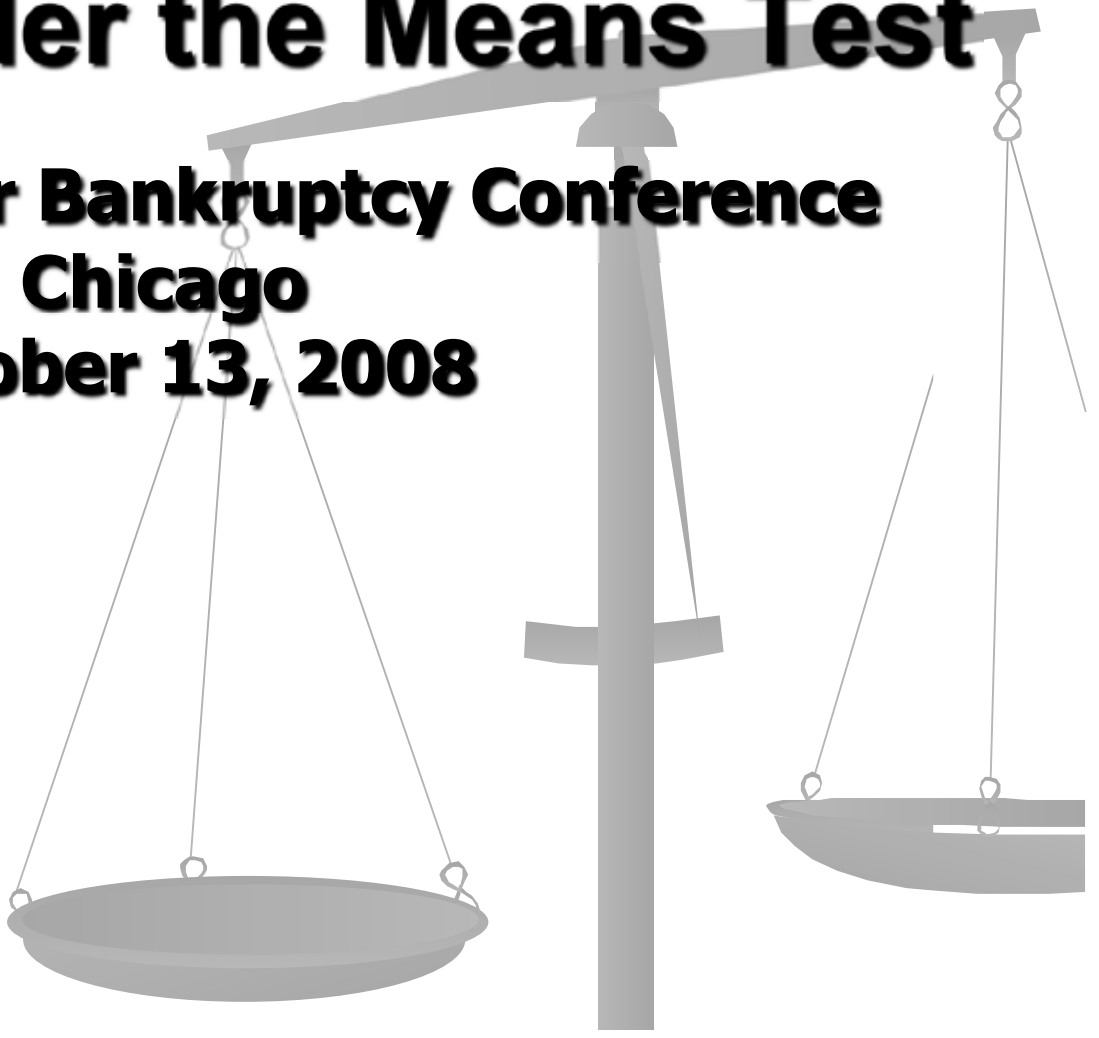
3 The *Arnold* court suggested that an above-median-income, self-employed debtor could deduct business expenses as part of "other necessary expenses" in computing disposable income. It cited the IRS Financial Analysis Handbook § 5.15.1.10, which describes the allowable "other necessary expenses." Although 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)).

Disposable Income: Choosing a Chapter under the Means Test

2008 Consumer Bankruptcy Conference
Chicago
October 13, 2008



Mark A. Redmiles

Deputy Director
Executive Office for
United States Trustees
Washington, DC

Overview

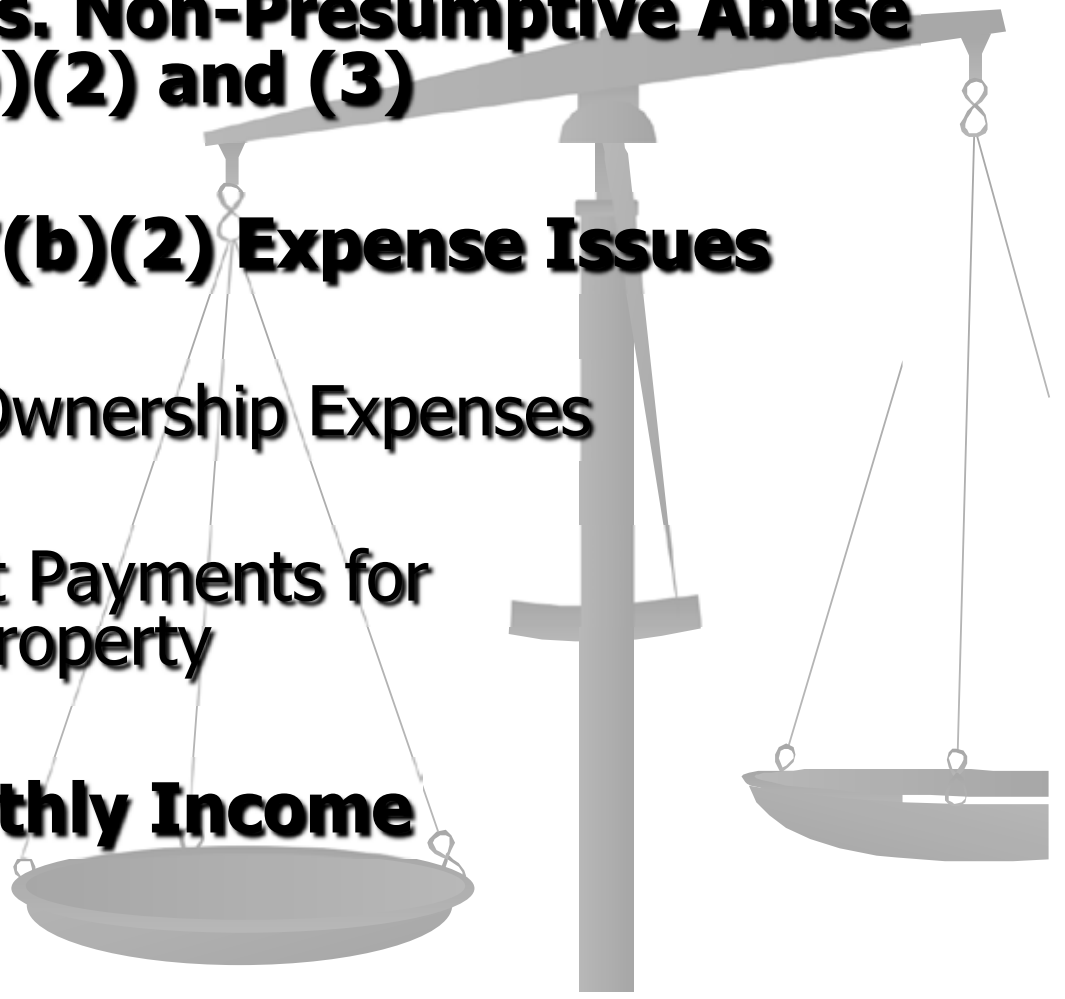
I. Presumptive vs. Non-Presumptive Abuse Under § 707(b)(2) and (3)

II. Selected § 707(b)(2) Expense Issues

A. IRS Vehicle Ownership Expenses

B. Secured Debt Payments for Surrendered Property

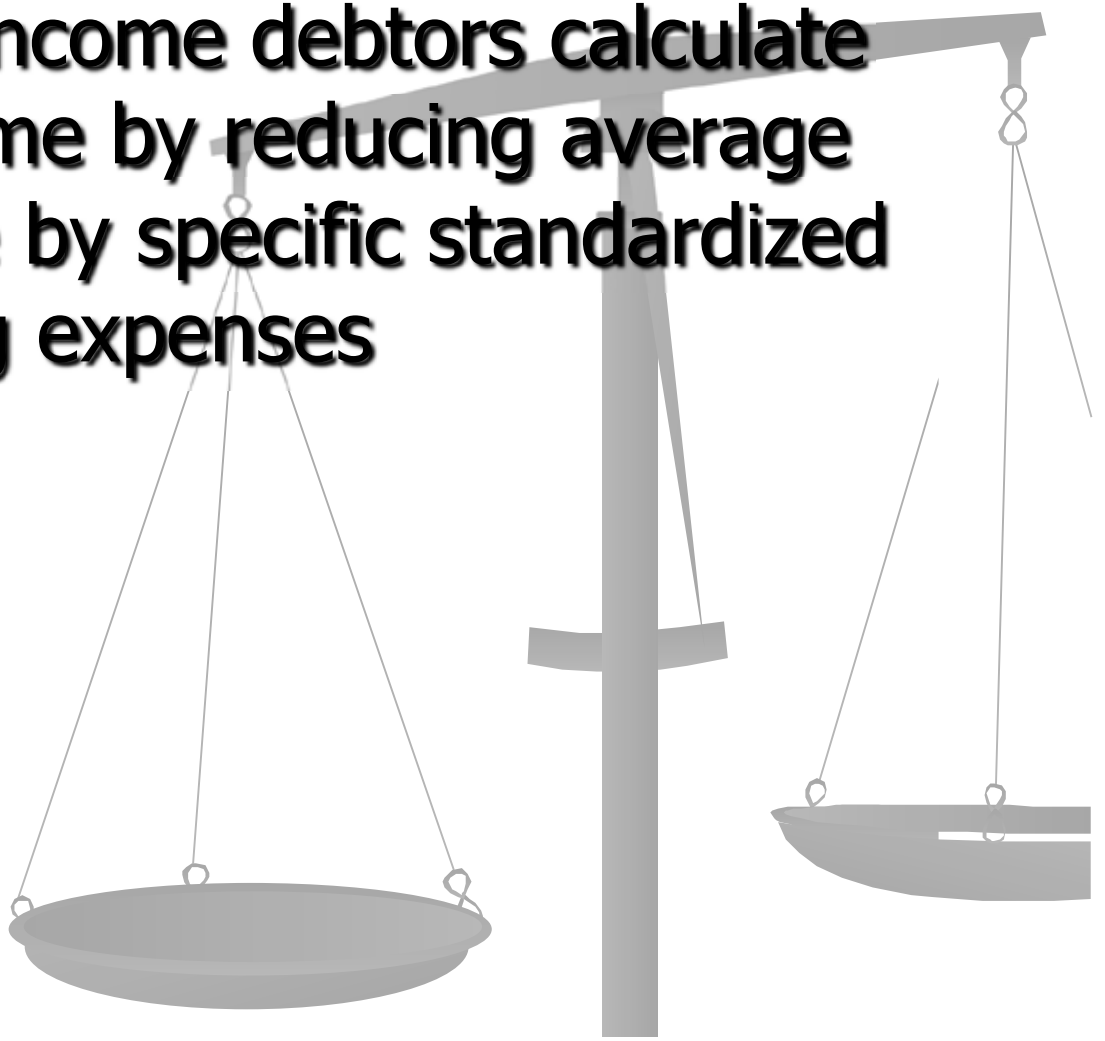
III. Current Monthly Income



Presumptive Abuse: § 707(b)(2)

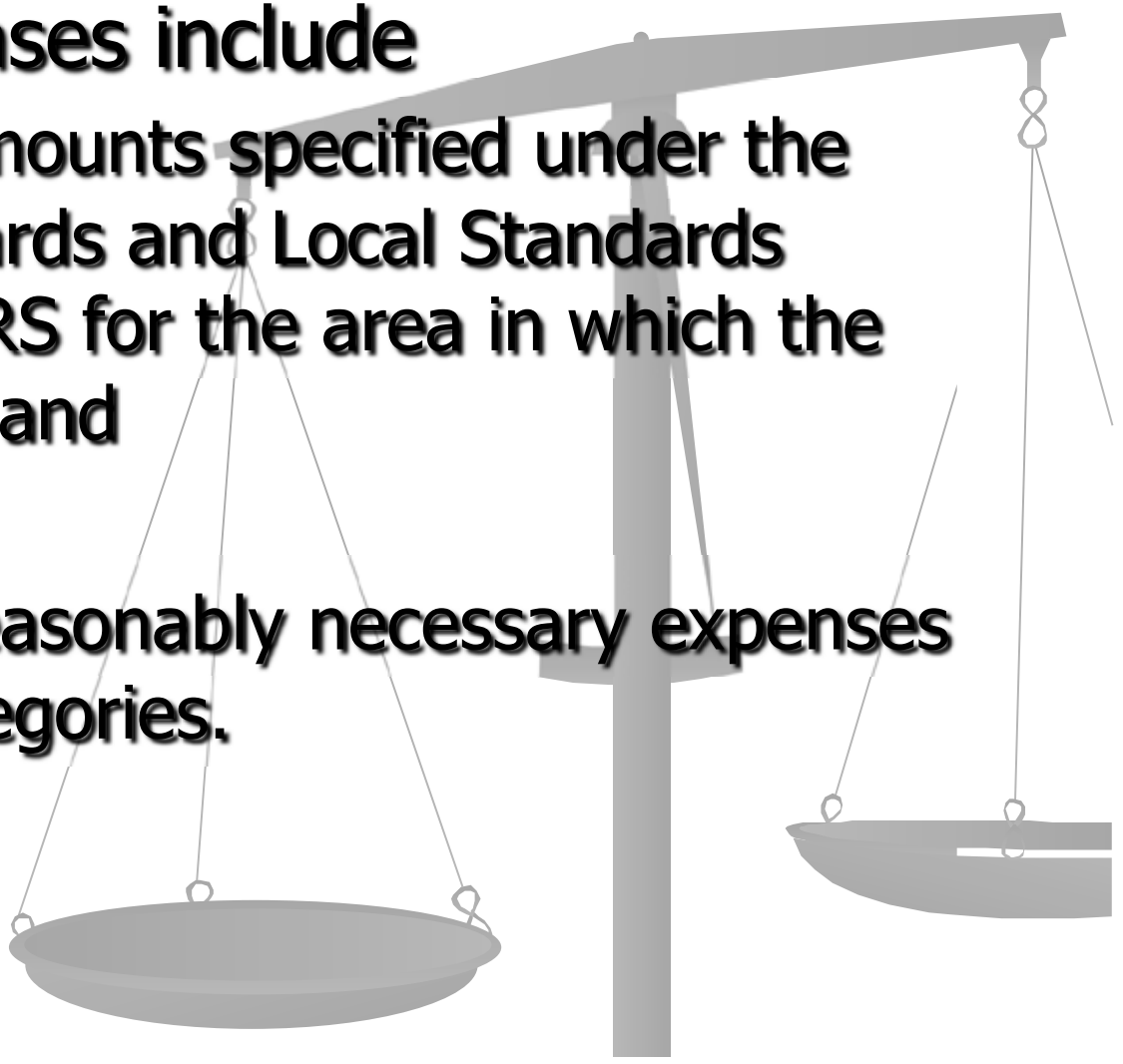
707(b)(2) Overview

- Above-median income debtors calculate disposable income by reducing average monthly income by specific standardized and actual living expenses



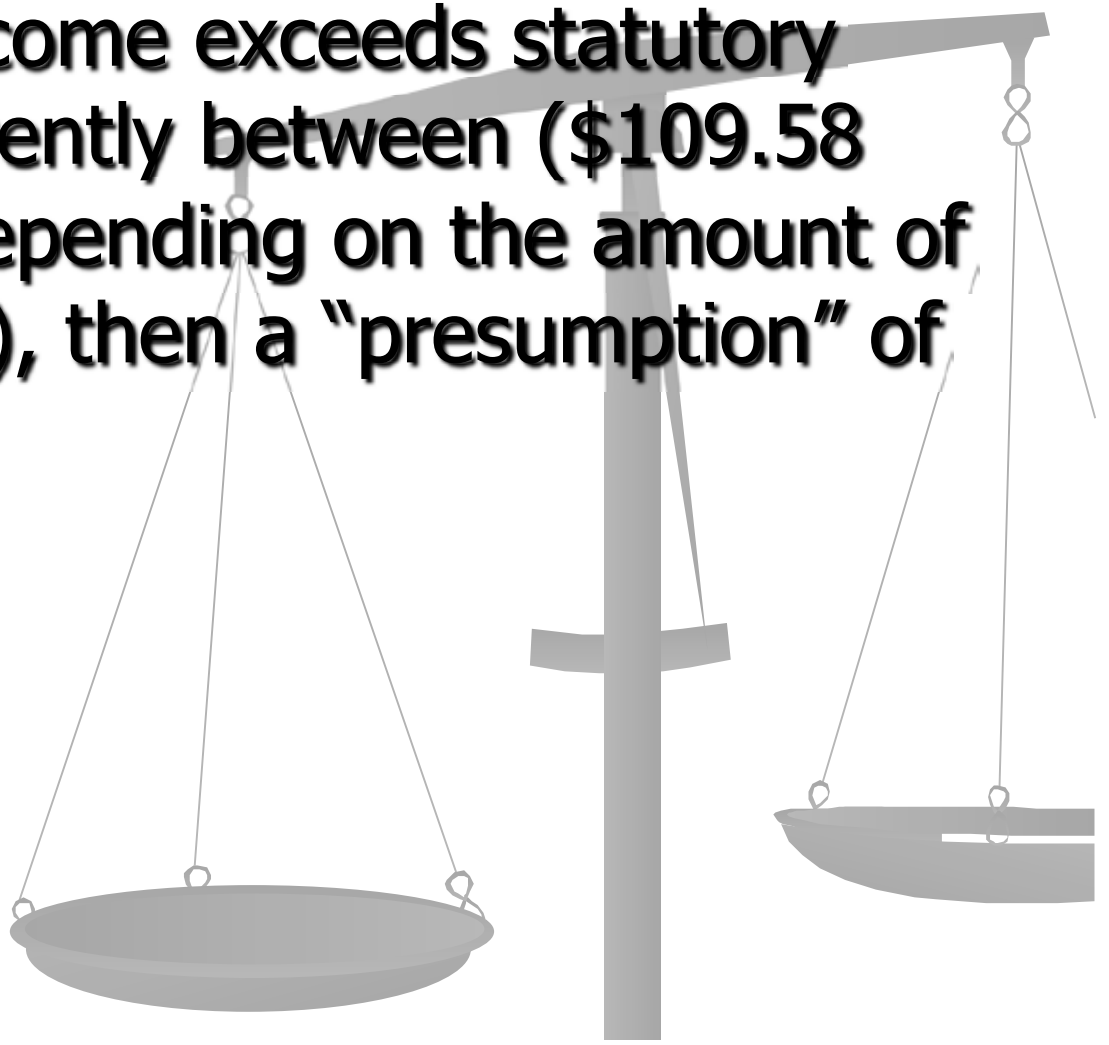
707(b)(2) Overview

- Allowable expenses include
  - standardized amounts specified under the National Standards and Local Standards issued by the IRS for the area in which the debtor resides, and
  - Other actual, reasonably necessary expenses in specified categories.



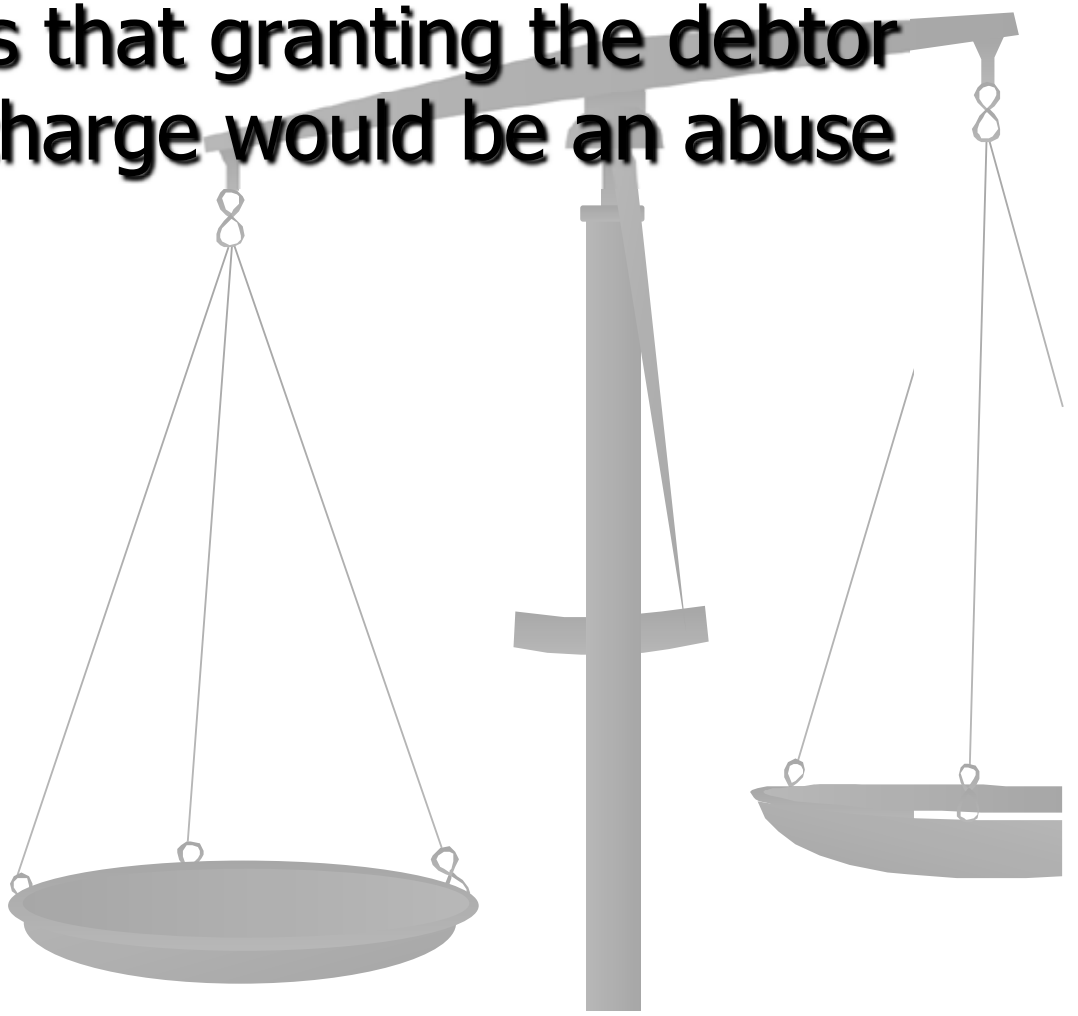
Presumption of Abuse

- If disposable income exceeds statutory thresholds (currently between ($109.58 and $182.50, depending on the amount of unsecured debt), then a "presumption" of abuse arises.



Presumption of Abuse

- "Presumption" is that granting the debtor a chapter 7 discharge would be an abuse

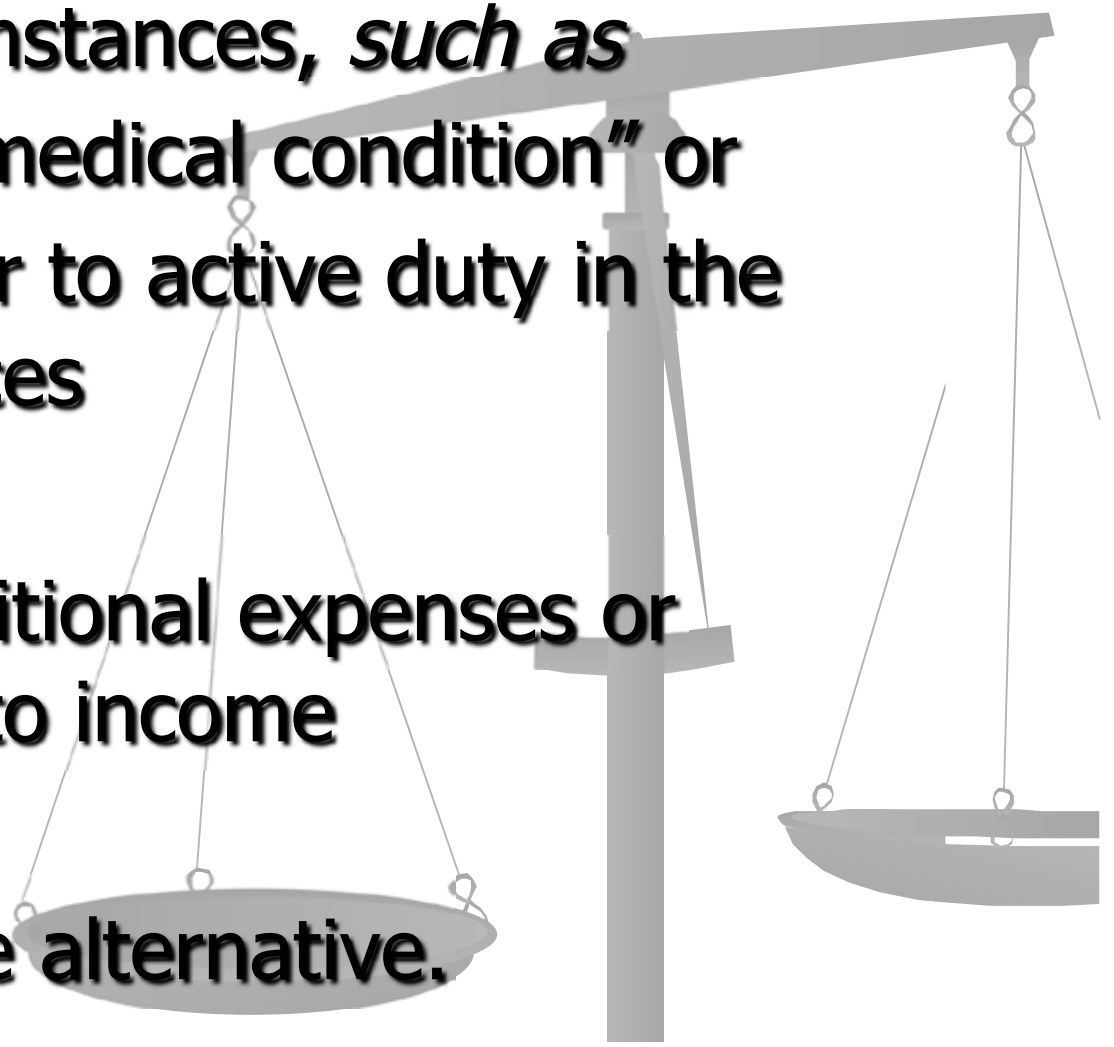


Rebutting the Presumption – Special Circumstances

- Debtors can rebut the presumption by establishing "special circumstances" under § 707(b)(2)(B).

Debtor Must Demonstrate

- Special circumstances, *such as*
  - a "serious medical condition" or
  - call or order to active duty in the Armed Forces
- justifying additional expenses or adjustments to income
- no reasonable alternative.



Proof to Establish Special Circumstances - § 707(b)(2)(B)(ii)

- Itemize each additional expense or adjustment of income

- Provide documentation and a detailed explanation that makes the expense or income adjustment necessary and reasonable