
U.S. Trustee's Office Perspective: Recent Developments in Consumer Cases

Gary L. Donahue

Office of the U.S. Trustee; Providence, R.I.

Christopher Lefebvre

Lefebvre & Lefebvre, PC; Pawtucket, R.I.

Lisa D. Tingué

Office of the U.S. Trustee; Worcester, Mass.

Anne J. White

Demeo & Associates, P.C.; Boston

AMERICAN BANKRUPTCY INSTITUTE
NORTHEAST CONSUMER WINTER FORUM

SELECTED MEANS TESTING ISSUES UNDER BAPCPA

PHOEBE MORSE
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I. INCOME

11 U.S.C. § 101(10A) defines “current monthly income” as the “average monthly income from all sources that the debtor receives . . . derived during the 6-month period” preceding the date of filing. 11 U.S.C. § 101(10A)(B) further defines current monthly income as “including any amount paid by an entity other than the debtor . . . on a regular basis for the household expenses of the debtor” but excludes, among other things, benefits received under the Social Security Act. Bankruptcy courts disagree about whether unemployment compensation and veterans benefits are benefits received under the Social Security Act. In addition, courts have come to differing results on income issues raised by retirement distributions, amounts paid by persons other than the debtor for household expenses, income tax withheld from paychecks and funds returned as tax refunds.

A. Unemployment Compensation

In re Baden, 396 B.R. 617 (Bankr. M.D. Pa. 2008). Chapter 13 trustee objected to confirmation of debtors’ proposed plan on basis that plan failed to commit all of debtors’ disposable income to plan. Specifically, trustee argued that unemployment benefits received by debtors during six months prior to filing had to be included as part of debtors’ current monthly income (“CMI”). Court viewed “the distinction between unemployment

compensation and social security benefits as a manifestation of Congress' intent that the Bankruptcy Code treat current and temporary replacement of wages administered by the state differently than future benefits associated with old age, ordinarily administered by the federal government." Court held that unemployment compensation payments were not "benefits received under the Social Security Act," and therefore had to be included in calculating CMI. See *In re Kucharz*, 2009 WL 3518163 (C.D. Ill. 2009) for an excellent description of the history of unemployment compensation laws.

***In re Sorrell*, 359 B.R. 167 (Bankr. S.D. Ohio 2007).** UST moved to dismiss under Section 707(b)(2). Court held that unemployment compensation payments debtors received over six-month period preceding petition date were "benefits received under the Social Security Act" reasoning that, although unemployment compensation is undisputedly administered by the state, the Social Security Act provides a common funding source and common regulations for all unemployment programs. Court held that unemployment compensation could not be included in income calculations under 11 U.S.C. § 101(10A).

***In re Munger*, 370 B.R. 21 (Bankr. D. Mass 2007).** UST moved to dismiss under Section 707(b)(2). Debtors responded that the UST had improperly included unemployment compensation received by debtor-wife in calculating debtors' CMI. Court held that unemployment compensation payments debtor received over six-month period preceding petition date were "benefits received under the Social Security Act" that could not be included in calculating CMI.

B. Veteran's Benefits

***In re Hedge*, 394 B.R. 463 (Bankr. S.D. Ind. 2008).** Unsecured creditor objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Court held that debtor's veterans benefits had to be included in calculation of debtor's CMI as such benefits are not specifically excluded from CMI by statute.

In re Waters, 384 B.R. 432 (Bankr. N.D. W.V. 2008). Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Court held that debtor's veterans benefits had to be included in calculation of debtor's CMI as such benefits did not fall within an enumerated exception to CMI.

C. Retirement Distributions

Zahn v. Fink (In re Zahn), 391 B.R. 840 (B.A.P. 8th Cir. 2008). Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Non-filing spouse received a voluntary distribution from his individual retirement account ("IRA") within the six-month period preceding petition date. Bankruptcy Court held that debtor, in calculating her CMI, had to include income realized from the IRA distribution in order to achieve confirmation. The Bankruptcy Appellate Panel reversed, ruling that IRA distributions received during the six-month period prior to filing did not have to be included as part of a debtor's CMI calculation, but noted that the IRA distributions had not been received "on a regular basis."

In re DeThamplé, 390 B.R. 716 (Bankr. D. Kan. 2008). Chapter 13 trustee objected to confirmation of debtors' proposed plan on basis that plan failed to commit all of debtors' disposable income to plan. Debtor-wife received a single distribution from her employee retirement plan ("401K") within the six-month period preceding petition date. Court held that debtors, in calculating their current monthly income, had to include income realized from 401K distribution; the Court held, however, that the distribution did not need to be included in the calculation of projected disposable income for the purpose of chapter 13 plan payments.

In re Wayman, 351 B.R. 808 (Bankr. E.D. Tex. 2006). Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Debtor, as part of property settlement agreement with former spouse, obtained custody, care, and control of former spouse's IRA prior to the six-month period preceding petition date. Debtor then received early distribution from IRA during the six-month

period preceding petition date. Court held that debtor, in calculating her CMI, did not have to include income realized from IRA distribution because income was actually received when the debtor first obtained custody, care, and control over the IRA.

D. Amounts Regularly Paid for Household Expenses

In re Bostwick, 406 B.R. 867 (Bankr. D. Min 2009). The Chapter 13 trustee objected to the debtor's plan because the amounts paid by her roommate for rent and utilities were not included in her current monthly income. The debtor rented her house from the owner who did not live in the house. Her roommate held a separate lease with the landlord but shared utility bills with the debtor. The Court held that the debtor had to add the roommate's average utility payment to her current monthly income.

In re Epperson, 409 B.R. 503 (Bankr. D. Ariz. 2009). The UST moved to dismiss the debtor's chapter 7 case because he included his roommate in his household size but did not include the roommate's income except for \$900 the roommate paid toward household expenses. The bankruptcy court held that the debtor was entitled to include the roommate in his household size. The court further held that because the Bankruptcy Code explicitly limits a third party's contribution to CMI to the amount the third party pays toward household expenses, the debtor did not have to include all of the roommate's income in the calculation of his CMI.

E. Tax Refunds

In re Durczynski, 405 B.R. 880 (Bankr. N.D. Ohio 2009). In examining the income side of the means test in a chapter 7 case, the U.S. Trustee sought to dismiss the debtors' case under the totality of the circumstances because, among other things, the debtors averaged about \$3,000 in yearly income tax refunds. The Court agreed that tax refunds constitute a source of income so long as there is a realistic prospect of similar refunds in the future.

In re Michaud, 399 B.R. 365 (Bankr. D.N.H. 2008). In three separate cases the Court evaluated chapter 13 cases in which the debtors over-withheld federal income tax and received tax refunds, but did not include the income from the tax refund in their plans as projected disposable income. The Court held that, whether debtors are above or below median income, their tax expenses fall into the category of actual expenses, and thus debtors bear the burden of demonstrating that these expenses are actual, reasonable and necessary. The Court allowed the debtors to retain some amount of a tax refund depending on the particular circumstances in a particular case.

In re Kruse, 406 B.R. 833 (Bankr. N.D. Iowa 2009). In a chapter 13 case, the debtor included tax refunds in her monthly income on Schedule I and planned to pay her student loans, which she scheduled separately from other unsecured debt. The chapter 13 trustee objected to confirmation of the plan, asserting that the debtor should turn over her tax refunds to the trustee. Holding that the tax refunds were disposable income, the Court allowed the debtor to retain a portion of the money for reasonable expenses and ordered her to turn over the remainder of the refund to the trustee. The Court further held that the debtor's student loan claim should be paid through the plan and prorated with all unsecured claims.

F. Other Sources of Income

Blausey v. U.S. Trustee (In re Blausey), 552 F.3d 1124 (9th Cir. 2009). The UST moved to dismiss under 11 U.S.C. § 707(b)(2). In his motion, the UST asserted that debtors improperly calculated CMI by filing to include private disability insurance payments received during six-month period prior to filing. The bankruptcy court agreed and the debtors initiated a direct appeal to the Ninth Circuit Court of Appeals. The Ninth Circuit affirmed, ruling that private disability insurance payments received during six-month period prior to filing had to be included in the calculation of CMI.

In re Munger, 370 B.R. 21 (Bankr. D. Mass. 2007). The UST moved to dismiss the debtors' chapter 7 case alleging that the debtors did not include all their available income in their calculation of CMI by failing to include unemployment compensation benefits. The bankruptcy court held that the debtors acted properly because unemployment benefits were "benefits under the Social Security Act."

In re Royal, 397 B.R. 88 (Bankr. N.D. II. 2008), Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Among other things, the trustee argued that the debtor's "earned income tax credit" should be considered income for the purposes of CMI on the debtor's Form 22A. The bankruptcy court agreed, ruling that because earned the income tax credit was not specifically excluded from the plain language of Section 101(10A), Congress intended it to be included in the calculation of CMI.

II. "DISPOSABLE" INCOME AND "PROJECTED DISPOSABLE" INCOME

In chapter 13, if a trustee or unsecured creditor objects to the confirmation of a chapter 13 plan, the court may not approve the plan unless it provides that all of the debtor's "projected disposable income" will be applied to make payments to unsecured creditors. 11 U.S.C. §1325(b)(1)(B). "Disposable income" is defined to mean "current monthly income" less amounts "reasonably necessary to be expended" which, for above-median debtors, are defined

in accordance with Section 707(b)(2). See 11 U.S.C. §§ 1325(b)(2) and (3). The requirement that a debtor apply all “projected disposable income” to plan payments predates BAPCPA, but both the definition of “current monthly income” and the means test-based determination of amounts “reasonably necessary to be expended” for above-median debtors were added to the Code by BAPCPA. However, the term “projected disposable income” is not defined in the Code.

The Fifth, Seventh, Eighth and Tenth Circuits have concluded that the concept is either forward looking, utilizing Form 22C as the starting point subject to adjustment based on the debtor’s actual or anticipated income, or that bankruptcy courts may, at a minimum, consider reasonably certain future events in the calculation of projected disposable income. The Ninth Circuit has decided that “projected disposable income” means nothing more than the mechanical application of the “disposable income” figure on Form 22C. The Tenth Circuit case on this issue, *Hamilton v. Lanning*, is pending before the United States Supreme Court.

***Nowlin v. Peake (In re Nowlin)*, 576 F.3d 258 (5th Cir. 2009).** The chapter 13 trustee opposed confirmation of a plan where the debtor’s loan from a 401(k) plan would be repaid within two years but the plan payments did not increase once the loan was paid off. The debtor argued that repayment of the loan should not be considered for confirmation purposes because the calculation of “projected disposable income” under Section 1325(b)(1) should be mechanical, involving nothing more than determining her disposable income under Section 1325(b)(2) and multiplying that amount by the plan’s term. The bankruptcy court denied confirmation of the plan and the Fifth Circuit affirmed, holding that the phrase “projected disposable income” allows consideration of reasonably certain future events.

***Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652 (8th Cir. 2008).** The chapter 13 trustee agreed with the debtor that he had no projected disposable income because his disposable income on Form 22C was a negative number, but objected to his proposed 48 month plan. The bankruptcy court overruled the trustee’s objection and the bankruptcy appellate panel affirmed. The Eighth Circuit reversed, holding that the term “projected disposable income” necessarily

contemplates a forward-looking number and noting that “disposable income,” which is based on historical income and IRS tables, may or may not be an accurate projection for many debtors.

***In re Turner*, 574 F.3d 349 (7th Cir. 2009).** The chapter 13 trustee objected to the debtor’s deduction of mortgage payments on a house he intended to surrender and the consequent reduction of disposable income on Form 22C. The bankruptcy court rejected the trustee’s argument but on direct appeal the Seventh Circuit reversed. The Seventh Circuit, following *Frederickson*, held that the calculation of disposable income was simply a starting point for determining the debtor’s projected disposable income and that the final calculation could take into account changes that would take effect before the effective date of the plan.

***Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269 (10th Cir. 2008).** The chapter 13 trustee objected to the debtor’s plan arguing that the projected disposable income was the same as monthly disposable income, even though the debtor plainly could not afford to fund a plan at that figure which included a bonus payment from a job she had left. The court held that, as to the income side of the inquiry, the starting point for calculating projected disposable income is presumed to be the debtor’s current monthly income subject to a showing of a substantial change in circumstances.

***Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008).** The Ninth Circuit upheld the bankruptcy court’s determination that “projected disposable income” under section 1325(b)(1)(B) is calculated solely from the disposable income figure on Form 22C multiplied by the applicable commitment period, with no other adjustments. In an *amicus* filing, the UST argued that “projected disposable income” is based on the “disposable income” calculation derived from Form 22C, subject to adjustment to account for any significant increases or decreases in the debtor’s income that are likely in particular cases.

III. §707(b)(2) – HOUSEHOLD SIZE

***In re Bostwick*, 406 B.R. 867 (Bankr. D. Min 2009).** The Chapter 13 trustee objected to the debtor’s plan because the amounts paid by her roommate for rent and utilities were not included in her current monthly income. The debtor rented her house from the owner who did not live in the house. Her roommate held a separate lease with the landlord but shared utility bills with the debtor. The Court held because the roommate held a separate lease, the roommate’s rent liability was not a household expense of the debtor or the debtor’s dependants and therefore it did not need to be included in the debtor’s monthly income. Because the Census Bureau defines “household” as “all people, related and unrelated, who occupy a housing unit,” the Court held that the debtor was entitled to claim a household of two.

***In re Ellringer*, 370 B.R. 905 (Bankr. D. Minn. 2007).** UST moved to dismiss case under Section 707(b)(2). The Court denied the motion, ruling that Section 707(b)(7) precluded the filing of a motion based on a presumption of abuse. In doing so, the Court found that the term “household,” for the purposes of Section 707(b)(7), includes the debtor and all other people living in the debtor’s living quarters, whether related to the debtor or not. In making this determination, the Court utilized the Census Bureau’s definition of household and rejected the Internal Revenue Service’s position, which references dependents listed on a taxpayer’s latest income tax return. Specifically, the Court found that because Section 101(39A)(A) utilizes the Census Bureau’s definition of “household” in defining “median family income” it was appropriate to use that same definition in defining “household” for the purposes of Section 707(b)(7).

***In re Jewell*, 365 B.R. 796 (Bankr. S.D. Ohio 2007).** UST moved to dismiss case under Section 707(b)(2). The Court held that the debtors’ daughter and her dependants – each of whom were dependent upon the debtors for their support, were unable to contribute any of their income to the debtors after paying their expenses, showed no evidence that their living arrangement was intended to be temporary, and showed no evidence that they failed to function as an economic unit with the debtors – were part of debtors’ household. In making this determination, the Court rejected both the Census Bureau’s definition, and the Internal Revenue Service’s position regarding what constitutes a household.

IV. EXPENSE ALLOWANCES

Debtors whose CMI exceeds the state median income for their family size are subject to means testing. The means test calculates a debtor's average monthly disposable income by deducting itemized expenses from CMI. Debtors are entitled to deduct standard living expenses prescribed by the Internal Revenue Service ("IRS Standards") as well as certain actual expenses. "The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses for the area in which the debtor resides . . ." 11 U.S.C. § 707(b)(2)(A)(ii)(I). Because the IRS Standards are objective measures unrelated to a debtor's actual expenses, much of the litigation under BAPCPA is about the categorization of expenses.

A. Housing And Utility Expenses

In re Sullivan, 370 B.R. 314 (Bankr. D. Mont. 2007). UST moved to dismiss case under Section 707(b)(2). Court held that replacement costs for broken furnace and deck that posed safety threat to debtors and their family were allowable adjustments to local standard deduction for household expenses and utilities, but that other claimed adjustments – such as replacement of a fence, finishing a bathroom, and resurfacing a driveway – were not.

In re Turner, 376 B.R. 370 (Bankr. D. N.H. 2007). UST moved to dismiss case under Section 707(b)(2). The debtors successfully rebutted the presumption of abuse. However, in its ruling, the Court noted that the local standard deduction for household expenses and utilities takes into account amounts necessary for maintenance and repair such as pest control expenses.

B. Vehicle Expenses

The IRS Transportation Standards divide transportation expenses into two components: a nationwide allowance for ownership costs and an allowance to cover the costs of operating one or two vehicles. The Operating Expense Standard provokes little debate, but very few cases directly address it. The Ownership Expense Standard generates new cases on an almost weekly basis. Ownership cases generally follow one of two approaches: the plain language of Section 707(b)(2)(A)(ii)(I) allows a debtor to claim an ownership deduction regardless of actual expense, although the Ninth Circuit has just used “statutory language, plainly read” to come to the opposite result. Or, courts cite the Internal Revenue Manual, the interpretive guide used by the IRS in its collection process, as requiring an actual loan or lease payment in order to claim an ownership deduction. The Ownership issue has been decided in four Circuits (Fifth, Seventh, Eighth and Ninth) and is pending before two Circuits (First and Sixth).

1. Operating Expenses

Where there is no loan or lease payment obligation on a vehicle owned by the debtor that is over six years old or has reported mileage of 75,000 or more miles, an additional operating expense of \$200 may be allowable. See Internal Revenue Manual (“IRM”), Part 5, Chapter 8, Section 5, at § 5.8.5.5.2, which may be found at the IRS website: <http://www.irs.gov/irm/part5/ch08s05.html>. The vehicle must meet all requirements for the additional operating expense in order for the expense to be allowed: (1) there must be no loan or lease payment; (2) the vehicle must have 75,000 or more miles and/or be 6 or more model years in age; and (3) the debtor must actually own the vehicle and pay operating expenses with respect to the vehicle.

***In re Martinez*, 391 B.R. 424 (Bankr. E.D. Wis. 2008).** Chapter 7 debtors with debt payments on their cars that were all six years old or older argued that, if forced into a chapter 13 case, their loans would at some point expire and they should be entitled to take the additional \$200 in operating expenses for old and high mileage cars. The bankruptcy court noted that although the

IRM allows for an additional transportation expense for older vehicles where there is no secured debt, the Congress did not adopt the IRS collection financial standards nor did it adopt the IRM. The Court held that the debtors were limited to the expenses allowed by the IRS Standards only, disallowing the \$200 allowance for older cars because it did not appear in the means test and expenses outside the means test may only be argued as a special circumstance.

In re McGuire, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006). The Court expressly agreed that, because debtors are not entitled to an ownership expense because they do not have a loan or lease payment obligation, allowing the debtors the \$200 additional operating expense for unencumbered older/high mileage vehicles is “consistent with IRS Local Standards . . .” Such additional allowance “is allowed for debtors with cars more than six years old, or having more than 75,000 miles.”

2. Ownership Expenses

a. Representative Cases Allowing Ownership Expenses Without “Actual” Expense

Ross-Tousey v. Neary (In re Ross-Tousey), 549 F. 3d 1148 (7th Cir. 2008). UST moved to dismiss case under Section 707(b)(2) because the debtors deducted the IRS Local Standard amount for vehicle ownership for a vehicle they owned outright; the UST argued that the ownership expense was not “applicable” to the debtors because they did not have a loan or lease payment for their vehicle. The bankruptcy court disagreed and denied the UST’s motion. The district court reversed and held that debtors must have an “actual” expense for vehicle ownership before the expense can be “applicable” and thus allowable on the means test. On appeal the Seventh Circuit reversed, agreeing with the bankruptcy court that the plain language of the statute supports the allowance of a monthly ownership expense, reasoning that Congress intended a bright line formula for the means test and thus the word “applicable” means utilizing the expense amount from the applicable Local Standard that relates to the geographic area in which a debtor resides and the number of cars a debtor owns.

***Tate v. Bolen (In re Tate)*, 571 F.3d 423 (5th Cir. 2009).** In another case deciding whether the presumption of abuse arose under Section 707(b)(2), the Fifth Circuit ruled that chapter 7 debtors may deduct vehicle ownership expense amounts in calculating the means test despite the absence of actual vehicle ownership expenses. The Court relied extensively on the Seventh Circuit’s decision in *Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148 (7th Cir. 2008).

***Babin v. Washburn (In re Washburn)*, 579 F.3d 934 (B.A.P. 8th Cir. 2009).** Chapter 13 trustee and creditor objected to confirmation of plan because debtors made no car payments but claimed the IRS Local Standard for vehicle ownership. The bankruptcy court confirmed the plan. On direct appeal to the Eighth Circuit affirmed, holding that debtors without vehicle ownership expenses are allowed to deduct those expenses because such expenses are not applicable under Section 707(b)(2)(A)(ii)(I).

***Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518 (B.A.P. 6th Cir. 2008), appeal pending Case No. 08-5871 (6th Cir. 2008).** Chapter 13 trustee objected to confirmation of plan because debtors deducted the IRS Local Standard for vehicle ownership for vehicle owned free and clear of liens. The bankruptcy court overruled the trustee’s objection and entered an order confirming the debtors’ plan. On appeal the BAP affirmed, holding that above-median debtors were entitled to deduct an applicable monthly vehicle ownership expense for a vehicle that was not encumbered by a loan or lease payment. Noting that the legislative history of Section 707(b)(2)(A)(ii)(I) shows that Congress was aware of the IRM and “deliberately chose not to incorporate it into the statute,” the appellate panel found that the debtor’s actual monthly expenses were only relevant for categories identified as Other Necessary Expenses. The appellate panel noted that section 707(b)(2)(A)(ii)(I)’s explicit statement that “notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts” clearly established beyond doubt that Congress intended to allow an ownership expense even when a debtor has no debt payment on a vehicle. Finally, the appellate panel found that ownership expenses are for depreciation, insurance, licensing fees and taxes regardless of debt or lease payments.

***Burbank v. Boyajian (In re Burbank)*, 401 B.R. 67 (Bankr. D. R.I. 2009), appeal pending Case No. 09-1776 (1st Cir. 2009).** The bankruptcy court overruled the trustee’s objection to a chapter 13 plan because the debtors had deducted, among other things, vehicle ownership costs on vehicles they owned outright in calculating the amount of money they could devote to repaying unsecured creditors. The First Circuit accepted a direct appeal from the bankruptcy court.

b. Representative Cases Denying Ownership Expense Unless Debtor Has Loan or Lease Payment

***In re Ransom*, 577 F.3d 1026 (9th Cir. 2009).** Unsecured creditor objected to confirmation of chapter 13 plan because debtor deducted the IRS Local Standard for vehicle ownership for vehicle owned free and clear of liens. The bankruptcy court sustained the creditor’s objection and entered an order denying confirmation and the bankruptcy appellate panel affirmed. The Ninth Circuit, citing the “statutory language, plainly read,” ruled that an ownership cost “is not an expense” - either actual or applicable - if it does not exist . . .” The decision relies extensively on the bankruptcy appellate panel decision which held that the language of 11 U.S.C. § 707(b)(2)(A)(ii)(I), the common meaning of "applicable," and the overall scheme of the Bankruptcy Code each revealed that vehicle ownership expenses only apply if debtors actually have vehicle financing costs. The panel determined that to hold otherwise would be “counterintuitive to one of the main objectives” of BAPCPA: “to ensure that debtors repay as much of their debt as reasonably possible.”

***Wieland v. Thomas (In re Thomas)*, 382 B.R. 793 (D. Kan. 2008).** The bankruptcy court allowed Chapter 7 debtors who owned their vehicles outright to take ownership expenses for their cars and the district court reversed. Examining the phrase “the applicable expenses amounts specified under the National and Local Standards,” the district court held that the IRS Standards do not represent expense allowances; “rather, they represent *caps* on expense allowances, as the IRS intends the *lesser* of the Standard amount and the person’s actual expense be used.” Thus, the district court concluded that a debtor is not allowed his actual expenses in this category. The court went on to hold that the word “actual” in section 707(b)(2)(A)(ii)(II) is

used, not in connection with the IRS Standards, but in connection to uncapped existing expenses in the “Other Necessary Expense” categories. (The Bankruptcy Appellate Panel for the Tenth Circuit reached a different result, in an opinion that was later vacated by the Tenth Circuit when the debtor converted his case to chapter 7. *See Pearson v. Stewart (In re Stewart)*, 390 B.R. 706 (B.A.P. 10th Cir. 2008), *vacated sub nom Stewart v. Pearson*, Case No. 08-8060, 2009 WL 205408 (10th Cir. Jan. 22, 2009)).

C. Payroll Deductions (Income Tax and 401K Deductions)

The majority of cases post-BAPCPA hold that the allowable amount of the debtor’s tax liability to be deducted on Line 25 of Form 22A (Line 30 of Form 22C) is the debtor’s *actual tax liability*, and not the *amount withheld* from the debtor’s paycheck. Similarly, deductions for 401K contributions and loan repayment are not “mandatory” payroll deductions.

***In re Riggs*, 359 B.R. 649 (Bankr. E.D. Ky. 2007).** Chapter 13 trustee objected to confirmation of plan because debtors calculation of projected disposable income included a deduction for payroll taxes in the amount withheld from their paychecks, rather than actual tax liability. The bankruptcy court sustained the objection, ruling that the debtors’ tax deduction should reflect their actual tax liability and not the amount withheld from their paychecks.

***Egebjerg v. Anderson (In re Egebjerg)*, 574 F.3d 1045 (9th Cir. Aug. 3, 2009).** The UST moved to dismiss the debtor’s chapter 7 petition, arguing that he had improperly included his 401K loan repayment in his necessary expenses. The bankruptcy court dismissed the petition. On direct appeal, the Ninth Circuit held, among other things, that 401K loan repayments are not an “actual monthly expense for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service” under Section 707(b)(20(A)(ii).

***In re Turner*, 376 B.R. 370 (Bankr. D.N.H. 2007).** The UST moved to dismiss the debtors’ chapter 7 case because, among other things, they claimed deductions from her paycheck in connection with her 401K employee retirement plan loans. The bankruptcy court held that

such deductions were not “mandatory payroll deductions” under Section 707(b)(2)(A)(ii)(I). The court ruled that BAPCPA expressly gives chapter 13 debtors the ability to deduct 401K payments from the disposable income calculation, noting that BAPCPA did not include any similar exemption from income for chapter 7 debtors.

D. Retirement Contributions/Loan Repayments

1. 401(k) Loans as Secured as Secured Claims

Egebjerg v. Anderson (In re Egebjerg), 574 F.3d 1045 (9th Cir. 2009). The UST moved to dismiss the debtor’s case, arguing that his case was presumptively abusive under Section 707(b)(2)’s means test and further, that even if the presumption of abuse did not arise, the court should dismiss the case under Section 707(b)(3)’s totality of the circumstances test. The bankruptcy court rejected the UST’s Section 707(b)(2) argument, concluding that the debtor’s 401K loan was a “secured debt” that could be deducted from income, but dismissed on the totality of circumstances ground. The Ninth Circuit joined the “vast majority of courts” and held that a debtor’s obligation to repay a loan from a retirement account is not a “debt” under the Bankruptcy Code, thus finding that the debtor’s case was presumptively abusive. *See also* discussion of the court’s holding that 401K loans are not an “Other Necessary Expense, *supra*.

Bolen v. Adams (In re Adams), 403 B.R. 396 (N.D. Miss. 2009). The UST moved to dismiss the debtor’s case, arguing that his case was presumptively abusive under Section 707(b)(2)’s means test. The district court noted that the Bankruptcy Code defines “debt” as a “liability on a claim” and defines claim as a “right to payment,” further noting that when a person defaults on a 401K loan, the plan administrator usually offsets the unpaid balance of the loan from the person’s account. Consequently, the plan administrator does not have a “right to payment.” The court held that because the debtor’s 401K obligation lacked the core characteristic of a debt - the creditor’s right to repayment - it could not be included as a deduction on the means test.

McVay v. Otero (In re Otero), 371 B.R. 190 (W.D. Tex. 2007). UST moved to dismiss case under Section 707(b)(2). The UST’s motion challenged the debtors’ claimed secured debt repayment expense for a retirement plan loan repayment. The bankruptcy court ruled that the

debtors were entitled to claim the expense. The district court reversed, holding that the debtors could not claim the expense because the loan payments in question were not “payments on account of a secured debt.”

***Eisen v. Thompson (In re Thompson)*, 370 B.R. 762 (N.D. Ohio 2007).** UST moved to dismiss case under Section 707(b)(2). The UST’s motion challenged the debtor’s claimed secured debt repayment expense for a retirement plan loan repayment. The bankruptcy court ruled that the debtor was entitled to claim the expense. The district court reversed, holding that the debtor could not claim the expense because the loan payments in question were not associated with a debt.

2. 401K Loans as a “Special Circumstance”

***Eisen v. Thompson*, 370 B.R. 762 (N.D. Ohio 2007).** The district court reversed the bankruptcy court’s decision in *In re Thompson*, 350 B.R. 770 (Bankr. N.D. Ohio 2006), concluding that retirement plan loans are neither “debts” nor “secured debts” under the Bankruptcy Code. The district court also found that assessing special circumstances requires the court to analyze whether the circumstances that led to taking the loan from the retirement account were “special” or whether they were not “special” and instead the result of the debtors’ longstanding inability to keep up with their obligations to creditors. Without more, an occurrence as common as a withdrawal from one’s retirement funds cannot be a “special circumstance.” In the absence of evidence indicating that the circumstances under which the debtor borrowed the retirement funds was “special,” it is an abuse of discretion for a court to hold a 401K loan or its repayment to be a “special circumstance.”

***In re Turner*, 376 B.R. 370 (Bankr. D.N.H. 2007).** The bankruptcy court held that amount which was deducted each month from debtor-wife’s paycheck in repayment of 401K loans could not be deducted from income because, among other reasons, the debtors failed to show that this expense rose to level of “special circumstance.” *See also* discussion of this case, *supra*, holding that 401K employee retirement plan loans are not “mandatory payroll deduction.”

E. Payments on Surrendered Collateral

Morse v. Rudler, (In re Rudler), 576 F.3d 37 (1st Cir. 2009). UST moved to dismiss under Section 707(b)(2). The UST's motion challenged the debtor's claimed secured debt repayment expenses for a house he intended to surrender. The bankruptcy court ruled that the debtors were entitled to claim the expenses and the bankruptcy appellate panel affirmed. The First Circuit affirmed, holding that the plain language of the statute allows a debtor to claim the expenses notwithstanding the intent to surrender. The court noted that Congressional intent to encourage predictability and discourage judicial discretion also support its holding. The court limited its discussion to the application of section 707(b)(2) in chapter 7 cases, and expressly declined to address whether section 707(b)(2)(A)(ii)(I) should be given the same construction for purposes of the projected disposable income test in chapter 13, which incorporates section 707(b)(2) by reference. The First Circuit has accepted a direct appeal from the bankruptcy court on this issue. *See Burbank v. Boyajian (In re Burbank), 401 B.R. 67 (Bankr. D.R.I. 2009), appeal pending Case No. 09-1776 (1st Cir. 2009).*

In re Turner, 574 F.3d 349 (7th Cir. 2009). The chapter 13 trustee objected to the debtor's deduction of mortgage payments on a house he intended to surrender before the date the plan took effect. The bankruptcy court rejected the trustee's argument. On direct appeal the Seventh Circuit reversed, holding that a mortgage payment that would vanish before the plan would take effect could not be used as a deduction in calculating disposable income. The court specifically rejected the debtor's argument that Section 707(b)(2)(A)(ii) requires that "payments on account of secured debts," such as a debt secured by a mortgage, must be calculated as of the date of the petition.

Randle v. Neary (In re Randle), Case No. 07-631, 2007 WL 2668727 (N.D. Ill. 2007). UST moved to dismiss case under Section 707(b)(2). The UST's motion challenged the debtor's claimed secured debt repayment expense for a home she intended to surrender. The bankruptcy court ruled that the debtor was entitled to claim the expense. The district court affirmed, holding that the debtor could claim the expense notwithstanding her intent to surrender. The district court concluded that the debtor's mortgage payments "were still contractually due . . . even if [she] had not been paying [the] monthly mortgage payments," and that her filing of a Statement of Intent to surrender was "not an actual surrender."

In re Ray, 362 B.R. 680 (Bankr. D.S.C. 2007). UST moved to dismiss case under Section 707(b)(2). The UST's motion challenged the debtors' claimed secured debt repayment expense for vehicles they intended to surrender. The bankruptcy court ruled that the debtors were not entitled to claim the expense, noting that in considering the phrase "amounts scheduled as contractually due" Congress contemplated a forward looking calculation requiring consideration of events contemplated in the debtors' Statement of Intent.

F. Court Ordered Payments

In re Casey, 356 B.R. 519 (Bankr. E.D. Wash. 2006). Chapter 13 trustee objected to confirmation of plan because debtor, among other things, failed to properly amortize court ordered support payments that were due to expire on the 24th month of his plan. The bankruptcy court sustained the objection, ruling that the debtor was required to amortize court ordered payments over a 60 month period per Section 707(b)(2)(A)(iv) of the Code.

V. STATEMENT OF PRESUMED ABUSE

In re Draisey, 395 B.R. 79 (B.A.P. 8th Cir. 2008). UST filed a motion to dismiss pursuant to Section 707(b)(3) within the 60 day deadline established under Fed. R. Bankr. P. 1017. Debtor challenged the motion arguing that the UST was required to file a statement indicating either a presumed abuse or a lack of a presumed abuse within the 10 day deadline established under Section 704(b). The bankruptcy court denied the UST's motion, ruling that the UST's filing of a statement indicating either a presumed abuse or a lack of a presumed abuse within the 10 day deadline established under Section 704(b) constituted a pre-requisite to the filing of a motion to dismiss pursuant to Section 707(b)(3). The bankruptcy appellate panel reversed, holding that under the plain language of Section 704(B), the filing of a statement under Section 704(b) is not a condition precedent to filing a motion to dismiss under Section 707(b)(3).

***In re Close*, 384 B.R. 856 (D. Kan. 2008).** Debtors' Section 341 meeting of creditors was continued, and not concluded until 28 days after its originally scheduled date. UST filed a statement of presumed abuse within 10 days after that date, and a motion to dismiss pursuant to Sections 707(b)(2) and (3) within 30 days thereafter. Debtors challenged the (b)(2) portion of the motion, arguing that the statement of presumed abuse was filed after the 10 day deadline established under Section 704(b). The bankruptcy court entered an order denying the (b)(2) portion of the motion. The district court affirmed, ruling that the 10 day deadline established under Section 704(b) runs 10 days after the originally scheduled date for a debtor's 341 meeting of creditors notwithstanding whether the 341 meeting has been continued.

***In re Perrotta*, 390 B.R. 26 (Bankr. D.N.H. 2008).** Within 10 days of the 341 meeting the UST filed a statement that she could not determine whether or not the debtor's case was an abuse of the provisions of chapter 7. Later the UST filed a motion to dismiss the debtor's case pursuant to both Sections 707(b)(2) and (3). The debtor objected on the basis that the UST failed to file a timely statement of presumed abuse required under Section 704(b)(1)(A) and was therefore precluded from filing any motion to dismiss the debtor's case. The bankruptcy court sustained the debtor's objection in part, ruling that a timely statement under Section 704(b)(1)(A) was a prerequisite to a motion to dismiss for a presumption of abuse under Section 707(b)(2). *See In re Perrotta*, 378 B.R. 434 (Bankr. D.N.H. 2007). Later in this case, the bankruptcy court denied that portion of the objection requesting dismissal of the UST's motion to dismiss under the totality of the circumstances, concluding that the thirty day deadline in Section 704(b)(2) is not applicable to motions under Section 707(b)(3).

***In re Jasper*, Case No. 08-15086, 2009 WL 357945 (Bankr. E.D. Va. Jan. 13, 2009).** UST filed a motion to dismiss pursuant to Section 707(b)(2) and (3) within the 60 day deadline established under Fed. R. Bankr. P. 1017. Debtor challenged the motion arguing that the UST was required to file a statement indicating either a presumed abuse or a lack of a presumed abuse within the 10 day deadline established under Section 704(b). The bankruptcy court found that Section 704(b) does not create a limitations period for filing motions to dismiss for abuse, and that the UST was therefore not barred from bringing his motion.

VI. §707(b)(3) – BAD FAITH & TOTALITY OF CIRCUMSTANCES

A. §707(b)(2) Does Not Exclusively Determine Abuse

Neary v. Ross-Tousey (In re Ross-Tousey), 549 F. 3d 1148 (7th Cir. 2008). UST moved to dismiss case under Section 707(b)(2). The bankruptcy court denied the UST’s motion, the district court reversed, and the Seventh Circuit reversed the district court. In ruling, the Seventh Circuit found that while chapter 7 cases are initially evaluated for dismissal under Section 707(b)(2)’s means test (which evaluates a debtor’s historic income and statutorily prescribed expense amounts), passing Section 707(b)(2)’s means test does not guarantee chapter 7 relief. Instead, Section 707(b)(3)(B) requires the dismissal of cases that pass the means test when the totality of the debtor’s financial situation establishes abuse, an inquiry which is determined by evaluating a debtor’s “actual income and expenses.” See e.g., *Morse v. Rudler (In re Rudler)*, – F.3d –, 2009 WL 2385469 at *10 (Section 707(b)(3)’s totality of the circumstances test “remains a backup option when the Trustee is dissatisfied by the results of [Section 707(b)(2)’s] means test.”)

B. Each Prong of §707(b)(3) is Independent

In re Henebury, 361 B.R. 595 (Bankr. S.D. Fla. 2007). UST moved to dismiss case under Section 707(b)(3)(B). The bankruptcy court granted the UST’s motion. In doing so, the court engaged in a detailed discussion of Section 707(b)(3) and noted that “the debtor’s total financial situation as a measure of ability to pay, and bad faith are separate and sufficient grounds for dismissal. Either ability to pay or bad conduct in connection with the bankruptcy will warrant dismissal for abuse under §707(b)(3).” Thus, each prong of Section 707(b)(3) is independent. If a debtor engages in bad faith, the debtor’s case may be dismissed under Section 707(b)(3)(A). Conversely, if the totality of the debtor’s financial circumstances demonstrate abuse, dismissal is appropriate under Section 707(b)(3)(B).

C. Bad Faith Under §707(b)(2)(A)

In re Reese, 402 B.R. 43 (Bankr. M.D. Fla. 2008). UST moved to dismiss case under Section 707(b)(2), (b)(3)(A), and (b)(3)(B). The bankruptcy court denied the UST’s motion. In ruling, the court noted that the following ten factors may be indicia of bad faith under a Section 707(b)(3)(A) analysis: (1) the debtor has only one asset in which it does not hold legal title; (2) the debtor has few unsecured creditors whose claims are small in relation to the claims of the secured creditors; (3) the debtor has few employees; (4) the debtor is not financially distressed; (5) the property is the subject of a foreclosure action as a result of arrearages on the debt; (6) the debtor’s financial problems involve essentially a dispute between the debtor and the secured creditors which can be resolved in a state court action; (7) the timing of the debtor’s filing evidences an intent to delay or frustrate the legitimate efforts of the debtor’s secured creditors to enforce their rights; (8) the debtor made purchases on the eve of filing; (9) incomplete or false disclosures by the debtor; and (10) failure by the debtor to cooperate with the trustee. Further, the court found that “[t]he common thread running through all of the indicia of bad faith is improper intent. A debtor, for bad faith to exist, must have purposefully acted and such action was motivated by an improper purpose.”

Haney v. Clippard (In re Haney), Case No. 06-150, 2007 WL 781321 (W.D. Ky. March 9, 2007). UST moved to dismiss case under Section 707(b)(3)(A). The bankruptcy court granted the UST’s motion, and the district court affirmed. In ruling, the district court found that the “smell test” is an appropriate standard for determining whether a bankruptcy petition was brought in bad faith and that dismissal based on lack of good faith should be “confined carefully and ... utilized only in ... egregious cases,” such as where the debtor “has misrepresented assets and/or sources of income.”

In re Mitchell, 357 B.R. 142 (Bankr. C.D. Cal. 2006). UST moved to dismiss case under Section 707(b)(3)(A). The bankruptcy court granted the UST’s motion. In ruling, the court found that in determining whether to dismiss under Section 707(b)(3)(A), a court must evaluate “whether, in light of all the relevant facts and circumstances, it appears that the debtor’s intention in filing a

bankruptcy petition is inconsistent with the Chapter 7 goals of providing a ‘fresh start’ to debtors and maximizing the return to creditors.” Further, the court concluded that neither malice nor fraudulent intent by the debtor is required to find bad faith under Section 707(b)(3)(A).

D. Totality of the Circumstances of the Debtor’s Financial Situation

***In re Calhoun*, 396 B.R. 270 (Bankr. D.S.C. 2008), *aff’d in unpub. opn*, Case No. 09-00822 (D.S.C. 2009), *appeal pending* Case No. 09-1646 (4th Cir. 2009).** UST moved to dismiss case under Section 707(b)(3)(B). The bankruptcy court granted the UST’s motion. In ruling, the court held that “while the totality of all of the debtor’s financial circumstances must be examined, the ability to pay a significant dividend to creditors and the failure to do so standing alone can be an abuse of chapter 7, absent mitigating factors.” Additionally, the court found that social security income may be considered as part of an assessment of an ability to pay under the totality of the circumstances test notwithstanding its express exclusion from CMI under the means test.

***In re Baeza*, 398 B.R. 692 (Bankr. E.D. Cal. 2008).** UST moved to dismiss case under Section 707(b)(3)(B). The bankruptcy court granted the UST’s motion. In framing the issue, the bankruptcy court concluded that “the question before the court [was] not whether the Debtors would be required to pay anything to their unsecured creditors in a chapter 13, but rather, whether they [had] the ability to pay something substantial to their unsecured creditors.” Based on the debtors’ schedules, the bankruptcy court found that they did, and that absent their voluntary conversion of their case to one under chapter 13 of the Bankruptcy Code, dismissal under Section 707(b)(3)(B) was appropriate.

***In re Johnson*, 399 B.R. 72 (Bankr. S.D. Cal. 2008).** UST moved to dismiss case under Section 707(b)(3)(B). The bankruptcy court denied the UST’s motion. In ruling, the court held that because the debtors’ mortgage expense was provided for in an unlimited amount under Section 707(b)(2)’s means test, *see* 11 U.S.C. § 707(b)(2)(A)(iii), it was precluded from considering the mortgage expense under the totality of the circumstances test.

VII. Other Cases of Note

***In re Dudley*, 405 B.R. 790 (Bankr. W.D. Va. 2009), appeal pending Case No. 09-00336 (W.D. Va. 2009).** The debtors filed a chapter 13 petition in 2008 and, after the chapter 13 trustee objected to their plan, the debtors voluntarily converted their case to one under chapter 7. The UST moved to dismiss the debtors' case under Section 707(b)(2) as presumptively abusive. The debtors filed a motion for summary judgment, arguing that Section 707(b)(2)'s means test does not apply to cases converted to Chapter 7 from another chapter of the Bankruptcy Code. The bankruptcy court agreed with the debtors and the UST has appealed.

***In re Mravik*, 399 B.R. 202 (Bankr. E.D. Wisc. 2008).** UST moved to dismiss case under Section 707(b)(2) and (b)(3)(B). The bankruptcy court denied the UST's motion. In ruling, the court found that notwithstanding that the presumption of abuse arose, and that the debtor failed to rebut the presumption, Section 707(b)(1) provided the court with discretion to dismiss a case, convert a case, or simply do nothing. In this particular case, the court held that the case should not be dismissed because there was "no suggestion that expenses claimed on the [d]ebtor's Form 22A [were] unreasonable" or "that she ha[d] manipulated her income or expenses to qualify for a [c]hapter 7 discharge." Further, the court found that because a hypothetical plan under chapter 13 would lead to no repayment to creditors, the case should not be converted. Accordingly, the court denied the motion and did nothing.

***In re Woodruff*, 416 B.R. 369 (Bankr. D. Mass. 2009).** The UST moved to dismiss the debtor's chapter 7 case, the court held that although section 707(b)(1) does not appear to mandate that the court dismiss a case once a presumption arises, the better view is that dismissal is mandatory unless special circumstances pursuant to section 707(b)(2)(B) have been found. *See also In re Haman*, 366 B.R. 307 (Bankr. D. Del. 2007).