THE BANKRUPTCY OF HAIG-SIMONS? THE INEQUITY OF EQUITY AND THE DEFINITION OF INCOME IN CONSUMER BANKRUPTCY CASES

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> *Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.*[1]
>
> *Disposable income is simply a measure of what can be done to promote fairness.*[2]

INTRODUCTION

I will pay $871,550 to anyone who can answer each of these questions correctly. Potential quiz-takers should be aware that I might consider purchasing a house between the date of writing and the date this article is published and that the monthly payments may be exactly the amount of my modest professorial income after expenses for whatever is reasonably necessary for my maintenance and support. So do not expect to collect.[3]

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[1] HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

[2] Rowley v. Yarnall, 22 F.3d 190, 193 (8th Cir. 1994).

[3] Moreover, the statement is "subject to contract." *See* Carlill v. Carbolic Smoke Ball Co., 2 Q.B. 484, 488 (1892) (considering expressed sincerity of offeror in determining existence of contract where manufacturer of medical device advertised promise to pay cash "reward" to any person who contracted influenza despite using medical device as instructed). Moreover, anyone interested in collecting should know that I do not have the present intent or ability to pay the sum. Besides, it's a joke. *See* Keith A. Rowley, *Beware of the Dark Side of the Farce*, 10 NEV. LAW. 15, 16 (2002) (stating premise that obvious joke does not give rise to contract (citing Berry v. Gulf Coast Wings, Inc., No. 01-2642 Div. J (Fla. 14th Cir. Ct., Bay County, filed July 24, 2001) (discussing "it was a joke" defense advanced by Florida Hooters restaurant in lawsuit brought by employee waitress for breach of promise to award new Toyota to winner of contest where actual prize awarded was toy "Yoda" figurine))).

1. Debtor buys a house in Year 1 for $60,000. In Year 2, when the house is worth $75,000 and for sale, Debtor files a chapter 13 case. Three months later and while her plan is yet unconfirmed, Debtor sells the house for $85,000. How much income does Debtor have from the sale for purposes of the "disposable income" test?
(a) Zero.
(b) Only $10,000.
(c) Only $25,000.
(d) $85,000.
(e) Any or all of the above.

2. Debtor owns a cookie-cutter house in an expensive subdivision in Boca Raton, Florida (where such homes are exempt). The fair rental value of the house is $3000 per month.
(a) Debtor has $3000 of rental income and a $3000 rental expense every month; her rental expense is unreasonable and confirmation of her plan should be denied.
(b) Debtor has $3000 of rental income and no rental expense every month; she must devote the entire $3000 to the plan.
(c) Debtor has neither rental income nor rental expense from the house because her choice of residence has nothing to do with disposable income.
(d) Debtor has neither rental income nor rental expense from the house because she is neither actually receiving nor actually paying any money.

3. The Debtor from Question 2 rents her house for $3000 per month and moves into the identical house next door, for which she pays $3000 per month. Does your answer change and, if so, to which choice?

4. Debtor leases her residence under an unusual lease, which obligates her to pay $500 per month for 60 months, after which she can live in the house rent-free for the rest of her life. Her chapter 13 budget and proposed plan allow her to continue making the required monthly payment and provide a ten per cent dividend to unsecured creditors. An identical house next door rents for $300 per month under an ordinary annual lease; if Debtor paid $300 per month in rent, her plan would provide a 100% dividend to unsecured creditors.
(a) Her plan should be confirmed if other debtors are permitted to spend $500 per month in rental expense.
(b) Her plan should be confirmed because courts have no business scrutinizing debtor's expenses.
(c) Her plan should not be confirmed because $500 per month is an unreasonably high rental expense.
(d) Her plan should not be confirmed because her budgeted rental expense is, in significant part, pre-paid rent for a lifetime lease term and therefore is not necessary for the debtor's maintenance and support solely for the plan period.

5. Assume the same facts and choices as in Question 4 except that, instead of a lease, the Debtor is paying the last five years on her mortgage.

"Ability to pay" and its most popular measure, the Haig-Simons definition of income (quoted exergually above),[4] have played a central role in tax policy discussions for the past several decades.[5] Consumer bankruptcy law has for several decades focused increasingly on debtors' "ability to repay" their debts through future income;[6] bankruptcy scholarship, however, has never made an attempt at a comprehensive or systematic examination of the definition of income or of the

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[4] *See supra* quotation at beginning of this article. *See generally* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967), which explains the Haig-Simons definition of income as follows:

> Haig defined personal income as "the money value of the net accretion to one's economic power between two points of time," a formulation that was intended to include the taxpayer's consumption, and that was thought by Simons to be interchangeable with his own: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."

Id. at 932.

[5] *See id.* (stating that commentators suggest use of Haig-Simons definition in computation of taxable income as "touchstone"); Maureen B. Cavanaugh, *On the Road to Incoherence: Congress, Economics, and Taxes,* 49 UCLA L. REV. 685, 711 n.114 (2002) (commenting that most tax analysts start with Haig-Simons definition of income); David Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 PA. L. REV. 1111, 1114 (1986) (explaining that intellectual basis for accrual taxation is Haig-Simons definition of income). *See generally* Michael A. Livingston, *Reinventing Tax Scholarship: Lawyers, Economists, and the Role of the Legal Academy*, 83 CORNELL L. REV. 365, 375–80 (1998) (discussing Haig-Simons definition of income in traditional tax scholarship); Edward J. McCaffrey, *Tax's Empire* 85 GEO. L.J. 71, 77–82 (1996) (discussing application of Haig-Simons definition of income in tax scholarship).

I acknowledge that there are serious criticisms of the Haig-Simons definition of income. Some argue it is tautological. *See, e.g.*, *id*. at 78 (1996) (arguing that Haig-Simons definition of income is "little more than an accounting identity, a tautology: it tells us only that all income is either spent [consumption] or not [savings], which is obvious enough"); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 834 (1979) (observing that "net receipts, receipts minus the cost of obtaining the receipts, tautologically consists of consumption plus savings. All money the taxpayer controls or 'voluntarily' disposes of must go to either consumption or savings"). Others observe that it is "only a surrogate utility measure." RICHARD TRESCH, PUBLIC FINANCE: A NORMATIVE THEORY 267 (1981). Some fault it for neutrality between savings and consumption. *E.g.*, *id*. at 269; *see also* NICHOLAS KALDOR, AN EXPENDITURE TAX 53 (1955). Some of these criticisms may be somewhat off the mark, to the extent they conceive of Haig-Simons as dependent on utility. *See, e.g.*, Stephen Utz, *Ability to Pay*, 23 WHITTIER L. REV. 867, 915–17 (2002) (discussing Simons's rejection of utility as the basis of the ability-to-pay standard). Indeed, Simons rejected both the notion that humans are "equally efficient pleasure machines," SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 11, and the idea that taxation can take account of interpersonal utilities. *Id*. at 5. Simons sought a measurable definition for income but his solution is open to criticism for reifying troubling dichotomies. Nancy Staudt, *The Political Economy of Taxation: A Critical Review of a Classic*, 30 L. & SOC'Y REV. 651 (1996) (observing that the Haig-Simons definition depends on the distinction between market and non-market values). A discussion of income in consumer bankruptcy must start somewhere, however, even if with an imperfect definition.

[6] *See* Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. L. & POL. 393, 427–28 (2001) (commenting on Congressional reform of bankruptcy law focusing on ability to pay); *see also* John M. Czarnetzky, *The Individual and Failure: A Theory of the Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 455–56 (2000) (examining ability to repay in § 707(b) "substantial abuse" context); Edith H. Jones & Todd J. Zywicki, *It's Time For Means-Testing*, 1999 B.Y.U. L. REV. 177, 200 (1999) (using ability to repay to determine chapter 7 eligibility); Letter from Members of the New Democrat Coalition to House Speaker Dennis Hastert, Sept. 3, 2002, *available at* http://www.abiworld.org/legis/dooley.pdf (last visited Sept. 6, 2002) (advocating bankruptcy reform legislation requiring debtors with ability to repay debts to do so).

distributional consequences of any given definition, despite inconsistency and indeterminacy in bankruptcy courts' application of the term "income."[7] Although most bankruptcy courts routinely decline to apply the Tax Code's definition of income in consumer cases, preferring a broader and more flexible definition,[8] I suggest that both scholarship and policy debate about consumer bankruptcy courts may benefit from a robust discussion of the concept of income as the measure of ability to pay. For purposes of beginning the discussion, this paper focuses on income from consumer debtors' property, specifically their homes. I propose bankruptcy courts borrow from tax law and scholarship a broader definition of income than what they generally use; either the definition in *Commissioner v. Glenshaw Glass Co.*[9] – "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion"[10] – or something approaching the Haig-Simons definition of income.

This paper addresses what I consider a few problems of income from property. In it, I offer (in lieu of various kinds of analysis of how and why the law is what it is) four discrete and relatively modest normative proposals. First, bankruptcy courts should adopt a uniform rule requiring debtors to include in "disposable income" the gain from the sale of a residence. When a debtor sells a house during a

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[7] One might expect scholars to jump at what might be called the effect of *differance*, or the occasion of some authority's or authorities employing law as tactics for the accomplishment of different ends. Jacques Derrida, *Signature Event Context*, *in* MARGINS OF PHILOSOPHY 307 (Alan Bass, trans., 1982) (1972) (promulgating term *"differance"*); J.M. Balkin, *Deconstructive Practice and Legal Theory*, 96 YALE L.J. 743, 752 (1987) (discussing French philosopher Jacques Derrida's term *"differance"* as "the chicken-and-egg quality of mutual dependence and difference that the terms of hierarchical oppositions have for each other."); Jacques Derrida, *Force of Law: The "Mystical Foundations of Authority,"* 11 CARDOZO L. REV. 919 (1990) (discussing law and legal system as forces that both hide and reflect economic and political interests of dominant forces of society). *See generally* Michel Foucault, *Governmentality*, *in* THE FOUCAULT EFFECT: STUDIES IN GOVERNMENTALITY 95 (Graham Burchell, Colin Gordon & Peter Miller, eds., 1991); Ratna Kapur & Tayyab Mahmud, *Hegemony, Coercion, and Their Teeth-Gritting Harmony: A Commentary on Power, Culture, and Sexuality in Franco's Spain*, 5 MICH. J. RACE & L. 995, 1003–04 (2000) (proposing interplay of coercion and ideology represents necessary and unique vantage point for interpretation of law); Madeleine Plasencia, *Who's Afraid of Humpty Dumpty: Deconstructionist References in Judicial Opinions*, 21 SEATTLE U. L. REV. 215, 227–38 (1997) (examining diverse methodologies of interpretation).

[8] *See In re* Wagner, 808 F.2d 542, 549 (7th Cir. 1986) (deeming statute to incorporate federal income tax law definition in reference to chapter 12 eligibility); *In re* King, 272 B.R. 281, 293 (Bankr. N.D. Okla. 2002) (denying chapter 7 discharge for failure to disclose income); *In re* Lamb, 209 B.R. 759, 760–61 (Bankr. M.D. Ga. 1997) (concluding "gross income" has normal Tax Code meaning in reference to chapter 12 eligibility); *In re* Cochran, 141 B.R. 270, 272 (M.D. Ga. 1992) (holding income tax refund paid to chapter 13 debtor is income for disposable income test); *In re* Martin, 130 B.R. 951, 966 (Bankr. N.D. Iowa 1991) (holding proceeds of life insurance paid to chapter 12 debtor were income under disposable income test). Some courts, mostly in the context of chapter 12 eligibility, hold that the term income carries the same definition as in the Tax Code. These courts emphasize the importance of the predictability and certainty provided by the tax definition. *See In re* Van Fossan, 82 B.R. 77, 79 (Bankr. W.D. Ark. 1987) (utilizing same definition as Tax Code concerning chapter 12 eligibility); *In re* Pratt, 78 B.R. 277, 280 (Bankr. D. Mont. 1987) (defining income in accordance with Tax Code regarding chapter 12 eligibility); *see also In re* Gregerson, 269 B.R. 36, 40 (Bankr. N.D. Iowa, 2001) (denying debtors motion to convert case to chapter 11 where debtor filed chapter 12 with knowledge that debtor did not have enough income for chapter 12 eligibility).

[9] 348 U.S. 426 (1955).

[10] *Id*. at 431.

chapter 13 case, appreciation that occurred during the plan period should be required to be used to pay unsecured creditors. Second, courts should impute rental income to homeowners who own their homes free and clear and who live in their homes; they should similarly allow such homeowners a reasonable imputed rental expense. Third, debtors should be prohibited from or limited in their ability to acquire equity in their homes. Finally, debtors who owe significantly more on their home mortgages than their homes are worth should not be allowed to retain their homes and continue to make mortgage payments.

It should be observed that, in distinguishing the tax definition of income from the more flexible one required by bankruptcy law, many courts reject tax definitions but do not distinguish among the various definitions of income in tax law. There are, for example, "constitutional income,"[11] "income" unmodified by the various exclusions from gross income,[12] "gross income" (which does not include the items specified in Part III of Subchapter B),[13] "adjusted gross income,"[14] "taxable income,"[15] and "alternative minimum taxable income."[16] There are also more obscure definitions of income; subchapter J, for example, provides that, for the income taxation of estates and trusts, the term "income" means "the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law," that is, fiduciary accounting income;[17] this meaning of income is distinguished from "distributable net income," which consists of taxable income with modifications for certain deductions, capital gains and losses, and extraordinary dividends.[18] The term "income" also appears, for example, in the sections governing the pass-through of items to partners and subchapter S corporation shareholders[19] and the adjustment of their outside bases on account of those items;[20] this definition specifically includes items of tax-exempt income.

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[11] *See, e.g.*, Crane v. Comm'r, 331 U.S. 1, 15 n.42 (1947) (noting possibility of income being considered statutory or constitutional). *See generally* Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts,* 25 CONN. L. REV. 1, 52 (1992) (positing constitutional income should be interpreted to equitably burden citizens according to ability to bear tax burden).

[12] *See, e.g.*, Gitlitz v. Comm'r, 531 U.S. 206, 212–16 (2001) (holding discharge of indebtedness of insolvent subchapter S corporation, although excluded from income under I.R.C. § 108(a), is "item of income" for purposes of basis adjustment to shareholders' shares in corporation required by I.R.C. § 1367(a)(1)(A)).

[13] I.R.C. §§ 61, 101–139 (2000).

[14] *Id*. § 62.

[15] *Id*. § 63.

[16] *Id*. § 56.

[17] *Id*. § 643(b).

[18] *Id*. § 643(a).

[19] *Id*. §§ 702(a), 1366(a)(1)(A). *See also* Treas. Reg. §§ 1.702-1(a)(8), 1.704-1(b)(5) ex. 7, 1.1366-1(a)(2)(viii) (2002); Rev. Proc. 72–18, § 4.05, 1972-1 CB 740. *See generally* Mark P. Gergen, *Reforming Subchapter K: Special Allocations*, 46 TAX L. REV. 1, 40 (1990) (observing certain income should be stated separately on partnership return); Christine Rucinski Strong & Susan Pace Hamill, *Allocations Attributable to Partner Nonrecourse Liabilities: Issues Revealed by LLCs and LLPs*, 51 ALA. L. REV. 603, 615 n.31 (2000) (noting § 702 requires certain categories of income to be stated separately).

[20] I.R.C. §§ 705(a)(1)(B), 1367(a)(1)(A).

When teaching "gross income" in a basic federal income tax class, I frequently ask my class: "If § 61 were the only section in the Internal Revenue Code, would [this receipt or enjoyment of money, value, etc.] be income?" Only after a positive answer to that question do we proceed to consider whether an exclusion, such as those for gifts, interest on state and local bonds, extraterritorial income, etc., might apply. A similar exercise might prove useful for the term that appears in section 1325(b) of the Bankruptcy Code, in which, as the Supreme Court said of the term in section 61, "Congress applied no limitations as to the source of . . . receipts, nor restrictive labels as to their nature."[21] It is income in this sense that I aim to discuss.

In light of the reluctance of many bankruptcy courts to employ a tax definition of income, it may be appropriate to defend my having chosen a definition of income from the field of taxation. I have chosen to apply a tax definition for three reasons: (1) both tax policy and consumer bankruptcy policy debates are dominated by discussions of the "ability to pay"; (2) chapter 13 is analogizible to both a positive and negative income tax; and (3) proponents of means-testing have already employed comparisons to tax law in support of pending bankruptcy reform.

Both the "substantial abuse" test for chapter 7 case dismissal and the "disposable income" test for chapter 13 plan confirmation focus on debtors' "ability to pay" their creditors.[22] "Ability to pay" also plays a central role in calls for reform of the consumer bankruptcy system. It is also central to both the definition of income and the concept of equity within the tax system. Given that analysis of the "ability to pay" is extremely well developed in tax law, policy, and scholarship, it may be useful to apply insights from tax to bankruptcy's relatively recent appropriation of the concept.[23]

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[21] Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 429–30 (1955).

[22] *See, e.g.*, *In re* Taylor, 212 F.3d 395, 396–97 (8th Cir. 2000); *In re* Kornfield, 164 F.3d 778, 784 (2d Cir. 1999); In re Koch, 109 F.3d 1285, 1288 (8th Cir. 1997); *In re* Smith, 848 F.2d 813, 820 (7th Cir. 1988); *In re* Kelly, 841 F.2d 908, 914 (9th Cir. 1988). "Ability to pay" has also been held central to a debtor's good faith. *E.g.*, *In re* Spagnolia, 199 B.R. 362, 366 (Bankr. W.D. Ky. 1995). *But see, e.g.*, Educ. Assist. Corp. v. Zellner, 827 F.2d 1222, 1227 (8th Cir. 1987) (holding that, after the enactment of § 1325(b), "our inquiry into whether the plan 'constitutes an abuse of the provisions, purpose or spirit of Chapter 13' has a more narrow focus" and does not address "ability to pay") (citation omitted); *In re Smith*, 848 F.2d at 820 (stating that enactment of "disposable income" test removes "ability to pay" from the question of good faith). It is also central to the dischargeability of student loans, and of marital property settlements. *E.g.*, *In re* Cirilli, 278 B.R. 248, 251 (Bankr. M.D. Ga. 2001).

[23] It is perhaps not surprising that bankruptcy practitioners, judges, and academics have not tapped abstract tax policy scholarship to help them understand the implications of means-testing proposals, given most normal people's aversion to discussions of tax and the fact, as Professor Jack Williams has pointed out, that (for whatever reason) "one [can] go to countless bankruptcy seminars and never hear the word 'tax' mentioned." Jack F. Williams, *Rethinking Bankruptcy and Tax Policy*, 3 AM. BANKR. INST. L. REV. 153, 153 (1995). Indeed, the Haig-Simons definition of income seems to have gone unnoticed by all American scholars of consumer bankruptcy save one. *See* Adam J. Hirsch, *Inheritance and Bankruptcy: The Meaning of the "Fresh Start"*, 45 HASTINGS L.J. 175, 213 n.117 (1994) (observing, in the context of including gifts and inheritances, within property of estate, how the "line between earnings and gratuities is surely visible to the naked eye – but the closer one looks the blurrier it becomes" and discussing proposals in tax policy to ignore the distinction). I might include Frances Hill but I do not because she is a tax scholar. *See* Frances R. Hill, *Toward a Theory of Bankruptcy Tax: A Statutory Coordination Approach*, 50 TAX LAW. 103, 114–15 (1996) (discussing treatment of tax claims in bankruptcy).

Second, chapter 13 may be analogized to a positive income tax.[24] Central to chapter 13 is a levy, albeit a voluntary one, on income. Chapter 13 may, therefore, perhaps usefully be seen (as may any total levying, taking, or denying of a good)[25] as a 100% tax on net income ("disposable income"), which is defined as all income less certain deductions (expenses that are reasonably necessary for the maintenance and support of the debtor and her dependents).[26]

Chapter 13 can also be said to resemble a negative income tax.[27] Mechele Dickerson and Eric Posner have compared bankruptcy to welfare or public benefit

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[24] *See* Donald R. Price & Mark C. Rahdert, *Distributing the First Fruits: Statutory and Constitutional Implications of Tithing in Bankruptcy*, 26 U.C. DAVIS L. REV. 853, 912 (1993) (rejecting the analogy between tax and bankruptcy for purposes of determining whether an outright denial of debtors' ability to tithe violates freedom of religion and distinguishing tax cases from bankruptcy cases).

[25] *See, e.g.*, Karen C. Burke & Grayson M.P. McCouch, *Women, Fairness, and Social Security*, 82 IOWA L. REV. 1209, 1214–15 (1997) (arguing that "reducing the spousal [Social Security] benefit by the amount of any primary benefit attributable to the spouse's own earnings . . . can be recast as leaving the spousal benefit intact while imposing a 100% tax on the spouse's primary benefit (up to the amount of the derivative benefit)."). It has been argued that the opposite is also true: "an income tax of 100% imposed on a single individual – for example, Bill Gates – would violate the Takings Clause." Calvin R. Massey, *Takings and Progressive Rate Taxation*, 20 HARV. J.L. & PUB. POL'Y 85 (1996). This objection apparently does not arise either in voluntary bankruptcy or in a system to collect or enforce valid debts. In any case, the relation between a tax and a complete taking or deprivation is so complete that legislatures and courts have for some time simply taken for granted that the labels are interchangeable. *See, e.g.*, McDowell v. Heiner, 9 F.2d 120 (W.D. Pa. 1925); Doll v. Evans, 7 F. Cas. 855 (Cir. Ct. E.D. Pa. 1872).

[26] *See* Hung-Jen Wang & Michelle J. White, *An Optimal Personal Bankruptcy Procedure and Proposed Reforms*, 29 J. LEGAL STUD. 255, 261 (2000) (identifying the fraction of non-exempt earnings as the "'bankruptcy tax' rate"); Michelle J. White, *Why it Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change*, 65 U. Chi. L. Rev. 685, 712 (1998) (referring to "tax" on non-exempt earnings). In addition to allowing a deduction for reasonable consumption, bankruptcy courts also examine expenses in light of the cost of producing income. They frequently discuss whether expenses are allowable based on whether they enable a debtor to earn the income necessary to fund the plan, particularly in the context of transportation expenses, which are justified as necessary for the debtor to get to and from work. *See, e.g.*, *In re* Marshall, 181 B.R. 599, 602, 602 n.3 (Bankr. N.D. Ala. 1995); *see also In re* Schnabel, 153 BR 809, 818–19 (Bankr. N.D. Ill. 1993); Robert M. Singer, *Zero Down and Zero Later – The Problem of Collection: A Comparison of Procedures Under State Collection Law, The Bankruptcy Code, and the Internal Revenue Code*, 105 COM. L.J. 159, 179–80 (2000). Some courts have considered whether a debtor's contributing to a pension or repaying a pension loan is a reasonable expense in light of whether the repayment is necessary for the debtor's employment. *E.g.*, *In re* Davis, 241 B.R. 704, 707 (Bankr. D. Mont. 1999); *In re* Tibbs, 242 B.R. 511, 518–19 (Bankr. N.D. Ala. 1999). *But see, e.g.*, *In re* Taylor, 243 F.3d 124, 129–30 (2d Cir. 2001) (holding bankruptcy court has wide discretion in deciding, based on the debtor's individual circumstances, whether repayment is reasonably necessary for maintenance and support); *In re* Helms, 262 B.R. 136, 141 (Bankr. M.D. Fla. 2001) (holding repayment of pension loan is *per se* not reasonably necessary for maintenance and support). Courts that follow the *Taylor* approach emphasize that "[e]quity is best served by a complete review of the facts of each case." In re Guild, 269 B.R. 470, 474 (Bankr. D. Mass. 2001).

[27] A negative income tax is a form of government assistance. Originally, the term referred to proposals under which "an individual whose income is too low to allow him to use all his income tax exemptions and deductions should receive from the federal government a payment determined by application of a negative tax rate to the unused value of those exemptions and deductions." Sheldon S. Cohen, *Administrative Aspects of a Negative Income Tax*, 117 U. PA. L. REV. 678, 678 (1969). The concept has expanded since:

> Basically, a negative income tax is a system of cash transfers to families in which the amount of a family's cash transfer varies inversely with its income: the lower a family's pretransfer income, the greater the amount of the government's net transfer to it. Generally, a simple negative income tax can be defined with two policy variables. The

programs.[28] To the degree bankruptcy relief is accorded in inverse relation to ability to pay, bankruptcy could, like certain government programs, be likened to a negative income tax. To the extent it is, perhaps an analysis of need would be well informed by the definition of income used in discussions of the negative income tax.[29]

Judge Jones and Professor Zywicki, two of the more outspoken proponents of means-testing, have compared ability-to-pay means-testing to tax progressivity, under which "higher-income earners are expected to pay more, " and observe that "needs-based relief is the hallmark of most social welfare programs. "[30] But they do not provide much more in the way of justification because they consider it the responsibility of "those who disagree with bankruptcy means-testing . . . to explain why the bankruptcy system is or should be so different from other institutions."[31] They simply state that means-testing is "designed to maximize social equity as well as assure some repayment in the course of discharging debts. "[32] Given the ubiquity

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> target or breakeven income level is the income level at which a family becomes negligible for benefits and the government subsidy equals zero. The benefit-reduction rate (sometimes called the marginal tax rate) determines the rate of reduction of a family's subsidy as the family's pretransfer income increases. In a simple negative income tax, the family's subsidy is the product of the benefit-reduction rate and the excess of the breakeven income level over the family's pretransfer income. The maximum subsidy (sometimes called the guarantee) is received by a family with no other income. A household's net (i.e., posttransfer) income for the year is the sum of its actual income plus the amount of the subsidy it receives.

Jonathan Barry Forman, *Promoting Fairness in the Social Security Retirement Program: Partial Integration and a Credit for Dual-Earner Couples*, 45 TAX LAW. 915, 950 n.165 (1992).

[28] Mechele Dickerson, *To Love, Honor, and (Oh!) Pay: Should Spouses Be Forced to Pay Each Other's Debts?*, 78 B.U. L. REV. 961, 1013–14 (1998); Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 307 (1995); *see also* A. Mechele Dickerson, *Bankruptcy Reform: Does the End Justify the Means?*, 75 AM. BANKR. L.J. 243, 270–71 (2001); *cf.* Elizabeth Warren, *What Is a Women's Issue? Bankruptcy, Commercial Law, and Other Gender-Neutral Topics*, 25 HARV. WOMEN'S L.J. 19, 53 (2002) (asserting view of bankruptcy as government welfare program is "flatly wrong").

[29] Criticisms of Haig-Simons are muted in the negative income tax. Scholars unanimously agreed from the beginning that a complete economic definition of income was most appropriate for the negative income tax. *See* Sheldon S. Cohen, *Administrative Aspects of a Negative Income Tax*, 117 U. PA. L. REV. 678, 683–87 (1969); William A. Klein, *Some Basic Problems of Negative Income Taxation*, 1966 WIS. L. REV. 776, 782–86 (1966); William D. Popkin, *Administration of a Negative Income Tax*, 78 YALE L.J. 388, 389–92 (1969); James Tobin et al., *Is a Negative Income Tax Practical?*, 77 YALE L.J. 1, 11–14 (1967); *see also* Anne L. Alstott, *The Earned Income Tax Credit and the Oversimplified Case for Tax-Based Welfare Reform*,108 HARV. L. REV. 533, 571–76 (1995); George K. Yin, *Accommodating the "Low-Income" in a Cash-Flow or Consumed Income Tax World*, 2 FLA. TAX REV. 445, 472 (1995); Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 98–99 (1990). George Yin observes the scholarly consensus that:

> [T]he tax base for purposes of the [negative income tax] should be much more comprehensive than that for the positive income tax system, potentially encompassing such items as the imputed net rental value of owner-occupied homes, the value of food grown and consumed on a farm, and other non-monetary forms of income.

George K. Yin, *supra* this note, at 472 n.68.

[30] Judge Edith H. Jones & Todd J. Zywicki, *It's Time For Means-Testing*, 1999 B.Y.U. L. REV. 177, 182 (1999).

[31] *Id.*

[32] *Id.*

of the ability-to-pay standard in tax policy, it is perhaps not surprising that Jones and Zywicki take for granted the appropriateness of the same standard in bankruptcy.[33]

Current law and the proposed reforms do focus on debtors' ability to pay. And bankruptcy – specifically the discharge (but also, the stay, for example) – is a public benefit.[34] It is not surprising, therefore, that there are those who are reluctant to confer that benefit to those who are not in "need. " The systematic exclusion of certain property income from the measurement of need, however, reveals a kind of discrimination and may say less about the economics of bankruptcy than about the deep-seated belief that every able-bodied person must work.[35] That the functional

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[33] It is fair to ask why ability to pay focuses solely on debtors. Jones and Zywicki chose "ability to pay" as the standard and analogized to tax and public entitlements, both of which contain ability-to-pay elements. Perhaps it seems natural to analogize a debtor to a taxpayer or a recipient of public benefits. Tax and bankruptcy differ, however, in that the income tax, which is roughly based on ability to pay, measures ability to pay based on sacrifice or based on ability to meet a positive exaction without regard to some corresponding benefit. That is, ability to meet the *burden*. Bankruptcy, however, does not impose an exaction only on debtors. Nor, as in tax and public entitlements, where interests of private taxpayers or welfare recipients are balanced against the public fisc, does bankruptcy pit individuals' ability to bear a burden against the government's revenue needs (still, a reduction in tax or an increase in benefits for some may represent an increased burden for someone else, assuming a zero-sum game). Rather, the government is imposing a cost, a burden, an exaction (if at all) on creditors. A direct analogy between tax's ability to pay standard and bankruptcy's ability to pay standard might equally focus, therefore, on *creditors'* ability to bear the burden. But bankruptcy does not focus on ability to bear the burden and frequently imposes greatest costs on those with no ability to bear them (such as tort victims and employees with non-diversifiable human capital) and imposes least cost on parties most able to bear burden (large institutional creditors with ability to diversify, such as issuers of credit cards). *See, e.g.*, Eric G. Brunstad, *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499, 539 n.153 (2000) (observing that "the debtor's inability to pay tort claims may have a more devastating effect on victims of the debtor's torts" than on trade creditors). *See generally, e.g.*, KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 169–73 (1997) (advocating subordinating claims of voluntary creditors to those of involuntary creditors); Henry Hansmann & Reiner Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1929–30 (1991) (contrasting unlimited shareholder liability for corporate torts and bankruptcy priority for victims of those torts).

"Ability to pay" imposes an information cost – either in formulating generally applicable rules or in adjudicating individual cases or in some combination of the two. *See, e.g.*, Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 22 (2001); Ed Flynn & Gordon Bermant, *Means Testing: Lessons Learned From a Single Case*, AM. BANKR. INST. J., Nov. 1999, at 30. Including creditors' ability to pay would increase those costs. In some instances, however, it may of equal relevance (especially in the relative cost of acquiring the information) what a creditor's ability to bear the loss would be. The Bankruptcy Code recognizes the desirability of considering harm to a creditor, in the rules for discharging a marital property settlement debt, in which the debtor's ability to pay and the relative abilities of the debtor and creditor to bear the loss are considered. *See* 11 U.S.C. § 523(a)(15) (2000).

[34] *See* Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 67 (1982). Then again, so are creditors' remedies. *See generally, e.g.*, Carol M. Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295, 314 (1992).

[35] *See, e.g.*, A. Mechele Dickerson, *America's Uneasy Relationship with the Working Poor*, 51 Hastings L.J. 17, 55–56 (1999). Christopher Hill has suggested the origins of this ideology. "'The law' in the seventeenth century aimed at turning the mass of the peasantry off the soil and forcing them into wage labour to produce wealth for their employers and their country, though not for themselves." CHRISTOPHER HILL, LIBERTY AGAINST THE LAW: SOME SEVENTEENTH CENTURY CONTROVERSIES 328 (1997); *see also id*. at 232–33 (citing Eric J. Hobsbawm, *Scottish Reformers and Capitalist Agriculture*, *in* PEASANTS IN HISTORY: ESSAYS IN HONOUR OF DANIEL THORNER (1960). Hill finds a shift in English attitudes toward

definitions of income in bankruptcy focus much more on income from labor than income from capital also suggests that "ability to pay" is more moral rhetoric than "objective" economics.[36]

I. BACKGROUND: HOMES IN AMERICA AND INCOME IN BANKRUPTCY

Before turning to these proposals, I first provide some background on the importance of homes within the American economy and of the value of rental in and out of bankruptcy. I also provide some background on the evolution of American bankruptcy law as it relates to increased emphasis on income.

A Houses and Rent

According to the Census Bureau, over two-thirds of all occupied housing units in the United States are occupied by their owners.[37] According to *The Fragile*

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work with the rise capitalism, which imposed "the discipline of wage labour," HILL, *supra* this note at 63, and to support the new attitude quotes Mandeville who wrote: "*We* have hardly poor enough to do what is necessary to make *us* subsist." *Id*. at 64 (quoting BERNARD MANDEVILLE, THE FABLE OF THE BEES 212 (3d ed. 1724). For elites to profit from the wage labor of the poor, particularly in times of labor scarcity, it was necessary to develop an ideology making work a moral imperative. Captain John Smith's apocryphal statement conditioning eating upon working may have thrown a class-leveling twist on the formula but was informed by the prevailing English tradition. The recent development of consumer capitalism adds the "discipline of debt" to the "discipline of wage labor."

[36] So does the fact that "disposable income" requirements apply only in individual cases. Even under the reform bills, which would extend the disposable income test to chapter 11, nonhumans would be exempt from devoting their available income to the repayment of debt. *See* Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 321 (1st Sess. 2001).

[37] UNITED STATES CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2000 at 719 (2000) (Table no. 1209: Housing Units–Characteristics by Tenure and Region: 1997), *available at* http://www.census.gov/prod/www/statistical-abstract-us.html. Home ownership is, however, much more prevalent in the white community, in which 70.3% of units occupied by whites are owner-occupied, as compared to 45.2% for African-Americans and 42.8% for Hispanics. *Id.* at 721 (2000) (Table no. 1212: Occupied Housing Units–Tenure by Race of Householder: 1991 to 1997). To the extent bankruptcy law privileges homeowners, that benefit may be conferred disproportionately on white debtors. *See* Roberta F. Mann, *The (Not So) Little House on the Prairie*, 32 ARIZ. ST. L.J. 1347, 1365 (2000) (noting similar effect of tax deduction for home mortgage interest); Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751, 774–76 (1996) (illustrating blacks are less likely than whites to own homes). However, to the extent non-whites are overrepresented in bankruptcy or among "precariously housed households," TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 46, 231 (2000), the picture may be more complicated. Home ownership also varies by age, gender and marital status. Married-couple families had a home-ownership rate in 1999 of 81.8%, whereas families headed by a sole female had a rate of 48.2% and by a sole male had a rate of 56.1%. Male and female one-person households had home-ownership rates of 46.3% and 57.6%, respectively. To the extent bankruptcy law privileges home ownership, it may confer a benefit disproportionately on married debtors. Finally, the preference for homeowners may effect discrimination based on age and geography. The older the occupant, the more likely he or she is to own than lease. UNITED STATES CENSUS BUREAU, *supra* this note, at 722 (2000) (Table no. 1213: Homeownership Rates by Age of Householder and Family Status: 1985 to 1999). Home-ownership also varies geographically. In 1999, the District of Columbia, New York, and California had home ownership rates of 40.0%, 52.8%, and 55.7%, respectively. The District's neighbor, Maryland, had a home ownership rate of

Middle Class,[38] the most comprehensive empirical study of recent consumer bankruptcy, there were approximately 650,000 homeowner bankruptcies in 1998.[39] This number represents about one per cent of the nation's approximately 65 million owner-occupied dwellings. Assuming a very conservative average value of $50,000,[40] there would be $32.5 billion of housing value passing through the bankruptcy courts each year.

Homes function as both consumer durables and investment property.[41] It is a commonplace that a "family residence is both the largest consumer purchase and the main investment"[42] for most Americans and even more homeowners.[43] And just

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69.6% and New York's neighbor, Pennsylvania, had a rate of 75.2%. Maine, South Carolina, and Michigan had the highest rates of 77.4%, 77.1%, and 76.5%, respectively. *Id.* at 722 (2000) (Table no. 1214: Homeownership Rates by State: 1985 to 1999).

[38] TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT (2000).

[39] *Id.* at 202. Flynn and Bermant found that 41.8% of debtors in their study reported owning a home. Ed Flynn & Gordon Bermant, *The Class of 2000*, AM. BANKR. INST. J., Oct. 2001, at 21.

[40] Sullivan, Warren, and Westbrook report the median value of debtor residences in 1991 as $53,700. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 222. Fifty thousand dollars as an average value ten years later seems to be both reasonable and conservative. The median value of all homes is approximately $169,000, according to HUD's website. *See* U.S. Department of Housing and Urban Development, *at* http://www.hud.gov.

[41] *See, e.g.*, *In re* Kitson, 65 B.R. 615, 616 (Bankr. E.D.N.C. 1986) (providing how debtors expanded their budget and purchased home as investment).

[42] Pete V. Domenici, *The Unamerican Spirit of the Federal Income Tax*, 31 HARV. J. ON LEGIS. 273, 294 (1994); s*ee also* SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 199, 220 (2000) (finding home equity represents Americans biggest source of personal wealth); Noel B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A "Revolutionary" Approach to Ownership*, 47 TAX L. REV. 725, 801 (1992) (discussing personal residence as investment expected to appreciate over time); Daniel Halperin, *Valuing Personal Consumption: Cost Versus Value and the Impact of Insurance*, 1 FLA. TAX REV. 1, 27–28 (1992) (comparing value of residence investments with other investment losses); Deborah A. Geier, *Tufts and the Evolution of Debt-Discharge Theory*, 1 FLA. TAX REV. 115, 181 n.195 (1992) (finding decreases in loss on house used as personal residence arise from personal consumption and are nondeductible); J. B. McCombs, *Refining the Itemized Deduction for Home Property Tax Payments*, 44 VAND. L. REV. 317, 328 (1991) (analyzing government subsidies for home purchases); Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L. J. 431, 454 (1991) (describing homes as investment expected to appreciate in profit); *cf*. Julia Patterson Forrester, *Mortgaging the American Dream: a Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 377 n.16 (1994) (stating consumer or investment debt may arise from home improvement loan depending on whether debtor intended to live in home or make it more marketable); Harriet Thomas Ivy, Comment, *Means Testing under the Bankruptcy Reform Act of 1999: A Flawed Means to a Questionable End*, 17 BANKR. DEV. J. 221, 223 n.9 (2000) (stating same). *But see* Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CALIF. L. REV. 569, 618 n.145 (1984) (arguing homeowners have primarily consumption rather than investment motive in purchasing home and are therefore less likely to rely on Fifth Amendment "insurance" and over invest in property likely to be "taken"); David J. Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 U. PA. L. REV. 1111, 1165–66 (1986) (arguing accrual taxation of reduction in liabilities would affect elastic choice of home ownership because "decision to buy a home, and thus to borrow for that purpose, is much more a consumption decision than an investment decision."). After a home, the next largest consumer investment is generally a new car. *E.g.*, Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 818 (1991).

[43] Evidence suggests the percentage of total assets comprised of consumer items (cars, housing, etc.) or of traditional investment vehicles (business equity, other real estate, etc.) may vary between different racial

as homes are the largest single part of individual *net* worth in the United States [44] and represent "America's hidden savings,"[45] debtors-homeowners' median equity of $5,500[46] or average equity of $16,620[47] in 1991 reported in *The Fragile Middle Class* represents over 40% of the mean and median of debtors' *total* assets.[48]

For many debtors, bankruptcy is primarily a means – in some cases the only means[49] – of trying to save the family home,[50] sometimes at the very last minute[51] or after.[52] This is particularly so of chapter 13.[53] The attempt to save one's home is of course also the attempt to prevent another from recovering her collateral. Many secured creditors, therefore, seek and receive dismissal or stay relief when a debtor

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groups. *See* Moran & Whitford, *supra* note 37, at 764–65 (making comparisons between different races within several income ranges). Given that housing falls within both categories of consumption and investment item, treating housing as one or the other may have disparate effect on different racial groups.

[44] UNITED STATES CENSUS BUREAU, *supra* note 37, at 480 (Table no. 763: Nonfinancial Assets Held by Families by Type of Asset: 1998).

[45] SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 220; *see also* National Bankruptcy Review Commission Report 117, 125 (1997) ("For many Americans, home equity is a form of long-term savings and an informal retirement plan").

[46] SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 220.

[47] *Id.* at 353 n.73.

[48] *Id.* at 65 (showing median of $12,650 and mean total assets of $38,478). Because only "positive equity" (which is a redundancy) can be considered an asset, "negative equity" is excluded here, as it is in *The Fragile Middle Class*, in which, to derive the mean and median equity from the raw data in the Consumer Bankruptcy Study, an excess mortgage amount over property value amount was assigned zero value; taking both positive and negative equity into account would have resulted in a mean of $5666. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38.

[49] *See, e.g.*, *In re* Heath, 188 B.R. 17, 19 (Bankr. D.S.C. 1995) (finding no bad faith on eve-of-foreclosure filing on debtor's first filing where it "was the only way she could save her *substantial* equity in the property").

[50] *See, e.g.*, SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 220 (explaining Americans face losing homes if incomes are inadequate to meet mortgage payments); *see also In re* Walker, 171 B.R. 197, 199 (Bankr. E.D. Pa.1994) (describing "desperate efforts" to save property from foreclosure); *In re* Willey, 24 B.R. 369, 374 (Bankr. E.D. Mich. 1982) (finding saving home is primary reason debtor performs conditions of chapter 13 plan); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 528 (1993) (finding chapter 13 is used to retain collateral when debtor is in arrears on debts); Note, *A Reformed Economic Model of Consumer Bankruptcy*, 109 HARV. L. REV. 1338, 1350–51 (1996) (discussing that debtors file under chapter 13 to retain their homes).

[51] *See, e.g.*, *In re* Faulkner, 240 B.R. 67, 70 (Bankr. W.D. Okla. 1999) (finding debtor filing chapter 13 bankruptcy petition prior to home foreclosure did not cut off debtor's right to cure default on home); *see also In re* Chisum, 68 B.R. 471, 473 (B.A.P. 9th Cir. 1986), *aff'd*, 847 F.2d 597 (9th Cir. 1988) ("Filing a bankruptcy petition to prevent foreclosure if undertaken pursuant to a legitimate effort at reorganization is not reprehensible and is in accord with the aim of the Bankruptcy Code.").

[52] *See In re* Smith, 85 F.3d 1555, 1560 (11th Cir. 1996) (finding debtor has right of home redemption after filing chapter 13 petition); *In re* Bobo, 246 B.R. 453, 455 (Bankr. D. Colo. 2000) (stating debtor has right to cure default until residence is sold at foreclosure sale conducted in accordance with bankruptcy law); *In re* Sims, 185 B.R. 853, 867 (Bankr. N.D. Ala. 1995) (explaining debtor has right to cure default even after foreclosure sale through statutory right of redemption only through lump sum payment including principal, interest, and other charges); *In re* Felberman, 196 B.R. 678, 683–84 (Bankr. S.D.N.Y. 1995) (describing trend of multiple bankruptcy filing by different family members to prevent foreclosure on property).

[53] *See* Note, *supra* note 50, 1350–51 (finding debtors file under chapter 13 in order to retain homes because people often feel attachment to their homes).

has filed on the "eve of foreclosure"[54] Aside from the interest secured creditors may have in preventing debtors from using bankruptcy in such an attempt, however, other creditors may have an interest in doing so even when a lienholder is quite content to receive payments during the bankruptcy case.[55] Because of secured creditors' preferred status in bankruptcy, every dollar paid on an allowed secured claim reduces the recovery to every unsecured creditor, who, but for the bankruptcy, might proceed to obtain a judgment lien.

Many debtors seek to retain their homes because they may have equity in them (and they wish to retain economic "rent" on the property) or wish to continue paying to acquire equity (in essence, pre-pay the rental expense for residing on the property until Judgment Day). In 1998, the rental[56] value of owner-occupied homes constituted over $622 billion, over ten per cent of all personal consumption in the United States[57] and an amount equal to seven per cent of the gross domestic product.[58] This amount was more than the combined expenditures for clothing, drug preparations, legal services, higher education, video and audio products, and computer hardware and software. The value of owner-occupation consumption equaled 96% of the amount of all expenditures for transportation, including purchase of new and used automobiles, repairs, maintenance, parking, mass transit and inter-city rail, bus, and air travel.[59] In consumer bankruptcy cases, where expenditures are both limited by circumstances and generally overseen by trustees

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[54] *See In re* Hobbs, 257 B.R. 778, 780 (Bankr. E.D. Va. 2000) (dismissing third eve-of-foreclosure filing); *In re* Brown, 251 B.R. 916, 919 (Bankr. M.D. Ga. 2000) (dismissing second such filing); *see also In re* Copeland, 268 B.R. 273, 278 (Bankr. D. Kan., 2001) (imposing sanctions for multiple filings on eve of foreclosure). *But, cf. In re* Boswell, 206 B.R. 421, 424 (Bankr. W.D. Va. 1997) (finding no bad faith in third eve-of-foreclosure bankruptcy would justify annulment of stay).

[55] Unsecured creditors are affected by the treatment of secured creditors. *See In re* Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061, 1065 (9th Cir. 2001) (affirming approval, over objection of unsecured creditors, of settlement among estate, secured creditors, and other parties); *In re* Fleshman, 123 B.R. 842, 846–47 (Bankr. W.D. Mo. 1990) (refusing to permit chapter 12 debtor to pre-pay secured creditors at expense of unsecured creditors).

[56] Following convention, I employ the term "rental" to mean value paid for the use of an asset over time and the term "rent" to mean, except where the context clearly indicates otherwise (as in discussing, for example, a security interest that includes "rents") the return to a factor of production. *See, e.g.*, PAUL A. SAMUELSON, ECONOMICS 562 (10th ed. 1976); *see also* THE MCGRAW-HILL DICTIONARY OF MODERN ECONOMICS (3d ed. 1983) (defining "economic rent" as "the return to a unique factor used in production in excess of the amount which that factor (human or nonhuman) could earn in its next best alternative employment."). To avoid confusion, I have not used the term "rent" as a verb, opting instead for the word "lease," whether referring to the action of lessor or lessee. Some economists describe "economic rent" as the return from a factor that is purely inelastic. SAMUELSON, *supra* this note, at 562 (1976). To the extent that an individual's labor may or may not be completely inelastic, I may be violating some tenet of economic theory in treating returns from labor as rent.

[57] UNITED STATES CENSUS BUREAU, *supra* note 37, at 457 (Table no. 723: Personal Consumption in Expenditures in Current and Real (1996) Dollars by Type: 1990 to 1998).

[58] In 1998, the gross domestic product was $8,759.9 billion. UNITED STATES CENSUS BUREAU, *supra* note 37, at 451 (Table no. 715: Gross Domestic Product in Current and Real (1996) Dollars: 1960 to 1999).

[59] UNITED STATES CENSUS BUREAU, *supra* note 37, at 457 (2000) (Table no. 723: Personal Consumption in Expenditures in Current and Real (1996) Dollars by Type: 1990 to 1998).

and judges, one would expect rental value of owner-occupied homes to occupy an even higher percentage of consumption.

The amount of unpaid rental consumed by debtor homeowners may be significant. In 1998, there were 65,487,000 owner-occupied housing units in the United States, for an average annual rental value per unit of approximately $9500.[60] Given that about one per cent of the nation's housing stock is pulled into bankruptcy proceedings in any recent year, and even if the imputed rental for debtors' homes is half the national average, the amount of imputed rental consumed by debtor homeowners may be more than $3 billion per year. If one-third of that value were captured for the benefit of unsecured creditors (which is not beyond the realm of possibility, considering that debtors' rental expenses are approximately one-half of debtors' homeownership expenses),[61] they might receive as much as even the rosiest estimates of repayment under currently proposed bankruptcy reforms – and considerably more than under less optimistic projections.[62]

B Bankruptcy's Income Requirements and Definitions of Income

1. From Liquidation to Arrangement

The earliest English bankruptcy laws focused on preventing debtors fleeing the jurisdiction and on the orderly liquidation of all of the debtor's assets for the benefit of creditors. These antecedents have carried through in English law to modern remedies such as Mareva injunctions and to a continued preference for liquidation over voluntary arrangements. Early American federal bankruptcy law, although designed to be accessed voluntarily by debtors, also limited available relief to liquidating the debtor's assets and providing the debtor a "fresh start."[63] Federal bankruptcy enactments, however, were generally short-lived and followed some discrete economic crisis. By relatively early in the twentieth century bankruptcy relief was firmly established as appropriate means by which the government could alleviate the burdens of periodic depressions.[64] By the second half of the century,

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[60] UNITED STATES CENSUS BUREAU, *supra* note 37, at 31 (Table no. 30. Mobility Status of the Population, by Selected Characteristics: 1980 to 1998).

[61] Flynn & Bermant, *supra* note 39, at 21–22.

[62] *See* Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 31 (1999) (predicting estimated $450 million increase in repayment under H.R. 3150). According to studies by Ernst & Young and VISA, five-year plans under proposed means-testing would result in repayment of between $4 and $5 billion. *Id*.

[63] *See generally* Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49 (1986) (discussing history and legal theory of fresh start policy); Jay Cohen, *The History of Imprisonment for Debt and Its Relation to the Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153 (1982); Louis Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1 (1919).

[64] *See* Louisville Bank v. Radford, 295 U.S. 555, 581–82 (1935) (stating that each national bankruptcy act followed major or minor depressions).

bankruptcy became not a response to economic cycles but a permanent safety net for the insolvent and overextended.

More importantly, however, the most valuable asset of most individuals had become future earnings.[65] In 1874, the 1867 Bankruptcy Act was amended to include compositions, which allowed debtors to repay their debts through future income; the Bankruptcy Act of 1898 re-enacted the composition provisions.[66] The 1934 Frazier-Lemke Act, enacted during the "Great Depression," permitted "family farmers" to effect a composition of their debts and obtain a moratorium on collection and mortgage foreclosure during repayment. Four years later the Chandler Act codified a practice, common in Birmingham, Alabama,[67] and elsewhere,[68] for wage earners to enter into arrangements with their creditors for repayment of debt. Although assignment of wages to creditors had been common for some time,[69] the rehabilitative form of relief in new chapters XII and XIII was so far beyond the perceived definitions of "bankruptcy" that they were challenged (unsuccessfully) as being beyond Congress's power to pass bankruptcy legislation.[70]

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[65] *See* Local Loan Co. v. Hunt, 292 U.S. 234, 243–45 (1934) (disallowing assignment of future wages as contrary to policy of Bankruptcy Act); A. Fortas, *Wage Assignments in Chicago–State Street Furniture Co. v. Armour & Co*., 42 Yale L.J. 526 (1933) ("The most satisfactory security which a creditor can obtain from an impecunious, property less workingman, is a pledge of the proceeds of his labor."); Joan Williams, *Is Coverture Dead? Beyond a New Theory of Alimony*. 82 GEO. L.J., 2227, 2257–58 (1994) (discussing importance of earning potential in context of division of resources at divorce).

[66] Richard E. Coulson, *Consumer Abuse of Bankruptcy: an Evolving Philosophy of Debtor Qualification for Bankruptcy Discharge*, 62 ALB. L. REV. 467, 489–91 (1998).

[67] *See Revision of the National Bankruptcy Act: Hearings Before a Subcommittee of the Committee on the Judiciary* 65–72 (1938) [hereinafter *Bankruptcy Hearings*] (Statement of Valentine J. Nesbit, Special Referee in Bankruptcy, Birmingham, Alabama). One Georgia judge has observed: "'Wage earner' plans are a creature of American law, born and suckled on the love and values of the southeastern United States of America." Georgia Railroad Bank & Trust Co. v. Kull (*In re* Kull), 12 B.R. 654, 657 (S.D. Ga. 1981), *aff'd*, Kitchens v. Georgia Railroad Bank & Trust Co. (*In re* Kitchens*)*, 702 F.2d 885 (11th Cir. 1983). *See generally* Wesley A Sturges & Don E. Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L.J. 487, 498–501 (1933) (detailing state by state statistics for wage earner bankruptcies in 1921 and 1931, including data indicating greater than 80% of bankruptcies in Alabama during relevant periods were "wage earner" bankruptcies).

[68] Referee Nesbit indicated in his testimony that Norfolk, Montgomery, and Atlanta had a smaller number of "debtor's court" cases and that "[s]ome people in Kansas City were very much interested in it." *Bankruptcy Hearings*, *supra* note 67, at 71. The Eastern District of Virginia, Middle District of Alabama, Northern District of Georgia, and Western District of Missouri continue to have a high percentage of chapter 13 cases. In Ohio municipal courts, for example, similar arrangements were available under state law. And in Chicago, the American Amortization Company and other private collection services supervised pre-bankruptcy amortization of the debts of public utility employees and other wage earners. *See* William O. Douglas, *Wage Earner Bankruptcies–State v. Federal Control*, 42 YALE L.J. 591, 636–37 (1933) (discussing practice of pre-bankruptcy amortization in Chicago); Fortas, *supra* note 65, at 527–31 (1933) (stating same). Other jurisdictions had special "debtor courts" in which proceedings were initiated by creditors and which effectively entered installment payment or wage garnishment orders for the collection of judgments. *See, e.g.*, Peter R. Nehemkis, Jr., *The Boston Poor Debtor Court–A Study in Collection Procedure*, 42 YALE L.J. 561 (1933) (analyzing operation of Boston Poor Debtor Court).

[69] *See* Reginald H. Smith, *The History and Purpose of the Wage Assignment Statutes with a Suggestion for Amendment*, 5 MASS. L.Q. 479 (1920) (detailing history of wage assignment statutes).

[70] *See* Louisville Bank v. Radford, 295 U.S. 555, 581–83 (1935) (invalidating provision of Frazier-Lemke Act that imposed moratorium on mortgage foreclosure as violating Fifth Amendment).

Just as one purpose of common law compositions was "a retention and a continuation by the debtor of his business,"[71] the rehabilitative compositions and extensions under chapter XIII were designed to allow debtors to retain their property while repaying their debts.[72] Chapter XIII (and its successor, chapter 13) recognized what has come to be known as the "debtor's bargain."[73] If the debtor were to liquidate, she would have to surrender her non-exempt property; by choosing, however, to repay all or some debts through future income, the debtor is entitled to keep all of her property.

Chapter XIII was available only to insolvent "wage earners." The statute defined a wage earner as "an individual who works for wages, salary or hire at a rate of compensation which, when added to all his other income, does not exceed" a specific amount.[74] Commissioned employees were excluded until 1959.[75] And some individuals who earned a salary, particularly professionals and business executives, were also ineligible.[76] Eligibility depended on income earned in certain kinds of relationships and from certain kinds of activities.[77] A wage earner was one "depend[ent] for a living upon the result of individual labor or effort, without the aid of property or capital."[78]

The bankrupt was required to file a plan that provided for repayment of debts through either composition (less than full repayment) or extension (amortization and full repayment over an agreed term) or both. The plan could be accepted by all affected creditors or confirmed by the court if a majority of creditors accepted the plan.[79] The statute mandated minimum repayment amount but required "submission of future wages" to the trustee to the extent required to effectuate the plan.

The submission of earnings ordinarily took the form of either a complete or partial assignment of wages to the trustee. In the case of a complete assignment the

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[71] CHARLES E. NADLER, THE LAW OF DEBTOR RELIEF § 17 (1954).

[72] 11 U.S.C. § 1002 (repealed) (specifically exempting chapter XIII from provision governing liquidation of estate).

[73] *In re* Burgie, 239 B.R. 406, 410 (Bankr. 9th Cir. 1999); *In re* Jacobs, 263 B.R. 39, 48 (Bankr. N.D.N.Y. 2001); *In re* Euler, 251 B.R. 740, 748 (Bankr. M.D. Fla. 2000); *see also* McLean v. Federal Land Bank of Omaha, 130 F.2d 123, 126–27 (8th Cir. 1942) (discussing purpose of Frazier-Lemke Act); Corden Corp. v. Williams, 93 F.2d 758, 760 (9th Cir. 1937) (discussing same); *In re* Burke, 51 F.Supp. 552, 554 (S.D. Ga. 1943) (discussing same).

[74] 11 U.S.C. § 1006(a) (repealed). $1,500 when the law was enacted, then $3,600 until 1950, and $5,000 from 1950 until the cap was lifted in 1959. *See generally* Wesley A. Sturges & Don E. Cooper, *Credit Administration and Wage Earner Bankruptcies*, 42 YALE L.J. 487, 487 n.5 (reflecting data from *Strengthening of Procedure in the Judicial System*, Sen. Doc. 65, 72d Cong., 1st Session, 1932, including *Report to the President on the Bankruptcy Act and its Administration in the Courts of the United States*).

[75] *See, e.g.*, Thompson v. Kronheim, 178 F.2d 476 (6th Cir. 1949).

[76] *See* Stella v. Gov't Dev. Bank of P. R., 663 F.2d 326, 330 (1st Cir. 1981) (showing narrow interpretation of "wage earner" does not include partner); *see also* Nicholson v. Williams & Shelton Co., 121 F.2d 740, 740–41 (4th Cir. 1941) (addressing farmer); *In re* Harriman, 31 F.Supp. 50, 51 (S.D.N.Y. 1939) (stating appropriate time to assess whether party is 'wage earner' under chapter XIII).

[77] *See generally* NADLER, *supra* note 71, §§ 396–397.

[78] *In re* Reed, 368 F. Supp. 615, 617 (E.D. Va. 1968) (quoting First Nat'l Bank v. Barnum, 160 F. 245, 247 (M.D. Pa. 1908).

[79] 11 U.S.C. §§ 1051–1052 (repealed).

employer would pay the entire wage to the trustee, who would distribute payments to creditors and the remainder to the debtor.[80] In a case of a partial assignment, the employer would write two checks, one to the trustee and the other the bankrupt employee.[81] The amount and use of the wage received by the debtor was generally beyond the concern of the court, although the court retained jurisdiction over these amounts for the remainder of the case to prevent garnishment or attachment under the authority of any other court. Chapter XIII was exclusively concerned with "earnings and wages" of the debtor, which required no consideration of other forms of income, actual or constructive.

2. Requirements to use income under the Bankruptcy Code

a. Shifting from "Wages" to "Income"

Since the 1930s, the economy has changed. Although income from labor is still an important part of individuals' income, more wage- and salary-earners now have wealth and income from other sources. More are invested in pensions,[82] which are in turn invested in equity markets. More individuals are invested in equity markets.[83] More Americans own their homes now[84] and treat them as investments,[85] buying low and selling high.[86]

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[80] *See* ABRAHAM I. MENIN & ASA HERZOG, BANKRUPTCY FORMS AND PRACTICE UNDER THE CHANDLER ACT 818–19 (1939); NADLER, *supra* note 71, § 512.

[81] Clarence W. Algood, *Chapter XIII: Wage Earners' Plans*, 15 NAT'L ASS'N OF REFEREES IN BANKR. 20 (1940); NADLER, *supra* note 71, § 512.

[82] Pension fund reserves rose from 14.8% in 1980 to 23.1% in 1990 and 29.6% in 1998. UNITED STATES CENSUS BUREAU, *supra* note 37, at 509 (Table No. 791: Flow of Funds Accounts—Assets of Households: 1980–1999). In 1998, of families with annual incomes of between $10,000 and $24,999, over seven percent held stocks directly, 7.6 percent had mutual funds, and over one-quarter had retirement accounts. Of families with incomes between $25,000 and $49,999, those percentages were 17.7%, 14.0%, and 54.2% respectively. *Id*. (Table No. 792: Financial Assets Held by Families by Type of Asset: 1992–1998).

[83] Even as late as 1990, 12.1% of household financial assets were directly-held corporate equities; by 1999, that percentage had jumped to 22.9%. UNITED STATES CENSUS BUREAU, *supra* note 37, at 509 (Table No. 792: Financial Assets Held by Families by Type of Asset: 1992–1998).

[84] Home ownership rates rose about 50% from the 1930s to the 1990s. In the first census after the enactment of the Chandler Act, 43.6% of American families owned their own homes; in 1990, the number had risen to 64.2%. BUREAU OF CENSUS, UNITED STATES DEP'T OF COMMERCE, 1990 CENSUS OF POPULATION AND HOUSING: SUMMARY POPULATION AND HOUSING STATISTICS, Summary Tape File 1C; *see also* BUREAU OF CENSUS, UNITED STATES DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, at 646 (1975). According to the Department of Housing and Urban Development, "67.8 percent of American households were homeowners in 2001." United States Department of Housing and Urban Development, *U.S. Housing Market Conditions Summary, available at* htttp://www.huduser.org/periodicals/ushmc/winter2001/summary.html (last visited March 22, 2002). *See generally* James C. Smith, *The Dynamics of Landlord-Tenant Law and Residential Finance: the Comparative Economics of Home Ownership*, 44 WASH. U. J. URB. & CONTEMP. L. 3, 60–61 (1993). As discussed, *supra* note 37, home ownership rates are considerably lower among African-Americans and Hispanics. The 1999 Annual Housing Survey shows home ownership rates for those groups of 46.5% and 45.2%, respectively.

[85] *See* Pete V. Domenici, *The Unamerican Spirit of the Federal Income Tax*, 31 HARV. J. ON LEGIS. 273, 294 (1994) (stating family residence is largest consumer purchase and investment for most Americans); *see*

Two major changes since 1978 have made "income" rather than "wages" nominally and, to some extent, actually the focus of the ability to repay debt. First, in 1978, the Bankruptcy Reform Act expanded chapter 13 eligibility and eliminated the "wage-earner" restriction. Now, to be eligible for chapter 13, a debtor need only have a "regular income" and have debts within certain specified limits. An "individual with a regular income" is defined to mean an individual whose income is sufficiently stable and regular to enable such individual to make payments under a chapter 13 plan.[87] Under the "regular income" rule, eligibility may be predicated on proceeds from the rental of real property[88] or the liquidation of assets.[89] "Regular income" may take the form of gifts from a spouse,[90] children,[91] siblings,[92] or in-

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also SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 220; Noel B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: a "Revolutionary" Approach to Ownership*, 47 TAX L. REV. 725, 801 (1992) (explaining investment aspect of purchasing home); Deborah A. Geier, *Tufts and the Evolution of Debt-discharge Theory* 1 FLA. TAX REV. 115, 181 n.195 (1992) (applying potential implications of casualty loss of home investment); Daniel Halperin, *Valuing Personal Consumption: Cost Versus Value and the Impact of Insurance*, 1 FLA. TAX REV. 1, 27–28 (1992) (discussing gains and losses associated with home investments); J. B. McCombs, *Refining the Itemized Deduction for Home Property Tax Payments*, 44 VAND. L. REV. 317, 328 (1991) (describing purposes for buying a home); *cf*. Julia Patterson Forrester, *Mortgaging the American Dream: a Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 377 n.16 (1994) (discussing consumer or investment debt may arise from home improvement loan depending on whether debtor intended to live in home or make it more marketable); Harriet Thomas Ivy, Comment, *Means Testing under the Bankruptcy Reform Act of 1999: a Flawed Means to a Questionable End*, 17 BANKR. DEV. J. 221, 223 n. 9 (2000) (stating same). *But see* Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CALIF. L. REV. 569, 618 n.145 (1984) (arguing homeowners have primarily consumption rather than investment motive in purchasing home and are therefore less likely to rely on Fifth Amendment "insurance" and over-invest in property likely to be "taken"); David J. Shakow, *Taxation Without Realization: a Proposal for Accrual Taxation*, 134 U. PA. L. REV. 1111, 1166 (1986) (arguing accrual taxation of reduction in liabilities would affect elastic choice of home ownership because "decision to buy a home, and thus to borrow for that purpose, is much more a consumption decision than an investment decision.").

[86] In 2001, the National Association of Realtors reported existing home sales also set a record of 5,251,000 homes, up 2.7 percent from the 5,113,000 sold in 2000. Assuming about 65 million owner-occupied homes in America, approximately eight percent of all homeowners sold their homes in 2001. United States Department of Housing and Urban Development, *U.S. Housing Market Conditions Summary, available at* htttp://www.huduser.org/periodicals/ushmc/winter2001/summary.html (last visited March 22, 2002).

[87] 11 U.S.C. § 101(30) (2000). Certainly the notion of "regular income" carries with it the notion of periodicity condemned by Simons. However, the administration of chapter XIII cases would indeed be difficult if all of the debtor's income were sporadic. Assuming it is not unreasonable, therefore, to require regularity, the term income remains, as does the need to define it.

[88] *In re* Rebeor, 89 B.R. 314, 322 (Bankr. N.D.N.Y. 1988).

[89] *In re* Moore, 17 B.R. 551, 553 (Bankr. M.D. Fla. 1982).

[90] *Compare In re* Antoine, 208 B.R. 17, 20–21 (Bankr. E.D.N.Y. 1997) (finding individual unemployed debtor's income sufficiently stable and regular to support his chapter 13 plan because debtor's wife was employed full-time and agreed to contribute her entire salary to pay his expenses and obligations under the plan), *with In re* Sigfrid, 161 B.R. 220, 223 (Bankr. D. Minn. 1993) (deciding to conditionally deny confirmation of chapter 13 plan of unemployed debtor who proposed to rely entirely on payments by her non-debtor husband to fund her plan not because contributions were not income but rather because of lack of evidence income to fund plan stable and regular).

[91] *See In re* Baird, 228 B.R. 324, 328 (Bankr. M.D. Fla. 1999) (citing *In re* Rowe, 110 B.R. 712, 718 (Bankr. E.D. Pa. 1990) (finding debtor's monthly receipt of $200 from son was stable and regular income)).

laws.[93] Receipts as diverse as child support payments,[94] business income,[95] and a graduate research stipend[96] support eligibility as "regular income." Public assistance, such as AFDC payments,[97] unemployment benefits,[98] and social security survivor benefits,[99] have all been held to be "regular income." Chapter 13 is not just for wage-earners any more.

Second, in 1984, in response to a perceived surge of bankruptcy filings,[100] Congress imposed positive requirements for the use of income. Under the 1984 amendments, courts may dismiss chapter 7 cases that constitute "substantial abuse" of the provisions of the Bankruptcy Code.[101] Most courts consider "substantial abuse" to consist of seeking relief under chapter 7 liquidation notwithstanding an ability to repay all or a significant portion of one's debts under chapter 13.[102] The effect of this provision is to encourage more debtors to file chapter 13 than chapter 7. Chapter 13 also saw an income-related amendment in 1984. Prior to 1984, the only condition affecting the amount of income required to fund a chapter 13 plan is the so-called "best interests of creditors" or liquidation test; under this test, the amount of income and value of property devoted to payment of allowed unsecured claims under the plan must yield at least as much as they would in a chapter 7 case. To have a plan confirmed after the 1984 amendments, the debtor must commit all "projected disposable income" to the repayment of unsecured debt.[103] Under the so-called "disposable income test,"[104] on an objection by the holder of an allowed unsecured claim or by the trustee, the court is prohibited from confirming a chapter 13 plan unless the debtor devotes all of his or her "disposable income" to the plan

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[92] *See In re* Campbell, 38 B.R. 193, 196 (Bankr. E.D.N.Y. 1984) (holding that, in certain cases, "sufficiently stable and regular" payments by family members can constitute regular income).

[93] *Id.*

[94] *In re* Taylor, 15 B.R. 596, 597–98 (Bankr. D. Ariz. 1981).

[95] *In re* Whitten, 11 B.R. 333, 335 (Bankr. D.D.C. 1981).

[96] *In re* LeMaire, 883 F.2d 1373, 1381 (8th Cir. 1989), *reh'g granted, vacated on other grounds*, 891 F.2d 650 (8th Cir. 1989).

[97] Bibb County. Dept. of Family & Children Servs. v. Hope (*In re* Hammonds), 729 F.2d 1391, 1395 (11th Cir. 1984).

[98] *In re* Overstreet, 23 B.R. 712, 713–14 (Bankr. W.D. La. 1982).

[99] *See In re* Murray, 199 B.R. 165, 166 (Bankr. M.D. Tenn. 1996) (finding no objection by creditor and no statutory bar to debtor's use of social security benefits as regular income in funding proposed repayment plan).

[100] *See, e.g.*, Charles Carter, *The Surge in Bankruptcies: Is the New Law Responsible?* 67 ECON. REV. 1020, 1111 (1982).

[101] 11 U.S.C. § 707(b) (2000).

[102] *See In re* Attanasio, 218 B.R. 180, 184–89 (Bankr. N.D. Ala. 1998) (collecting cases). *See generally* Ted Janger, *Crystals And Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 601 (2001) (defining concealment of assets and ability to pay as "key abuses").

[103] *See* Robert B. Chapman, *Coverture and Cooperation: The Firm, the Market, and the Substantive Consolidation of Married Debtors*, 17 BANKR. DEV. J. 105, 113–14 (2000) (explaining § 1325(b) requirement that debtor devote all disposable income to repayment plan for at least three years).

[104] Unlike the liquidation test, the mandatory nature of section 1325(b) has virtually never been questioned. *See, e.g.*, *In re* Delnero, 191 B.R. 539, 542 (Bankr. N.D.N.Y. 1996). *But see In re* Schyma, 68 B.R. 52, 63 (Bankr. D. Minn. 1985) (stating that § 1325(b) is intended to provide court with "discretionary or permissive power to refuse 'approval' of the plan rather than to mandate denial of confirmation").

for at least three years. Disposable income includes all of the debtor's income not reasonable necessary for the debtor's own support and for the support of the debtor's dependents.

The Bankruptcy Code contains several other provisions that condition relief for consumer debtors on their willingness and ability to repay debts through future income. Even if a debtor may remain in a non-abusive chapter 7 case, the discharge of student loans and of marital property settlements may hinge on ability to repay them.[105] For student loans, "undue hardship" generally means an inability to repay them (from the debtor's income or a spouse's income) without reducing the debtor's standard of living beyond an acceptable minimum.[106] For marital property settlements, the issues are whether the debtor has the ability to pay the debt[107] and whether the harm to the payee of discharging a property settlement outweighs the harm to the debtor of not discharging it;[108] both are measured by income. Finally, bankruptcy courts have interpreted chapter 13's requirement that the debtor not propose a plan in bad faith to impose a requirement that the debtor use certain income to repay debts.[109] In short, the Bankruptcy Code in large part conditions relief for consumer debtors on their "ability to pay" their debts.

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[105] *See In re* Pena, 155 F.3d 1108, 1114 (9th Cir. 1998) (discharging student loan debt based on debtors' lack of employment potential and failed good faith attempt to repay); Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987) (conditioning discharge of student loans due to undue hardship on current and prospective inability to repay).

[106] *See* Ipsen v. Higher Educ. Assist. Found. (*In re* Ipsen), 149 B.R. 583, 585 (Bankr. W.D. Mo. 1992); Lezer v. N.Y.S. Higher Educ. Serv. Co. (*In re* Lezer), 21 B.R. 783, 788 (Bankr. N.D.N.Y. 1982) (using inability to maintain poverty standard of living after repayment as initial test in finding undue hardship); Bagley v. Conn. Student Loan. Found. (*In re* Bagley), 4 B.R. 248, 250–51 (Bankr. D. Ariz. 1980) (stating any reduction in funds necessary to maintenance of minimal standard of life is factor in finding undue hardship).

[107] *See* Gamble v. Gamble (*In re* Gamble), 143 F.3d 223, 226 (5th Cir. 1998) (focusing on debtor's ability to pay divorce property settlement debt in determining dischargeability); Oswald v. Asbill (*In re* Asbill), 236 B.R. 192, 196 (Bankr. D.S.C. 1999) (same); Shea v. Shea (*In re* Shea), 221 B.R. 491, 499–500 (Bankr. D. Minn. 1998) (same); Halper v. Halper (*In re* Halper), 213 B.R. 279, 282–83 (Bankr. D.N.J. 1997) (same); Fitzsimonds v. Haines (*In re* Haines), 210 B.R. 586, 590–91 (Bankr. S.D. Cal. 1997) (same); Custer v. Custer (*In re* Custer), 208 B.R. 675, 682 (Bankr. N.D. Ohio 1997) (same); Beasley v. Adams (*In re* Adams), 200 B.R. 630, 633–34 (N.D. Ill. 1996) (same); Cleveland v. Cleveland (*In re* Cleveland), 198 B.R. 394, 398–99 (Bankr. N.D. Ga. 1996) (same); Morris v. Morris (*In re* Morris), 197 B.R. 236, 243–44 (Bankr. M.D. W. Va. 1996) (same); *In re* Jobe, 197 B.R. 823, 827 (Bankr. W.D. Tex. 1996) (same); *In re* Smither, 194 B.R. 102, 108 (Bankr. W.D. Ky. 1996) (same).

[108] *See In re* Crosswhite, 148 F.3d 879, 883 (7th Cir. 1998) (analyzing whether benefit to debtor outweighs detriment to debtor's former spouse or child in determining dischargeability of property settlement debt under § 523(a)(15)); *In re* Leonard, 231 B.R. 884, 889 (E.D. Pa. 1999) (same); Celani v. Celani (*In re* Celani), 194 B.R. 719, 721 (Bankr. D. Conn. 1996) (same); *see also* Gantz v. Gantz (*In re* Gantz), 192 B.R. 932, 936 (Bankr. N.D. Ill. 1996) (holding new spouse's income may not be considered under § 523(a)(15)(A) but must be considered under subparagraph (B)).

[109] *See In re* Cardillo, 170 B.R. 490, 494 (Bankr. D.N.H. 1994) (finding that debtor's plan was not proposed in good faith based on debtor's failure to apply all of her disposable income to plan); *In re* Kern, 40 B.R. 26, 28–29 (Bankr. S.D.N.Y. 1984) (discussing "mandate of § 1325(a)(3)" that plan be proposed in good faith); *see also* Kitchens v. Georgia Railroad Bank and Trust Co. (*In re* Kitchens), 702 F.2d 885, 888–89 (11th Cir. 1983) (discussing factors in determining debtor's good faith); *In re* Eustus, 695 F.2d 311, 314 (8th Cir. 1982) (discussing that several courts have reasoned that good faith requires substantial or meaningful payment to unsecured creditors).

b. Bankruptcy Code Definitions of Income

The Bankruptcy Code does not contain a definition of income. And it is not clear that the word "income" means the same thing in different sections.[110] Although "income" in the section that defines who is a "family farmer,"[111] for example, means the same as it means in section 61 of the Internal Revenue Code,[112] "income" in chapters 12 and 13 is generally held not to carry the Tax Code definition.[113]

For chapter 13, one relevant statutory definition is that of "individual with regular income," which "means individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title, other than a stockbroker or a commodity broker."[114] The court decisions interpreting the term "regular income" have generally focused more on whether something received will be received regularly and predictably than whether something received is income. This definition modifies but does not assist in elucidating the term "income."

Another relevant definition is of "disposable income," which is relevant in chapter 13 and means "income which is received by the debtor and which is not reasonably necessary to be expended" either for "the maintenance and support of the debtor or a dependent of the debtor" or for "payment of expenditures necessary for the continuation, preservation, and operation of the [the debtor's business]."[115] Calculating disposable income requires two adjustments. First, the income must be disposable, which requires some calculation of the excess of income over allowable expenses. Second, the income and expenses must be predictable. Again, however, the notion of income remains. One judge has criticized this definition as "not very helpful because it defines income by using the very term it purports to define."[116]

The definition of "current monthly income" proposed in recent means-testing amendments similarly avoids defining "income." It would define current monthly

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[110] *Compare In re* Gregerson, 269 B.R. 36, 40 (Bankr. N.D. Iowa 2001) (income for chapter 12 eligibility purposes carries Tax Code meaning), *and In re* Lamb, 209 B.R. 759, 760–61 (Bankr. M.D. Ga. 1997) (stating same), *with In re* Cochran, 141 B.R. 270, 272 (M.D. Ga. 1992) (income for chapter 13 disposable income test is broader than tax definition), *and In re* Martin, 130 B.R. 951, 966 (Bankr. N.D. Iowa 1991) (holding disposable income is not determined by Tax Code measures).

[111] 11 U.S.C. § 101(18)(A) (2000).

[112] *See In re* Wagner, 808 F.2d 542, 547 (7th Cir. 1986) (concluding that "gross income" for purposes of Bankruptcy Code's farmer's exemption from involuntary bankruptcy has same meaning as in Internal Revenue Code).

[113] *See In re* Cochran, 141 B.R. 270, 272 (M.D. Ga. 1992) (concluding that "income" for chapter 13 disposable income test is broader than tax definition); *In re* Martin, 130 B.R. 951, 966 (Bankr. N.D. Iowa 1991) (stating same).

[114] 11 U.S.C. § 101(30) (2000).

[115] *Id*. § 1325(b)(2).

[116] *In re* Stones, 157 B.R. 669, 670 (Bankr. S.D. Cal. 1993) (Adler, J.). Another problem with this definition is that essentially the same definition is used in chapter 12, where, however, it is given a very different meaning. *See* 11 U.S.C. § 1225(b)(2) (defining "disposable income").

income as "the average monthly income from all sources which the debtor, or in a joint case, the debtor and the debtor's spouse, receive" during the six months prior to the dates on which current monthly income is determined; but it would not define "income."[117] The provision has certain modifications that are, unfortunately, not particularly helpful in determining what "income" means. Income is not limited to "taxable income,"[118] although it is not clear whether it would be limited to any other broader categories of income used in tax law, such as constitutional income, gross income, or adjusted gross income. Amounts regularly paid to household expenses would be included, raising the question whether irregular receipts, which would ordinarily be considered income, are excluded by implication. Finally "current monthly income" would exclude Social Security payments and "payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes,"[119] raising the question of what definition of income would encompass such items and would also necessitate the exclusions.[120]

The functioning of the means-testing provisions depends on three very different conceptions of income, drawn from tax law, bankruptcy precedent, and census data. Proposed section 707(b)(2)(C) would require that, as part of the schedule of current income and expenditures, the debtor shall include a statement of "monthly net income" and "the calculations that determine whether a presumption [of abuse] arises."[121] The term "income" in "monthly net income" is not defined but is required to be documented by the debtor's filing with the court either a tax return or tax transcript.[122]

Whether a motion to dismiss may or must be filed turns on a comparison of "current monthly income" (CMI), with respect to which "income" is also undefined, to median family income[123] as determined by the Census Bureau.[124] If the debtor's

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[117] Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 102(b) (1st Sess. 2001) (adding new 11 U.S.C. § 101 (10A)(A)). As of this writing, it appears bankruptcy reform will fail to be enacted during the 107th Congress but is likely to be taken up in substantially the same form in 2003, just as it has in each year since 1997. On the truly bizarre history of bankruptcy reform, *see*Jonathan C. Lipson, *Enron, Asset Securitization and Bankruptcy Reform: Dead or Dormant?*, 11 J. BANKR. L. & PRAC. 101 (2002) (discussing effect of Enron bankruptcy on reform legislation); Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 1–4 (2001) (discussing effects of Senator Jeffords' defection from Republican party and of events of September 11, 2001); Elizabeth Warren, *The Changing Politics of American Bankruptcy Reform*, 37 OSGOODE HALL L.J. 189, 192–96 (1999) (discussing origins of and lobbyists' and professionals' roles in bankruptcy reform during the 1990s).

[118] S. 420, 107th Cong. § 102(b) (adding new 11 U.S.C. § 101 (10A)(A)).

[119] *Id*. (adding new 11 U.S.C. § 101 (10A)(B)).

[120] *See* Douglas A. Kahn, *Compensatory and Punitive Damages for a Personal Injury: To Tax or Not to Tax?*, 2 FLA. TAX REV. 327, 341–47 (1995) (advocating return of capital theory).

[121] S. 420, 107th Cong. § 102(a) (amending 11 U.S.C. § 707(b)(2)(C)) (requiring debtor to file "schedule of current income and expenses"); *see also id*. § 102(b) (amending 11 U.S.C. § 521(1)(B)(v)).

[122] *See id*. (amending 11 U.S.C. § 521(1)(2)(A)).

[123] Empirical bankruptcy experts have noted the significant effect of Congress's choice of median family rather than median household income. Ed Flynn & Gordon Bermant, *Measuring Means-testing: It's All in the Words*, AM. BANKR. INST. J., Sept. 1998, at 1.

[124] It may (or in this case, may not) go without saying that the Census Bureau's Definition of income is merely one of many and has no special claim to "scientific" or "objective" accuracy. Even the Census Bureau acknowledges this.

annualized CMI is less than the median family income, as determined by the Census Bureau, for a family of specified size in the same state, the bankruptcy administrator or U.S. Trustee *may* but need not file a motion to dismiss or convert the case.[125] In this circumstance, no other creditor may seek conversion or dismissal.[126] If the debtor's CMI is enough below the median family income that the debtor's spouse's income does not make up the difference and bring the family income up to the median family income, no one may seek dismissal or conversion.[127] If the debtor's annualized CMI is between 100% and 150% of the median[128] and the presumption of abuse would not exist,[129] the bankruptcy administrator or U.S. Trustee may "decline to file" the motion but must file the statement of reasons for not filing the motion.[130]

If a motion is filed, the court must determine whether a presumption of abuse arises. To do so, the court must calculate CMI. In this calculation, the debtor's income is reduced by the amounts for living expenses allowed by the IRS in determining whether to accept offers in compromise,[131] by amounts expended for family members and chronically ill or disabled household members,[132] private school tuition,[133] by administrative costs,[134] by certain necessary and documented excess expenditures,[135] by a pro rata monthly amount of the debtor's priority debts,[136] and by a pro rata monthly amount of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition"[137] and additional costs for the debtor to retain necessary

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> Traditionally, income and poverty data presented in Census Bureau reports have been based on the amount of money income received during a calendar year before any taxes and excluding capital gains. This definition of income is narrow and does not provide a completely satisfactory measure of the distribution of income. The omission of data on taxes, realized capital gains, and the value of noncash benefits has an effect on comparisons over time and between population subgroups.

U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, MEASURING THE EFFECT OF BENEFITS AND TAXES ON INCOME AND POVERTY 1979 TO 1991, at vii (Current Population Reports, Series P-60, No. 182-RD); *see also* Morton Paglin, *The Underground Economy: New Estimates from Household Income and Expenditure Surveys*, 103 YALE L.J. 2239, 2255–56 (1994) (discussing Census Bureau definition of income); Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 84 (1990) (criticizing empirical scholars of poverty for using data which includes deficient definition of income).

[125] Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 102(c) (1st Sess. 2001) (amending 11 U.S.C. § 704(b)(3)).

[126] *Id*. § 102(a) (adding new 11 U.S.C. § 707(b)(6)).

[127] *Id*. (adding new 11 U.S.C. § 707(b)(7)).

[128] *Id*. § 102(c) (amending 11 U.S.C. § 704(b)(3)(B)).

[129] *Id*. § 102(a) (adding new 11 U.S.C. § 707(b)(3)(A)).

[130] *Id*. § 102(c) (amending 11 U.S.C. § 704(b)(3)).

[131] *Id*. § 102(a) (adding new 11 U.S.C. § 707(b)(2)(A)(i)–(ii)).

[132] *Id*. (adding new § 707(b)(2)(A)(I)(ii)(II)).

[133] *Id*. (adding new § 707(b)(2)(A)(I)(ii)(IV)).

[134] *Id*. (adding new § 707(b)(2)(A)(I)(ii)(III)).

[135] *Id*. (adding new § 707(b)(2)(A)(I)(ii)(V)).

[136] *Id*. (adding new § 707(b)(2)(A)(I)(iv)).

[137] *Id*. (adding new § 707(b)(2)(A)(iii)(I)(aa)). The new section specifies that the debtor's allowable expenses do not include the repayment of debts, which eliminates the possibility of "double-dipping."

collateral (a house and car).[138] A presumption of abuse arises if the resulting number (CMI) is not less than the lesser of either 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000 (whichever is greater), or $10,000.[139] The debtor may rebut the presumption of abuse only "by demonstrating special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative."[140] If the debtor rebuts the presumption of abuse, the court must decide whether to dismiss the case based on whether the debtor filed the petition in "bad faith"[141] or if the "totality of the circumstances of the debtor's financial situation demonstrates abuse."[142] These last provisions almost certainly reinscribe bankruptcy's common law precedent regarding "income."

c. Judicial Definitions of Income

Because "income" is not defined in the Bankruptcy Code, courts have developed a variety of approaches for supplying a definition. Some courts, mostly in the context of chapter 12 eligibility, hold that the term income carries the same definition as in the Tax Code.[143] These courts emphasize the importance of the predictability and certainty provided by the tax definition. Other courts disagree, considering the term "income," as used in the "disposable income" provisions of chapters 12 and 13, to be broader than the tax definition of income.[144] Finally, some courts, in an overtly post-modern move,[145] simply declare that whether a debtor has

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[138] *Id*. (adding new § 707(b)(2)(A)(iii)(I)(bb)).

[139] *Id*. (adding new § 707(b)(2)(A)(i)). By way of illustration, if the debtors CMI is at least $166.67, a presumption of abuse arises regardless of the debtor's nonpriority unsecured claims. If the debtor's CMI is at least $100 per month, a presumption of abuse arises if the debtor's nonpriority unsecured claims do not exceed $24,000. If the debtor's nonpriority unsecured claims exceed $24,000 but do not exceed $40,000, a presumption of abuse arises only if the debtor's CMI, multiplied by 60, is at least one-quarter of the debtor's nonpriority unsecured claims.

[140] *Id*. (adding new 11 U.S.C. § 707(b)(2)(B)(i)).

[141] *Id*. (adding new 11 U.S.C. § 707(b)(3)(A)).

[142] *Id*. (adding new 11 U.S.C. § 707(b)(3)(B)).

[143] *See In re* Wagner, 808 F.2d 542, 549 (7th Cir. 1986) (concluding that definition of gross income in Bankruptcy Code is equivalent to definition in Tax Code in chapter 12 case); *In re* King, 272 B.R. 281, 293 (Bankr. N.D. Okla. 2002) (same); *In re* Gregerson, 269 B.R. 36, 40 (Bankr. N.D. Iowa 2001) (same); *In re* Lamb, 209 B.R. 759, 760–61 (Bankr. M.D. Ga. 1997) (same); *In re* Van Fossan, 82 B.R. 77, 79 (Bankr. W.D. Ark. 1987) (same); *In re* Pratt, 78 B.R. 277, 280 (Bankr. D. Mont. 1987) (same).

[144] *See In re* Cochran, 141 B.R. 270, 272 (M.D. Ga. 1992) (holding tax refund paid to chapter 13 debtor is income under disposable income test of § 1325(b); definition of "income" for tax purposes does not necessarily apply in bankruptcy context); *In re* Martin, 130 B.R. 951, 966 (Bankr. N.D. Iowa 1991) (holding proceeds of life insurance paid to chapter 12 debtor were income under disposable income test; "income" under disposable income test of § 1225(b) not determined by Tax Code approach). As it turns out, the bankruptcy definition of income is, in some ways, considerably narrower than the definition of taxable income in title 26. *See* discussion *infra* Part I.B.2.d.

[145] *See, e.g.*, Stephen M. Feldman, *The Supreme Court in a Postmodern World: A Flying Elephant*, 84 MINN. L. REV. 673, 699–700 (2000) (paraphrasing remarks of Justice Scalia that "even if judges make law, they must pretend to discover it . . . ." (citing James B. Beam Distilling Co. v. Georgia, 501 U.S. 529, 548–49 (1991) (Scalia, J. concurring)). *See generally* Peter C. Schanck, *Understanding Postmodern Thought*

income is to be determined in light of all the facts and circumstances with the "objective of reaching just and equitable results."[146]

Bankruptcy courts generally do not engage in any extended discussion of what does or does not constitute income. As Mr. Corish and Professor Herbert suggest:

> In measuring disposable income and its kindred provisions, the courts can be neatly if simplistically divided into two groups – discharge oriented and collection oriented. The primary concern of the former group is the debtor's fresh start; it is more sensitive to the burdens of bankruptcy. The latter is more concerned with abuses, present or potential, and is more censorious of those whose financial habits have created problems for their creditors as well as themselves.[147]

Because the case law as to the definition of income was "meager" at the time of their writing they devoted only two sentences to the definition of income, concluding courts had defined it broadly as every form of income that was not subject to creditors' attachment.[148] Their emphasis in discussing "disposable income," therefore, was more on which expenses were properly deductible from income in determining disposability. In determining what is or is not income, a pro-collection or pro-discharge bias would certainly be informative and may ultimately be determinative; however, as Corish and Herbert observe with respect to expenses, the definition of income may also depend on the extent to which bankruptcy courts' "review of the minutiae of a debtor's financial life become[s] an unwarranted intrusion into personal autonomy," and, in the absence of an "objective" standard for lifestyle, what seems "fair."[149] Finally, it may turn on an understanding of and dichotomy between income and property informed by the "debtor's bargain."

The two income concepts most crucial to chapter 13 – "regular income" and "disposable income" – serve important functions. Loosely, the first limits chapter 13 eligibility to those who may conceivably be able to fund a chapter 13 plan. The second, also loosely, requires the debtor to turn over to the trustee accretions to wealth, which the trustee can pay to creditors. Each is based, more or less, on the debtor's ability to pay debts. Interpreting the term "income" according to function, another provision may throw some light on the definition of "income" in consumer bankruptcy cases. Section 1322(a)(1) requires that a plan shall "provide for the submission of all or such portion of future earnings or other future income of the

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and Its Implications for Statutory Interpretation, 65 S. CAL. L. REV. 2505, 2508–09 (1992) (providing brief overview of postmodern school of thought in legal scholarship).

[146] *In re* Rott, 73 B.R. 366, 371–72 (Bankr. D.N.D. 1987); *accord In re* Gage, 159 B.R. 272, 280 (Bankr. D.S.D. 1993).

[147] Joseph P. Corish and Michael J. Herbert, *The Debtor's Dilemma: Disposable Income as The Cost of Chapter 13 Discharge in Consumer Bankruptcy*, 47 LA. L. REV. 47, 62 (1986).

[148] *Id.* at 63.

[149] *Id.* at 82.

debtor to the supervision and control of the trustee as is necessary for the execution of the plan." This requirement seems to contemplate that income is something that can be submitted to the trustee's supervision and control, that is, turned over to the trustee. Unrealized appreciation, in-kind income, income from services received, and cancellation of indebtedness income cannot readily be submitted to anyone; money, however, can be. Most courts seem unwilling, however, to limit "income" to money received[150] but they reach a variety of results on other forms of income. Courts differ as to whether income includes unrealized appreciation,[151] the value of services received,[152] and even gain from the sale of assets.[153] The remainder of this article addresses the inconsistency and preferences in bankruptcy courts' treatment of income from property by comparing reported decisions to the Haig-Simons "ideal."

d. Axes to Grind: Judicial Definitions of Income

There are several other axes of analysis to consider how bankruptcy courts define income.[154] One is whether income is exempt or non-exempt. Most bankruptcy courts hold that income in chapter 13 cases is property of the estate and must be included in the calculation of ability to pay whether or not the income is

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[150] *See* Berger v. Pokela (*In re* Berger), 61 F.3d 624, 626–27 (8th Cir. 1995) (considering discharge of indebtedness income); *In re* McNichols, 249 B.R. 160, 171 (Bankr. N.D. Ill. 2000) (including within debtor-wife's income her relief from children's expenses contributed by non-debtor husband).

[151] *See* discussion *infra* Part II.A.

[152] *Compare* White v. U.S. Dept. of Educ. (*In re* White), 243 B.R. 498, 510 (Bankr. N.D. Ala. 1999) (imputing to debtor-husband value of his non-debtor wife's market labor), *and In re* Bottelberghe, 253 B.R. 256, 262–63 (Bankr. D. Minn. 2000) (imputing to debtor-spouse the market value of non-debtor spouse's non-market labor), *with In re* Bolger, 1997 WL 851443 at 10 (Bankr. N.D. Ill. 1997) (discussing unemployment status of debtor's wife; court did not impute to debtor potential market earnings of his unemployed non-debtor wife), *and In re* Navarro, 83 B.R. 348, 350 (Bankr. E.D. Pa. 1988) (discussing debtor-spouse's recent unemployment status). *See generally In re* Weiss, 251 B.R. 453, 462–63 (Bankr. E.D. Pa. 2000) (disallowing debtor's expenses for child care and house-cleaning expenses as unnecessary because non-debtor spouse was unemployed and could perform those services at no expense); *In re* Attanasio, 218 B.R. 180, 198 (Bankr. N.D. Ala. 1998) (inquiring, hypothetically, whether bankruptcy courts should grant debtor discharge while unemployed non-debtor spouse is allowed to stay at home); Mechele Dickerson, *To Love, Honor, and (Oh!) Pay: Should Spouses Be Forced to Pay Each Other's Debts?*, 78 B.U. L. REV. 961, 1012–14 (1998) (arguing that debtor's right to relief should be conditioned on "stay-at-home" spouse gaining employment to provide financial support).

[153] *See* discussion *infra* Part II.A.1.

[154] Each of these axes represents a dichotomy. On the use and function of dichotomies, *see generally* JACQUES DERRIDA, DISSEMINATION 4 (Barbara Johnson trans., 1981); TORIL MOI, SEXUAL/TEXTUAL POLITICS (1985); Frances Olsen, *The Sex of Law, in* THE POLITICS OF LAW 453 (David Kairys ed., rev. ed. 1990); Inga Markovits, *Playing the Opposites Game: On Mirjan Damaska's The Faces of Justice and State Authority*, 41 STAN. L. REV. 1313 (1989). The Haig-Simons definition of income would reject each of these dichotomies; it would, however, operate on another dichotomy of market and non-market values. *See* Nancy Staudt, *The Political Economy of Taxation: A Critical Review of a Classic*, 30 L. & SOC'Y REV. 651, 664–65 (1996) (discussing market and non-market activities in tax analysis). *See generally* Frances Olsen, *The Family and the Market: a Study of Ideology and Legal Reform* 96 HARV. L. REV. 1497, 1501 (1983) (describing dichotomy between market and family). Is it possible to engage in non-dichotomous analysis? What is the alternative?

exempt under either state or federal law.[155] Most courts also hold that income must be included in calculating disposable income whether or not it is property of the estate.[156]

Another axis is whether income is regular and periodic or not.[157] Many bankruptcy courts define income as necessarily a "stream of payments,"[158] or at least a substitute for a stream of payments, and thus exclude certain gains from the sale of property.[159] *In re Baker*[160] represents the "stream of payments" approach. In

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[155] *See* Stuart v. Koch (*In re* Koch), 109 F.3d 1285, 1288, 1288 n.3 (8th Cir. 1997) (discussing exempt status of debtor's income in "ability to pay" analysis); *In re* Florida, 268 B.R. 875, 880–81 (Bankr. M.D. Fla. 2001) (rejecting debtor's argument that income from exempt property is not subject to treatment as disposable income); *In re* Stephens, 265 B.R. 335, 338 n.1 (Bankr. M.D. Fla. 2001) (holding that proceeds of debtor's worker's compensation claim were subject to disposable income test); *In re* Tolliver, 257 B.R. 98, 100 (Bankr. M.D. Fla. 2000) (collecting cases holding that exempt income must be considered in disposable income test); *In re* Minor, 177 B.R. 576, 582 (Bankr. E.D. Tenn. 1995) (stating that § 1325(b)(2) makes no exception for exempt income in defining disposable income); *In re* Morse, 164 B.R. 651, 656 (Bankr. E.D. Wash. 1994) (discussing disposable income test in context of § 707(b) determination); *In re* Rogers, 168 B.R. 806, 810 (Bankr. M.D. Ga. 1993) (including exempt naval retirement benefits in disposable income); *In re* Schnabel, 153 B.R. 809, 817–18 (Bankr. N.D. Ill. 1993) (including exempt pension and social security income in disposable income); *see also* United States v. Devall, 704 F.2d 1513, 1515–16 (11th Cir. 1983) (holding debtor with only exempt income eligible for chapter 13). *But see In re* Graham, 258 B.R. 286, 292 (Bankr. M.D. Fla. 2001) (holding debtors were under no obligation to fund plan with personal injury settlement that had been conclusively determined to be exempt and denying trustee's motion for modification); *In re* Hunton, 253 B.R. 580, 582 (Bankr. N.D. Ga. 2000) (holding exempt income is not part of estate and need not be used to fund plan); *In re* Tomasso, 98 B.R. 513, 516 (Bankr. S.D. Cal. 1989) (holding post-petition receipt of personal injury damages were not disposable income because such damages were exempt under California law); *cf. In re* Walker, 153 B.R. 565, 570 (Bankr. D. Ore. 1993) (holding post-petition appreciation realized on sale of residence includable in applying liquidation test as of date of plan as modified; post-petition appreciation inures to benefit of debtor limited only by amount of equity debtor can claim as exempt under state law). *See generally* Robert G. Drummond, *Disposable Income Requirements Under Chapter 13 of the Bankruptcy Code*, 57 MONT. L. REV. 423, 440–41 (1996) (discussing calculation of disposable income).

[156] *See In re* Talley, 240 B.R. 22, 23 (Bankr. D. Neb. 1999) (concluding that revenue from employer-provided deferred compensation plan includable in disposable income although not property of estate); *see also* Freeman v. Schulman (*In re* Freeman), 86 F.3d 478, 481 (6th Cir. 1996) (holding that higher than expected income tax refund was disposable income). *But see In re* Ferretti, 203 B.R. 796, 800 (Bankr. S.D. Fla. 2000) ("The clear language of 11 U.S.C. § 522(c) protects exempt property, regardless of form, from pre-petition debt. This express limitation cannot be ignored for purposes of defining disposable income under 11 U.S.C. § 1325(b)(2).").

[157] *See* I.R.C. § 663(a)(1) (2000) (excluding from trust beneficiary income amounts payable in three or fewer installments).

[158] *See* McDonald v. Burgie (*In re* Burgie), 239 B.R. 406, 410 (B.A.P. 9th Cir. 1999) ("The test [of disposable income] is whether the asset in question is an anticipated stream of payments. If it is a stream of payment, the payments must be included in projected income."); *In re* Profit, 269 B.R. 51, 57 (Bankr. D. Nev. 2001) (discussing "stream of payments" test (citing *In re Burgie*, 239 B.R. at 411)), *rev'd on other grounds*, 283 B.R. 567 (B.A.P. 9th Cir. 2002) (holding debtors had completed plan payments and modification was abuse of discretion because it required plan to exceed 60 months); *In re* Baker, 194 B.R. 881, 885 (Bankr. S.D. Cal. 1996) ("If the exempt asset in question is an anticipated stream of payments, it is included in projected income; if the exempt asset is other than a stream of payments, it is not included.").

[159] *See In re Profit*, 269 B.R. at 57 (stating that proper inquiry under "stream of payment" test is whether assets are income or income substitutes in concluding that proceeds from sale of property were not "future earnings or future income of the debtor." (citing *In re Burgie*, 239 B.R. at 411)). Nonetheless, many courts which follow the periodicity requirement employ the liquidation test of section 1325(a)(4) in such a way in the context of modification that non-periodic income is effectively treated as income. *See generally* 11

Baker, a joint debtor received $53,000 in life insurance proceeds when her debtor-husband died during the first year after plan confirmation. The debtor sought to modify her plan, presumably to reflect the household's decreased income after her husband's death. The trustee opposed the reduction in payments on the basis that the life insurance proceeds were income. The court examined cases holding that debtors' respective receipt of a personal injury settlement and ability to borrow from a pension plan or individual retirement account were not income but receipt of social security benefits were income, and distilled a simple and workable test: "If the exempt asset in question is an anticipated stream of payments, it is included in projected income; if the exempt asset is other than a stream of payments, it is not included."[161] Other courts, however, require the inclusion of "lump sum" payments that take the form of transactional gain,[162] gifts, and inheritances.[163]

The periodicity requirement no doubt derives in part from chapter 13's tradition of capturing the value of debtor's future earnings, which are typically paid periodically, and in part from the requirement under the 1984 amendments that income and disposable income be "projected" into the future. The Fifth and Ninth Circuits have described the method for calculating disposable income in the following general terms: "For practical purposes, this task is usually accomplished by multiplying the debtor's monthly income by 36. Next, the Bankruptcy Court must assess the amount of the debtor's income that is 'disposable.'"[164] Although bankruptcy courts understandably consider income in terms most familiar to them – and the Fifth and Ninth Circuits' statements are doubtless correct – constructing from the regularity of practice a rule that makes regularity or periodicity an essential characteristic of income ignores the very economic equivalence of immediate and deferred payment (assuming the appropriate interest or discount rate) that makes the entire financial sector possible and bankruptcy necessary for

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U.S.C. § 1325(a)(4) (providing that court shall confirm chapter 13 plan if value of property to be distributed on account of each unsecured claim is not less than amount that would be paid if debtor's estate were liquidated under chapter 7).

[160] 194 B.R. 881 (Bankr. S.D. Cal. 1996).

[161] *Id*. at 885. *Contra In re* Minor, 177 B.R. 576, 581 (Bankr. E.D. Tenn. 1995) (requiring debtors to fund plan with exempt "lump sum" workers' compensation award). The court did not consider the insurance products which pay the survivor in the form of an annuity or other deferred arrangement. Although virtually equivalent to a lump sum payment, such periodic payments would be excluded if *In re Baker*'s reasoning is taken at face value. The existence of such products makes *Minor* the more coherent decision (although *Minor* is perhaps objectionable for treating a return of human capital as income).

[162] *See, e.g.*, *In re* Surratt, 1996 WL 914095, at *3 (D. Or. 1996) (permitting modification of plan to include nonexempt proceeds from post-confirmation sale of asset); *In re* Solis, 172 B.R. 530, 532 (Bankr. S.D.N.Y. 1994) (permitting modification of plan to include proceeds from post-confirmation sale of debtor's medical practice).

[163] *See, e.g.*, Agribank, FCB v. Honey (*In re* Honey), 167 B.R. 540, 545 (W.D. Mo. 1994) (allowing modification of plan to include post-confirmation inheritance); *In re* Euerle, 70 B.R. 72, 73 (Bankr. D.N.H. 1987) (same); *see also In re* Nott, 269 B.R. 250, 254 (Bankr. M.D. Fla. 2000) (stating, in dicta, that modification was permitted where debtor inherited between $270,000 and $300,000 based on applying § 1325(a)(4) as of date of modification).

[164] Anderson v. Satterlee (*In re* Anderson), 21 F.3d 355, 357 (9th Cir. 1994) (quoting Commercial Credit Corporation v. Killough (*In re* Killough), 900 F.2d 61, 64 (5th Cir. 1990)).

most consumers.[165] Potential examples abound but here is one. Retirement benefits are income to a debtor when received;[166] however, plan participants can elect a lump sum distribution from either defined benefit or defined contribution plans,[167] increasing the amount of income from three years' worth of an annuity to the entire discounted value of an annuity, but the lump sum would not be "income." Courts that follow the "stream of income" requirement should explain the basis of the distinction, which appears to have no basis in logic or economics.[168]

Yet another is the source of the income, where bankruptcy law reflects disparate treatment of income if its source is capital or labor. The capital/income distinction is particularly important where a debtor may be under-investing in capital or labor such that the return on that investment is not fully maximized or is consumed by the debtor. Yet another is whether income is related to the personal or domestic spheres or is related to the business or investment spheres.

Finally, the extent to which a debtor may have control over income affects whether a bankruptcy court may treat an item as income for purposes of bankruptcy law. *Helvering v. Gregory*[169] introduced control as an essential characteristic of income for income tax purposes. Bankruptcy courts consider control, although there are instances in which a debtor may have effective control over income but the courts may decline to characterize it as "income." *Solomon v. Cosby (In re Solomon)*[170] holds that a debtor did not have disposable income in the form of his eligibility and ability to take distributions from his individual retirement account because he did not actually elect to take them.[171] Instead, he chose to defer receipt of the distributions until after his chapter 13 case and the discharge of millions of dollars of potential sexual assault claims against him. Under the common law of tax, his ability to receive those distributions and his effective control over those funds would create income for him; and but for specific Congressional action in amending the Internal Revenue Code to provide that amounts held in an IRA are not

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[165] Assume chapter 13 debtor A owes chapter 13 debtor B on B's claim against A. Under A's plan, A will repay B, along with A's other unsecured creditors, 20% of their claims. A wins the lottery and is clever enough to elect a single, lump sum distribution. Hence, A has no income that would support a modification but does have the resources to pay B the entire amount of the claim as a lump sum. B, whose plan was confirmed later and was required to include in disposable income the distributions to be made from A's plan, also receives a lump sum rather than a stream of payments from A. May B modify her plan based on a reduction in income? Has the "income" become "not income" by virtue of being pre-paid? B would certainly be rebuffed if she claimed A's immediate satisfaction of the deferred payments did not constitute income.

[166] *See* Solomon v. Cosby (*In re* Solomon), 67 F.3d 1128, 1133 (4th Cir. 1995) (holding individual retirement account distributions are income when received); *In re* Morse, 164 B.R. 651, 655 (Bankr. E.D. Wash. 1994) (holding U.S. Army pension and Coast Guard pensions are income); *In re* Rogers, 168 B.R. 806, 810 (Bankr. M.D. Ga. 1993) (holding debtor's U.S. Navy retirement benefits were income).

[167] *See, e.g.*, 26 U.S.C. § 417 (permitting surviving spouse to elect lump sum distribution in lieu of joint and survivor annuity).

[168] *See* Robert G. Drummond, *Disposable Income Requirements Under Chapter 13 of the Bankruptcy Code*, 57 MONT. L. REV. 423, 441 (1996) (characterizing distinction between income from exempt sources and income from proceeds of exempt assets as erroneous).

[169] 69 F.2d 809 (2d Cir. 1934).

[170] 67 F.3d at 1128.

[171] *Id*. at 1132–33.

income until actually received, the ability to access those amounts would be constructive receipt of the income. Although nothing in the Bankruptcy Code parallels the tax rule of deferred recognition until actual receipt, the Fourth Circuit disregarded Dr. Solomon's control over the amounts and declared he had no income. On the other hand, there are instances where a debtor may not have control and yet courts are willing to consider it "income." Bankruptcy courts are frequently willing, therefore, to treat as income of a debtor the earnings or other income of a non-debtor spouse without any concern for whether the debtor may actually gain control over the income.[172] In one such case, the Ninth Circuit Bankruptcy Appellate Panel, drawing on precedents that require exempt funds, which have been removed from the estate, be used to fund a chapter 13 plan, reasoned "[t]he characterization of [the non-debtor wife's] income as property of the estate or not has no impact on the disposable income analysis [in the debtor husband's case]. 'Projected disposable income' is not confined to 'property of the estate.'"[173] The debtor was therefore responsible for the disposal of his wife's income regardless of his degree of control over it.[174]

II. TRANSACTIONAL GAIN

Although the vast majority of consumers' income takes the form of earnings from labor, many debtors have other sources of income. From time to time, for example, a bankrupt strikes it rich and wins the lottery[175] or receives a sizable inheritance.[176] Under the Haig-Simons definition of income, such accretions to wealth would be income. Under section 61 of the Internal Revenue Code, both would be considered "gross income," although gifts and bequests are specifically excluded by section 102. Bankruptcy courts regard lottery winnings as income.[177]

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[172] *See, e.g.*, *In re* Carter, 205 B.R. 733, 736 (Bankr. E.D. Pa. 1996) (holding debtor responsible for submitting portion of non-debtor spouse's income to repayment of debtor's debts); *see also* Albert v. Ohio Student Loan Comm'n (*In re* Albert), 25 B.R. 98 (Bankr. N.D. Ohio 1982), where the court imputed non-debtor spouse's income to debtor spouse, for purposes of dischargeability of student loans, in the face of uncontroverted testimony that debtor and spouse maintained separate expenses. The court stated that "[i]t is not unreasonable to expect that both husband and wife will commingle funds and expenses." *Id*. at 101. *But see In re* Dresser, 33 B.R. 63, 64 (Bankr. D. Me. 1983) (refusing to impute non-debtor wife's income to debtor in determination of debtor's ability to repay student loan because "evidence indicates . . . that the marriage is troubled, and the debtor cannot rely on his wife's income.").

[173] *In re* Hull, 251 B.R. 726, 732 (B.A.P. 9th Cir. 2000).

[174] *Id*. at 733.

[175] Although a debtor's winning the jackpot is certainly cause for all (except perhaps other ticket purchasers) to rejoice the good fortune of the needy, economically unfortunate, or even the financially imprudent, there are other occasions, tragically, in which bankruptcy relief is required for those who have previously won lotteries. *See, e.g.*, *In re* BBL Group, Inc., 205 B.R. 625, 628 (Bankr. N.D. Ala. 1996) (discussing treatment as cash collateral of Maryland lottery annuity which entitled debtor to twenty annual payments of $175,000 each).

[176] *See, e.g.*, *In re* Euerle, 70 B.R. 72, 73 (Bankr. D.N.H. 1987) (explaining that debtor received post-petition testamentary gift from father worth $300,000).

[177] *In re* Cook, 148 B.R. 273, 277 (Bankr. W.D. Mich. 1992) (holding that debtor's future interest in annual lottery payments are part of bankruptcy estate); *In re* Koonce, 54 B.R. 643, 644–45 (Bankr. D.S.C. 1985)

Occasionally, less lucky debtors who have suffered personal injury recover a sum of money deemed by society to equal their loss. Under the Internal Revenue Code, personal injury damages are excluded from income[178] (although it is far from clear why all compensation for such an injury is an accession to wealth such that it would be considered constitutional income).[179] Bankruptcy courts routinely hold that the conversion of a debtor's body and its transformation into money is income to the debtor.[180]

In many cases – inheritance, lottery, or sale of residence – there is a discrepancy between the income the court "projected" as required by section 1325(b) and the actual income received by the debtor.[181] Serious procedural problems arise in the Bankruptcy Code's method of correcting an error in projecting disposable

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(holding where debtor won $1,300,000 lottery jackpot after confirmation of bankruptcy plan, trustee could petition court to modify plan to include winnings as part of estate, effecting full payment of creditors without undue hardship to debtors); s*ee also In re* Meyers, 139 B.R. 858, 860 (Bankr. N.D. Ohio 1992) (holding lottery proceeds are property of the estate); Brown v. Boyn (*In re* Brown), 86 B.R. 944, 947 (N.D. Ind. 1988) (holding lottery winnings, as matter of law and policy, are part of estate). If the rationale for including lottery prizes is actually that they are periodic income, one must wonder whether the debtors' bankruptcy attorney in cases such as *Koonce* and *Cook* should not have advised his clients to opt for a discounted lump sum distribution from the lottery agency; where available and effective, such an election would necessarily defeat the trustee's attempt to grab the prize as "disposable income."

[178] *See* I.R.C. § 104(a)(2) (2000) (providing gross income does not include "the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness . . . .").

[179] Indeed, during the early history of the tax law, amounts subsequently excluded by § 104 and its predecessors were not considered income at all. As *Burke* points out, an award to satisfy lost earnings should be income to the same extent as the earnings themselves. Similarly, if a debtor is compensated for incurring medical expenses, a bankruptcy definition of income that excluded that element of damage could result in a windfall if the debtor kept the recovery but discharged those very unpaid medical debts. On the other hand, it is hard to make the case that damages for pain and suffering are an accession to wealth. *See* F. Patrick Hubbard, *Making People Whole Again: The Constitutionality of Taxing Compensatory Tort Damages For Mental Distress*, 49 FLA. L. REV. 725, 766 (1997) (arguing against taxation of recovery for mental distress on the grounds that "[t]he only way to view this compensation as a gain to the victim is to ignore the reality of the loss suffered by arbitrarily placing a zero basis on the value of psychic well-being."); *see also* Mary L. Heen, *An Alternative Approach to the Taxation of Employment Discrimination Recoveries under Federal Civil Rights Statutes: Income from Human Capital, Realization, and Nonrecogition*, 72 N.C. L. REV. 549, 551–53 (1994) (arguing for exclusion of employment discrimination damages as compensation for loss of human capital).

[180] *See, e.g.*, *In re* Pendleton, 225 B.R. 425, 427 (Bankr. E.D. Ark. 1998) (holding proceeds of debtor's personal injury settlement are properly characterized as disposable income); *In re* Claude, 206 B.R. 374, 380 (Bankr. W.D. Pa. 1997) (holding that personal injury recovery is exempt only to extent necessary for support of debtor or dependents).

[181] *See, e.g.*, *In re* Bass, 267 B.R. 812, 817–19 (Bankr. S.D. Ohio 2001) (discussing actual versus projected income and citing authority and arguments for considering either). *Compare* Rowley v. Yarnall, 22 F.3d 190, 193 (8th Cir. 1994) (holding § 1225(b), which requires debtor to devote "all of the debtor's projected disposable income" to the plan, requires devotion of actual income), *and In re* Gallagher, 1999 WL 33543930 (Bankr. W.D.N.Y. Sept. 13, 1999) (describing practice of requiring debtors who are projected to have probable income increases to submit tax returns and pay actual income into the plan), *with In re* Anderson, 21 F.3d 355, 358 (9th Cir. 1994) (holding § 1325(b), which requires debtor to devote "all of the debtor's projected disposable income" to the plan, does not require devotion of actual income).

income.[182] Apart from the procedural difficulties, however, requests for modification reveal a serious divide among bankruptcy courts as to the definition of income. The divide is so deep, in fact, that it suggests either fundamental conceptual disagreement as to the definition of income or highly varying policy agendas among the various bankruptcy judges.

A Disagreement on the Realization of Transactional Gain

One relatively common form of increase in wealth during bankruptcy is appreciation in the debtor's residence. *The Fragile Middle Class* estimates that about half of all consumer debtors – 650,000 in 1991 – owned their own homes.[183] Chapter 13 debtors occasionally sell appreciated assets – frequently a residence – during their bankruptcy cases. A close examination of reported chapter 13 decisions in which debtors sell appreciated property suggests there is no agreement within bankruptcy on the definition of income. Although courts agree generally that gain cannot be income absent realization, courts disagree as to the effect of realization on gain. Some courts do consider realized post-petition gain to be income.[184] Other courts, however, take the position that the sale of appreciated

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[182] The issues in plan modification are elaborated with considerable clarity in *In re Jacobs*, 263 B.R. 39, 43–50 (Bankr. N.D.N.Y. 2001). Indeed, some of bankruptcy's most intractable problems arise precisely because much of the litigation in bankruptcy hinges on facts which have not yet occurred. Chapter 13 plan confirmation and dismissal of chapter 7 cases both require a projection of the debtor's earnings and expenses over several years. Dismissal or conversion of a chapter 11 case often depends on the likelihood of successful reorganization. Relief from the automatic stay and provision of adequate protection for secured creditors hinges more often than not on anticipated depreciation in property. Additionally, the Code has a variety of error correction methods. A significant change in disposable income which was not anticipated may permit modification of the plan under § 1329. An error in foreseeing depreciation of property and failure of adequate protection may give rise to a "superpriority" administrative expense claim, which may or may not compensate the secured creditor as adequate protection was intended to. Some errors, however, are uncorrectable. *In re* White, 243 B.R. 515 (Bankr. N.D. Ala. 1999), for example, holds that where the court has made a determination of the debtor's ability to repay a student loan, and has included the debtor's spouse's income, but between the date of the evidentiary hearing and the court's entry of the order, the spouse loses her employment, the court will not alter or amend its determination of the debtor's ability to pay. *Id*. at 516, 519.

[183] SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 202. Their 1981 study also found approximately half of all debtors were homeowners. *Id*. at 212; *cf*. Ed Flynn & Gordon Bermant, *The Class of 2000*, AM. BANKR. INST. J., Oct. 2001, at 21 (finding 41.8% of debtors in no-asset chapter in 2000 were homeowners). Reliance on the number of debtors described in *The Fragile Middle Class* is problematic, however, because the authors do not distinguish between cases in which one married debtor files an individual case, two debtors married to each other file individual cases separately, and both spouses file a joint case. I have discussed this issue in more detail elsewhere. *See* Robert B. Chapman, *Missing Persons: Social Science and Accounting for Race, Gender, Class, and Marriage in Bankruptcy*, 76 AM. BANKR. L.J. (forthcoming 2002); Robert B. Chapman, *Coverture and Cooperation: The Firm, the Market, and the Substantive Consolidation of Married Debtors*, 17 BANKR. DEV. J. 105, 134 n.135. Assuming a correlation between marriage and home-ownership, the number of debtors who are home-owners is likely significantly greater than *The Fragile Middle Class* estimates, although the number of homes at stake may actually be slightly lower.

[184] *See In re* Profit, 269 B.R. 51, 59 (Bankr. D. Nev. 2001) (granting trustee's motion to modify chapter 13 plan because post-petition property sales proceeds of debtor must be made available for unsecured creditors), *rev'd*, 283 B.R. 567 (B.A.P. 9th Cir. 2002) (holding debtors had completed plan payments and modification

property does not result in income. And although some courts exclude post-petition realization of appreciation primarily through strictly construing the requirements for modification, there is a general theme among the no-income courts that gain from appreciation during the bankruptcy case is simply not income. Finally, some courts view the possibility of a debtor's retaining the proceeds of appreciated property as implicating issues of good faith.[185]

Although it is a matter of the commonest knowledge that, for tax purposes, realized gain equals amount realized minus adjusted basis, bankruptcy courts have yet to agree on the method for calculating bankruptcy income from the sale or exchange of an asset. If, for example, a debtor sells for $100 property that, during the bankruptcy, has appreciated by $50, there is precedent to consider the debtor's income to be $0, $50, and $100. There is also authority, however, that effectively treats appreciation as income whether the asset is sold or not.

1. Realization criterion: No income unless gain realized

Courts do not treat consumer debtors as accruing income as their property appreciates; as in tax, the appreciation is ignored until the property is sold or exchanged.[186] *In re Trumbas*[187] represents the application of the realization criterion

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was abuse of discretion because it required plan to exceed 60 months); *In re* Barbosa, 236 B.R. 540, 556 (Bankr. D. Mass. 1999) (holding because Congress' intent was to encourage chapter 13 debtors to repay their debts to best of their abilities, it would be unjust to allow debtors to retain gain in lieu of satisfying unsecured claims), *aff'd*, 235 F.3d 31 (1st Cir. 2000); *see also In re* Kerr, 199 B.R. 370, 374–75 (Bankr. N.D. Ill. 1996) (suggesting non-exempt portion of proceeds from sale of appreciated assets would be includable in disposable income calculation); *In re* Suratt, No. 95-6183-HO, 1996 WL 914095, at *3 (D. Or. 1996) (holding that § 1329(a) is intended to protect rights of creditor to debtor's increased post-confirmation income where, as here, debtor has proceeds of sale from property that has increased in value); *In re* Solis, 172 B.R. 530, 533 (Bankr. S.D.N.Y. 1994) (holding chapter 13 debtor's receipt of $40,000 an "unanticipated" and "substantial" change in circumstances, warranting modification of plan pursuant to § 1329, to increase payment to unsecured creditors, and prevent bad-faith windfall to creditor).

[185] *E.g.*, *In re* Barbosa, 236 B.R. 540, 552 (Bankr. D. Mass. 1999), *aff'd*, 243 B.R. 562 (D. Mass.), *aff'd*, 235 F.3d 31 (1st Cir. 2000). *But cf.* Educ. Assist. Corp. v. Zellner, 827 F.2d 1222, 1227 (8th Cir. 1987) (holding that, after enactment of § 1325(b), "our inquiry into whether the plan 'constitutes an abuse of the provisions, purpose or spirit of Chapter 13' has a more narrow focus" and does not address "ability to pay") (citation omitted); *In re* Smith, 848 F.2d 813, 820 (7th Cir. 1988) (stating that enactment of "disposable income" test removes "ability to pay" from the question of good faith).

[186] Although courts ignore mere changes in value over time for purposes of determining whether the debtor has income, they are extremely attentive to precisely the same issue in deciding whether to grant relief from the automatic stay. Courts are certainly capable of making current determinations of appreciation and depreciation to determine whether to lift the stay, *e.g.*, *In re* Westchase I Assocs., L.P., 119 B.R. 521, 525 (Bankr. W.D.N.C. 1990) (refusing relief from stay where secured creditor was over secured, and property was both appreciating and necessary for successful reorganization), and in determining the amount of payments required for adequate protection. *See In re* Farmer, 257 B.R. 556, 561 (Bankr. D. Mont. 2000) (projecting continuation of straight-line depreciation); *In re* Cook, 205 B.R. 437, 440–41 (Bank. N.D. Fla. 1997) (using average decline in value per NADA bluebook). *See generally In re* Timbers of Inwood Forest Assocs., Ltd., 793 F. 2d 1380, 1396–97 (5th Cir. 1986) (discussing legislative history of proposed § 361 of Bankruptcy Reform Act of 1978), *aff'd*, United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd. (*In re* Timbers of Inwood Forest Assocs., Ltd.), 484 U.S. 365 (1988).

[187] 245 B.R. 764 (Bankr. D. Mass. 2000).

within bankruptcy. The debtor owned a house that she scheduled as having a value of $35,000 when she filed her petition. A few months after her case commenced, she and the Federal National Mortgage Association (which held a mortgage on the property to secure indebtedness of $180,737.57) stipulated that the value was $40,000. Four years after her plan was confirmed, she filed and withdrew a motion for authority to incur secured debt by borrowing $104,000 secured by her house, which she then represented had a fair market value of $131,000. Fannie Mae, which held a secured claim of $40,000 and an unsecured claim in the amount of $140,737.57, filed a motion to require the debtor to modify her plan to reflect her "windfall" of $96,000 and to devote that income to repayment of secured and unsecured creditors.

The court denied Fannie Mae's motion, relying in part on Fannie Mae's not meeting the requirements for modification and in part on what the court perceived to be the appropriate policy toward the honest and diligent debtor. Post-petition appreciation, the court observed, was foreseeable when the court confirmed the plan and Fannie Mae was required, therefore, to address the issue at that time.[188] Moreover, the debtor had made 57 out of 60 payments under her plan and should not be required "to incur new debt or sell her home as a condition precedent to obtaining her discharge."[189]

However, the court also addressed two issues more directly relevant to the bankruptcy definition of income. First, the court rejected what it considered the "absurd result that a Chapter 13 debtor could be required by consecutive motions from unsecured claim holders to continuously modify the confirmed plan if the debtor owns an asset that appreciates after confirmation of each modified plan."[190] Certainly, the realization criterion serves the function of pretermitting Zeno's paradoxes; so, however, does, for example, the requirement in tax law that holders of commodities futures mark to market only annually and not continuously.[191]

The second issue, however, is more at the heart of the bankruptcy definition of income. Despite the court's admonition that Fannie Mae should have attempted to address the foreseeable issue of post-confirmation appreciation prior to confirmation, the court betrays that it would not have responded favorably to such a course of action. In the next identical case, were Fannie Mae to object to confirmation on the grounds that this very foreseeable appreciation should be treated as projected disposable income and must therefore be devoted to repaying unsecured claims, the court would overrule the objection. In discussing Fannie Mae's characterization of the appreciation as a windfall, the court makes several points. First, the court rejects the pejorative term "windfall" because, as it states

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[188] *Id*. at 767 n.7.
[189] *Id*. at 767.
[190] *Id*. (quoting KEITH M. LUNDIN, 2 CHAPTER 13 BANKRUPTCY 6–132 (1996)).
[191] The word "absurd," therefore, is perhaps technically accurate but somewhat hyperbolic. The paradox of the stadia could theoretically arise, depending on how fast creditors could file their motions, but there are perhaps methods of addressing the question which fall short of a flat prohibition.

elsewhere, the appreciation was not unexpected.[192] Second, the debtor has not realized any income because she has not sold the house.

Third, however, the court suggests that realization might not result in income at all. "The change in value standing alone is simply an incident of ownership. It does not affect the Debtor's ability to pay based on her future earnings because *the Debtor has not experienced any change in income*."[193] By the same token, however, the realization of proceeds does not mean the debtor has income; exchanging property of a certain value for dollars of equal value cannot be said, in itself, to be a gain.[194] The income, if any, must be attributable to the appreciation.[195] The *Trumbas* court suggests that appreciation cannot be income because the debtor owns it just as she owns the property; this, however, is precisely what makes it income.

Perhaps a more plausible reading of the sentence just quoted is that sections 1325 and 1329 comprehend realized gain but do not contemplate requiring a debtor to treat any portion of unrealized gain as "disposable." Under this reading, *Trumbas* would stand simply for a policy choice in favor of the realization criterion; indeed, the court states that "the fact that the Debtor has not realized proceeds from the appreciation on her home . . . is determinative."[196] However, finding in *Trumbas* a reflection of a realization criterion in bankruptcy law is problematized by the holdings of several courts that even realized gains from post-petition appreciation are not included within the definition of income.

2. Applying the realization criterion: How much gain is income?

a. Realized gain is not income

The leading case holding that realized gain is not income is *In re Burgie*,[197] in which the Ninth Circuit Bankruptcy Appellate Panel held that post-petition gains are not income. Five days after the debtors' plan was confirmed, they sold their

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[192] *In re* Trumbas 245 B.R. at 767 n.6.

[193] *Id*. (emphasis added); *see also In re* Sounakhene, 249 B.R. 801, 806 (Bankr. S.D. Cal. 2000) (denying trustee's motion to modify confirmed plan to provide funds obtained from mortgage refinancing must be applied to plan payments, although not specifying whether refinancing was accomplished by securing indebtedness with equity existing as of effective date of plan or subsequent appreciation).

[194] *See In re* Jacobs, 263 B.R. 39, 48 (Bankr. N.D.N.Y. 2001) (holding appreciated assets cannot become post-petition income by virtue of their transmutation into cash). The Supreme Court recognized this long before it developed much of a theory of income. *See, e.g.*, Doyle v. Mitchell Bros., 247 U.S. 179, 185 (1918) (stating mere conversion of capital assets are not to be treated as income).

[195] *See, e.g.*, *Doyle*, 247 U.S. at 185.

[196] *In re* Trumbas, 245 B.R. 764, 767 n.6 (Bankr. D. Mass. 2000). Curiously, however, the *Trumbas* court observes that appreciation could have been anticipated and the confirmed plan, therefore, could not be modified: "That the Debtor's home would increase in value was foreseeable when the Court confirmed the Debtor's plan in 1995." *Id*. at 767. If appreciation is what should have been anticipated (and therefore projected), it would seem appreciation would be income. If only the sale of the home could produce income, the sale would have to be foreseeable; if unrealized appreciation is not income, it would not matter whether it could be anticipated or not.

[197] 239 B.R. 406 (B.A.P. 9th Cir. 1999).

home. They had claimed a homestead exemption in their home of $44,313, which suggests this was the amount of their equity at the time.[198] When they sold the home, however, they received proceeds of $63,000 in excess of their first and second mortgages and costs of the sale. They reinvested $43,000 as down payment for a new home; the trustee first characterized all of the proceeds as income but on appeal characterized only the remaining $20,000 as income. Assuming the debtors' acquisition price was equal to the mortgages they paid off on sale, the entire $63,000 would ordinarily be considered gain for tax purposes. Assuming, however, that the debtors' valuation as of the petition date was correct, the amount of post-petition appreciation would be approximately $20,000.[199]

The bankruptcy appellate panel held that none of the proceeds were income for purposes of the disposable income test. In a sentence that mixes categories wonderfully, the court stated: "A debtor's pre-petition homestead is a capital asset, not post-petition income."[200] Because chapter 13 debtors are entitled to keep their pre-petition property, the court suggests, and because creditors are entitled to receive the liquidation value of non-exempt assets as of the effective date of the plan, subsequent appreciation in pre-petition assets is not income the debtors must use for those creditors; this, according to the court, is the "debtor's bargain."

The *Burgie* court's reasoning is premised on a view of income, similar to that of the *Periodizitäts-* and *Quellentheoretiker* that Simons criticized,[201] that requires it to be periodic or repetitive to be income. The court specifies that "[o]nly regular income or substitutes therefor can be counted in the determination of disposable income."[202] In a proceeding that developed around the idea of income as wages, and expended to include other fixed or determinable periodic receipts, it is not surprising to find a court employing a notion of income so at odds with the theoretically ideal one.

The court characterizes the case law as developing what it called the "lump sum doctrine": "If it is a stream of payments, the payments must be included in projected income. If the asset is not a stream of payments, it is not included."[203] In doing so,

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[198] *Id*. at 408. *See generally* NEV. REV. STAT. § 115.010(1)-(2) (2001) (providing homestead exemption of up to $125,000 of owners' equity under Nevada statute).

[199] It appears the parties may have operated on an assumption, analogous to old section 1034, that gain from the sale of a residence should not include the amount of the proceeds that are reinvested in a new residence. Alternatively, the court may have employed a concept of income, similar to that found in a consumption or cash-flow tax, in which investment proceeds that are reinvested are not counted as income. *See e.g.*, William D. Andrews, *A Consumption-Type of Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1149 (1974). Applying such a cash flow concept would seem anomalous in chapter 13, in which debtors' reasonable consumption is exempt and in which amounts debtors might save or invest are generally subject to chapter 13's "one hundred per cent tax."

[200] *In re Burgie*, 239 B.R. at 410; *cf*. Shelley v. Kendall (*In re* Shelley), 184 B.R. 356, 359 (B.A.P. 9th Cir. 1995) (explaining that simply acquiring inventory is not enough to produce income; "[c]osts such as rent, payroll, and other expenses are necessary to transform inventory into income.").

[201] *See* SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 65–80 (discussing theories found in German scholarship).

[202] *In re* Burgie, 239 B.R. at 410.

[203] *Id*.

the BAP ignored cases holding inheritances to be disposable income[204] and also ignored cases holding at least some transactional gain is disposable income.[205]

Alternatively, *Burgie*'s reasoning may be premised on a notion of income somehow inhering in things rather than income as a personal attribute.[206] Indeed, *Burgie*'s holding represents an extreme extension of the now-repudiated statement in *Eisner v. Macomber*[207] that "enrichment through increase in value of capital investment is not income in any proper meaning of the term."[208] It simply eliminates the relevance of the value's being severed, which is logical enough, because if gain in value is not income, the exchange of two properties of equal value (a house and money) should not be income either. Eliminating both unrealized and realized gain eliminates income from capital entirely from the concept of income.

In re Euler[209] makes quite clear the elimination of income from capital. The debtors filed a chapter 13 petition, listing a townhouse valued at $142,000 and securing a debt of about $127,000. Within the last few months of the plan period, the debtors sought authority to sell the property for $207,000, which, after paying off their mortgage debt, would leave them with about $60,000 in net proceeds. They sought to pay the remaining $4644 required under the plan (which provided their unsecured creditors with a 42% dividend) and to retain the balance of the net proceeds. The trustee objected, arguing that the plan should be modified to require full repayment of unsecured creditors.

The court observed that the plan did not provide for the submission of sale proceeds to the trustee.[210] The court also noted, however, that the debtors could not have been required to provide for sale proceeds or unrealized appreciation.[211] Taking account of unrealized appreciation, the court held, would lead to the "absurd result" of continuous modifications that *Trumbas* feared.[212] Taking account of future proceeds would rob the debtor of the exclusive right to propose a plan that deals

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[204] *See, e.g.*, *In re* Agribank, FCB v. Honey (*In re* Honey), 167 B.R. 540, 545 (W.D. Mo. 1994) (holding debtors' right to inheritance constitutes disposable income which creditors are entitled to reach in satisfaction of unsecured claims); *In re* Euerle, 70 B.R. 72, 73 (Bankr. D.N.H. 1987) (stating inheritance received by debtor became property of estate obligating debtor to advise trustee of receipt of inheritance and to file supplemental schedule listing additional asset); *see also In re* Nott, 269 B.R. 250, 258 (Bankr. M.D. Fla. 2000) (stating, in dicta, that modification was permitted based on application of § 1325(a)(4) as of date of modification where debtor inherited between $270,000 and $300,000).

[205] *See, e.g.*, *In re* Surratt, 1996 WL 914095, at *3 (D. Or. 1996) (permitting modification of plan to include nonexempt proceeds from post-confirmation sale of asset); *In re* Solis, 172 B.R. 530, 532 (Bankr. S.D.N.Y. 1994) (permitting modification of plan to include proceeds from post-confirmation sale of debtor's medical practice).

[206] *See* SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 78–79 (discussing that personal income "cannot be defined apart from the circumstances of individuals.").

[207] 252 U.S. 189 (1920)

[208] *Id*. at 214–15 (1920); s*ee also* Meyer Jewelry Co. v. Comm'r, 3 B.T.A. 1319, 1322–23 (1926) (citing *Eisner*, 252 U.S. at 214–15).

[209] 251 B.R. 740 (Bankr. M.D. Fla. 2000).

[210] *Id.* at 745.

[211] *Id*.; *see also* Anderson v. Satterlee (*In re* Anderson), 21 F.3d 355, 358 (9th Cir. 1994) (rejecting Trustee's attempt to impose more burdensome requirement on debtor's plan as prerequisite to confirmation).

[212] *In re* Euler, 251 B.R. at 745.

with the debtor's assets.[213] The plan, as originally confirmed, did not address and did not need to address the future sale of property.

The court then proceeded to discuss the requirements for modification of a plan, holding that an unanticipated change is a prerequisite to modification.[214] The court stated the issue in *Euler*, therefore, as "whether or not it could have been reasonably anticipated that the debtor's non-exempt homestead real estate could appreciate over the 32 months of the Debtor's plan."[215] Because "[i]n a market economy, real estate values do indeed fluctuate and may well increase,"[216] any increase in value could have been anticipated. The court held, therefore, that the any increases in the value of property were foreseeable *as a matter of law*.[217] The court continued that the situation in which property increases in value is "easily distinguishable" from other cases of, for example, lottery winnings, inheritance, or an unanticipated "substantial income increase,"[218] as in *In re Arnold*.[219]

In *Arnold*, the debtor, whose income derived solely from sales commissions, experienced an increase from $80,000 per year at the inception of the plan to $200,000 per year during the plan period. The Court of Appeals, which affirmed the bankruptcy court's modification of Arnold's plan, concluded: "Here, there has been a substantial change (from $80,000 to $200,000 per year) that *must be considered* unanticipated."[220] The court seems to suggest the relative size of the increase mattered. The court acknowledges that earnings also fluctuate but has a different view on an increase in earnings from labor from the view *Euler* takes of an increase in the value of property.[221] In *Arnold*, the degree of fluctuation matters to whether it can be considered unanticipated. In *Euler*, however, all fluctuation is foreseeable.

Another difference between *Euler* and *Arnold* – and perhaps (to the extent the cases yield ready generalizations) in the treatment of income from labor and income from capital – is the consequences of the foreseeability of those fluctuations. In *Arnold*, the Court of Appeals states: "If it was anticipated, Arnold's expectations

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[213] *Id*.

[214] *Id*. at 746.

[215] *Id*. at 747.

[216] *Id*. (quoting *In re* Fitak, 121 B.R. 224, 228 (S.D. Ohio 1990)). Although I am not inclined to dispute this statement, I do raise the question what category of statement this is for evidentiary purposes. Is this a case-specific fact that would require factual testimony? Or is it a trans-case fact that might require expert testimony? Does it rest on fact or opinion? Is it indisputable, such that it might be subject to judicial notice? Is it a statement of law?

[217] *In re* Euler, 251 B.R. at 747.

[218] The fact that the court chose to characterize the facts of *Arnold* in this fashion—a "substantial income increase"—suggests the court simply viewed income as limited to earnings, which easily disposes of transaction gain.

[219] *In re* Arnold, 869 F.2d 240 (4th Cir. 1989).

[220] *Id*. at 243 (4th Cir. 1989) (emphasis added).

[221] What is anticipated or unanticipated is sometimes truly bizarre. Collier v. Valley Fed. Sav. Bank (*In re* Collier), 198 B.R. 816, 817 (Bankr. N.D. Ala. 1996), holds that insurance proceeds are unanticipated. In a "risk society," however, there are few things which are as meticulously calculated as the precise possibility that an insured will collect on an insurance policy.

should have been disclosed to the bankruptcy court before the original 36 month, $800 per month plan was confirmed."[222] *Arnold* imposes the burden on the debtor to disclose and include the foreseeable increase in the plan. In *Euler*, however, the inherently foreseeable fluctuations of a market economy do not require a debtor to disclose and include the anticipated appreciation in property. The reason for the distinction can only be that the appreciation is simply not income, in which case not only is foreseeability irrelevant but the court's discussion is entirely circular.

Foreseeability does not, in fact, matter under the logic of *Euler*. If the appreciation could have been foreseen, the debtor could not have been required to devote the gain to the plan. If the appreciation could not have been foreseen, such that modification might be appropriate, foreseeability would not matter because, as the court explains, the proceeds simply are not income. The discussion of foreseeability, therefore, is a canard.

Euler is not about the foreseeability of income; rather, it is about the definition of income. In *Euler*, the court accepted the reasoning of *Trumbas* – a "change in value standing alone is just an incident of ownership" and is therefore not income. But *Euler* goes further. Having established that appreciation is not income, it then rejects realization as income. It follows *Burgie* and states: "A debtor's post-petition real estate is a capital asset – not post-petition income." Realization alone does not result in income because the proceeds are merely a substitute for an asset of equal value to the proceeds. As *In re Jacobs*[223] states: "[A]n asset is just that, an asset, and cannot become post-petition income by virtue of its transmutation into cash."[224] Accepting these two propositions, *Euler* must be correct when it quotes *Burgie*: "The proceeds of the sale of a debtor's real estate can never become disposable income for purposes of chapter 13." By separating the senses of income as gain and as realization, these courts are able to eliminate either and whipsaw the trustee and unsecured creditors.[225] Having eliminated both gain and realization as sufficient

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[222] *In re Arnold*, 869 F.2d at 243.

[223] 263 B.R. 39 (Bankr. N.D.N.Y. 2001).

[224] *Id*. at 48.

[225] The etymology of income suggests the tension between realization and gain has existed in usage of the term for centuries. The earliest English usage of the term as a noun is to mean simply "coming in, entrance, arrival, advent." OXFORD ENGLISH DICTIONARY. The editors of the *Oxford English Dictionary* adduce works by Shakespeare and Chapman, for example, to show this usage at the turn of the seventeenth century. This usage would encompass the arrival of a child, or the receiving of an argument, JEREMY TAYLOR, THE REAL PRESENCE AND SPIRITUALLY OF CHRIST IN THE BLESSED SACRAMENT PROVED, AGAINST THE DOCTRINE OF TRANSUBSTANTIATION 23 (1654), or even immigrants, who in the sixteenth century were called "alienes or incommes." JOHANN BOEMUS, THE FARDLE OF FACIOUS CONTEINING THE AUNCIENTE MANERS, CUSTOMES AND LAWS, OF THE PEOPLES ENHABITING THE TWO PARTES OF THE EARTH, CALLED AFFRICKE AND ASIE, (William Waterman trans., 1555). This meaning is consistent with the notion of realization or gross proceeds. That income can also mean net proceeds, the *Oxford English Dictionary* editors offer the following quotation, taken from the 1802 edition of The Medical and Physical Journal: "Income, in its usual acceptance, is a loose and vague term; it applies equally to gross receipts and to net produce: But when the Legislature had limited it to be synonymous with profits and gains, it became as clear and precise as any other word." The idea that income is something "in addition" is also reflected in early usage. William Golding used the term as synonymous with "overplus." JOHN CALVIN, THE SERMONS OF M.

conditions for the existence of income – and not considering them together – there is nothing left to justify treating transactional gain as income. Transactional gain, therefore, can never be income.

Euler adds one other angle to this: that the realized gain is not income because it is instead merely an "indicia of ownership" and reflects the "debtor's bargain." The debtor is entitled, according to *Euler*, to the benefit of any post-petition appreciation just as she must bear the effect of any post-petition depreciation; that is, it is not income because the debtor is "entitled" to it.[226] The debtor owns it. *In re Richardson* elaborates this idea, saying, "Chapter 13 does not authorize collection, liquidation, and distribution of property."[227] Curiously, however, section 1325(c) specifically provides that any entity from which the debtor receives income can be ordered to pay it to the trustee. If the transactional gain were income, the court would have specific authority to require the buyer to pay some or all of the proceeds to the trustee, contingent *solely* on the presence of income. Section 1325(c) must not apply, therefore, because the debtor's profit on the sale is, according to these courts, simply not income.

There are two problems raised by *Euler*'s rather odd argument that transactional gain is not income because the debtor is "entitled" to it. First, ownership, control, or some form of entitlement of some value ordinarily is necessary for someone to have income.[228] To state the matter very loosely, the fact that the debtor owns it is part of what makes it income. It seems unusual to deny the existence of income because it belongs to the debtor.

Indeed, the debtor no doubt "owns" her labor – the efforts of her body – as much as she owns any property. The second problem, however, is that courts do not seem to have any difficulty characterizing as income money that belongs to the debtor and that is earned from her own labor. Nor do they balk at requiring it be turned over to the trustee. Earnings from personal services are value to which the debtor is entitled – but is nevertheless obligated to devote to the plan because they are income.

Second, the logic of *Euler*, *Burgie*, and *Jacobs* would likely be rejected in a number of counterexamples. Assume a chapter 13 debtor who runs a "mom and pop" (or a "mom or pop") store as a sole proprietorship. The income from the store would certainly be included in the disposable income calculation, less "the payment of expenditures necessary for the continuation, preservation, and operation of such business."[229] If the debtor sells inventory, should she be required to include the net

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[226] *In re* Euler, 251 B.R. 740, 747 (Bankr. M.D. Fla. 2000) (quoting *In re* Meeks, 237 B.R. 856, 861 (Bankr. M.D. Fla. 1999)); *see also, e.g.*, *In re* Moore, 188 B.R. 671, 676 (Bankr. D. Idaho 1995).

[227] *In re* Richardson, 283 B.R. 783, 792 (Bankr. D. Kan. Oct. 8, 2002) (discussing EconoLube N' Tune, Inc. v. Frausto (*In re* Frausto), 259 B.R. 201 (Bankr. N.D. Ala. 2000)).

[228] *Glenshaw Glass*, for example, defines income as "undeniable accessions to wealth, clearly realized, and *over which the taxpayers have complete dominion*." Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 429–30 (1955) (emphasis added).

[229] 11 U.S.C. § 1325(b)(2)(B) (2000).

proceeds of inventory sales, less either the cost of goods sold or the cost of replacing the inventory? Or should debtor be able to assert that the sale of property can never result in disposable income?[230] It seems unlikely a debtor could successfully advance the arguments of *Burgie*, *Euler*, or *Jacobs* in such a case. It seems equally unlikely a debtor engaged in business could succeed with the same argument to avoid paying a marital property debt.[231] Indeed, the same rationale would apply to any pre-petition asset that greatly increases in value post-confirmation.[232] Debtor owns a cause of action and properly schedules the property.[233] There is some likelihood that the debtor will recover. After confirmation, the debtor does, in fact, recover a handsome judgment. Under *Trumbas*, *Burgie*, *Euler*, and *Jacobs*, the mere appreciation in the cause of action is not income, nor is its mere "transmogrification" into cash. Nor would a debtor's pre-petition contest, lottery, or raffle ticket be any more than an asset if it turned out, after confirmation, to be a winner. Neither appreciation nor realization can turn a pre-petition asset into income; the right to retain post-petition appreciation is the basis of the debtor's bargain. The arguments of *Euler* and *Burgie* would likely be considered ridiculous if applied to these other assets. If there is a rationale for preserving certain value in the hands of the debtor – appreciation in a home, for example – it is *in spite of* its being income and not because somehow a clear accession to wealth, clearly realized, over which the debtor has complete dominion, is somehow outside the definition of income.

Nonetheless, other courts have adopted almost identical approaches. Each of the cases suggests realized gain is not income at all; however, each case also turns on whether the gain was reasonably foreseeable at the time of confirmation and the

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[230] The sale of inventory counts in the disposable income calculation in chapter 12 (which, incidentally, is worded identically). *See, e.g.*, Hammrich v. Lovald (*In re* Hammrich), 98 F.3d 388, 390 (8th Cir. 1996) (affirming bankruptcy court's determination that inventory of calves were includable in disposable income calculation).

[231] *See* Spiezio v. Vitek (*In re* Vitek), 271 B.R. 551, 560 (Bankr. S.D. Ohio 2001) (discussing possibility that debtor had the ability to pay marital property settlement through refinancing or sale of property, including inventory). Section 523(a)(15)(A) provides, however, that as part of the "ability to pay" test, the ability to pay is measured with reference to "income *or property* of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business." 11 U.S.C. § 523(a)(15)(A) (2000) (emphasis added).

[232] Courts do not apply the same logic to other substantially appreciated pre-petition assets on which the debtor realizes cash, whether the pre-petition asset is a life insurance policy, *In re* Florida, 268 B.R. 875, 881–82 (Bankr. M.D. Fla. 2001) (requiring debtor to treat proceeds of pre-petition life insurance policy as disposable income), a personal injury claim, *In re* Pendleton, 225 B.R. 425, 427 (Bankr. E.D. Ark. 1998) (holding recovery on pre-petition personal injury claim disposable income); *In re* Studer, 237 B.R. 189, 193 (Bankr. M.D. Fla. 1998) (same); Gaertner v. Claude (*In re* Claude), 206 B.R. 374, 380–381 (Bankr. W.D. Pa. 1997) (same); Watters v. McRoberts (*In re* McRoberts) 167 B.R. 146, 147 (S.D. Ill. 1994) (same), or a pre-petition workers compensation claim. *In re* Tolliver, 257 B.R. 98, 101 (Bankr. M.D. Fla. 2000) (treating as income the proceeds of a pre-petition workers compensation claim); *In re* Lush, 213 B.R. 152, 155 (Bankr. C.D. Ill. 1997) (same).

[233] Courts that apply judicial estoppel to unscheduled claims of the debtor expressly employ the rationale that the cause of action is property. *See, e.g.*, Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1288–89 (11th Cir. 2002).

motion to modify otherwise satisfies procedural requirements. The suggestion that the confirmed plan could be *res judicata* to the treatment of the gain where such gain was anticipated implies that it could have been litigated at the confirmation hearing and that the court *could* decide that projected gain from the future sale of appreciated assets is disposable income.[234] Only one court has addressed the issue of post-petition appreciation before confirmation; *In re James*[235] focuses solely on whether realized post-petition gain must be considered at confirmation but fails to address whether it is income. In *James*, the debtor[236] filed a chapter 13 case and scheduled shares of stock valued at $3,500. Some nine months post-petition but pre-confirmation, the debtor sold the shares and realized $700,000.[237] The trustee objected to the debtor's claim of exemption but the court held the objection was untimely. The trustee also objected to confirmation and the court upheld the objection and denied confirmation because the plan failed to provide creditors with at least as much as a hypothetical liquidation on the effective date of the plan.[238] *James* thus presents the question whether realized gain can be income apart from considerations of *res judicata* or the binding effect of confirmation. Because the court decided the case under section 1325(a)(4), however, the court declined to

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[234] *See, e.g.*, *In re* Jacobs, 263 B.R. 39, 48–49 (Bankr. N.D.N.Y. 2001). *In re Fitak*, 92 B.R. 243 (Bankr. S.D. Ohio 1988), holds that post-confirmation appreciation is foreseeable and therefore, under res judicata and the binding effect of confirmation, cannot be litigated as the basis for a modification of the plan. *Id*. at 250. However, the issue could be raised at the confirmation hearing; indeed, the court suggests, "one might argue that § 1325(b)'s disposable income test requires the devotion to the Plan of all sale proceeds over and above the amount needed to liquidate [the Plan]." *Id*. at 250–51.

This is not to say that claim or issue preclusion is only operative when the claim or issue may be decided either way. Certainly, a claim which fails to state a claim may be barred just as one that does. *See, e.g.*, Froebel v. Meyer, 217 F.3d 928, 939 (7th Cir. 2000); Begala v. PNC Bank, Ohio, Nat. Ass'n, 214 F.3d 776 (6th Cir. 2000); Zingher v. Vt. Div. of Voc. Rehab., 165 F.3d 1015 (2d Cir. 1999). A claim which might have been previously litigated might have resulted in dismissal for failure to state a claim; it would still be previously litigated.

Fitak, however, suggests that an objection to confirmation would require the debtor "automatically to submit all [her] disposable income to the Trustee," *In re Fitak*, 92 B.R. at 251, which further suggests an objection could in fact alter the outcome. It would not be unreasonable to assume the *Fitak* court would be favorably disposed to an objection to confirmation based on projected income from post-confirmation gain. *Jacobs*, however, suggests that even were the objection presented at the earliest opportunity, the court would not incline toward refusing confirmation. *Jacobs*'s view of income, borrowed from *Burgie*, is that "an asset is just that, an asset, and cannot become post-petition income by virtue of its transmutation into cash." *In re Jacobs*, 263 B.R. at 48.

[235] 260 B.R. 368 (Bankr. E.D.N.C. 2001).

[236] *James* was a joint case involving both husband and wife. *See* 11 U.S.C. § 302 (2000) (providing for joint cases for spouses). *See generally* Robert B. Chapman, *Coverture and Cooperation: The Firm, the Market, and the Substantive Consolidation of Married Debtors*, 17 BANKR. DEV. J. 105, 135–40 (2000) (discussing joint cases). Because the property in *James* belonged solely to the husband, 260 B.R. at 369, I have employed the singular case. However, this case provides an illustration of how the amorphous understanding of even the most basic income concepts is complicated in bankruptcy by the equally unclear rules of imputing income between spouses. *See generally* Chapman, *supra* this note, at 114–19, 164–76 (discussing bankruptcy rules and theory in regard to spouses). Although the gain derived from the sale of the debtor-husband's asset, the income was attributed to both the debtor-husband and the debtor-wife. *In re James*, 260 B.R. at 375.

[237] *In re James*, 260 B.R. at 369–70.

[238] *Id*. at 375.

reach the issue whether the gain was income under section 1325(b).[239] To the extent cases like *Burgie* (if they are decided "correctly") really hold that realized gain is not income, the *James* court would have to answer the question consistently. Only to the extent that cases like *Burgie* do not decide what is income, but rather what income may require modification of a confirmed plan, could the *James* court consider the gain to be income under section 1325(b).

In re Profit [240]addresses essentially the same situation, in the context of plan modification, as *James* and *Burgie* but does decide the issue under both sections 1325(a)(4) and 1325(b). *Profit* follows *Burgie* that realized gain is not "income" for purposes of section 1325(b) but effectively treats it as if it were by applying the liquidation test of section 1325(a)(4) as of the effective date of the plan modification. In *Profit*, the debtors' mortgagee forgave, a little more than three years into the plan period, a note and mortgage in the amount of $146,000. After confirmation, the debtors had moved from Reno, Nevada, to Palm Springs, California, where the debtor-husband's employer assisted the debtors in purchasing a home. The opinion suggests that a trust the employer controlled held a deed of trust under which the trust would transfer title when the purchase price was paid.[241] When the employer died, his estate forgave the note and transferred title to the debtors.[242] The debtors then sold the house free and clear and invested the proceeds in another house in North Carolina. The trustee sought to modify the debtors' plan and require the debtors to repay their creditors in full.

The court framed the issue as "whether the forgiveness of debt income on the Palm Springs property constitutes property of the estate and, if so, whether that value is available to creditors."[243] The court did not clearly identify whether the

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[239] *Id.* at 375 n.4. There would be no difference in the result under sections 1325(a)(4) and 1325(b) if the court had not allowed the exemption. The difference arises, however, because exempt income is generally considered in disposable income analysis. The $3,500 exempt gain would be excluded under section 1325(a)(4) because it is exempt; it would be excluded under section 1325(b) because that value already existed at the beginning of the income period and would function in the same manner as adjusted basis under I.R.C. § 1001 (2000).

[240] 269 B.R. 51 (Bankr. D. Nev. 2001), *rev'd on other grounds*, 283 B.R. 567 (B.A.P. 9th Cir. 2002) (holding debtors had completed plan payments and modification was abuse of discretion because it required plan to exceed 60 months).

[241] *Id.* at 54–55. The income, therefore, could be the house itself or the discharge of indebtedness.

[242] *Id.* The issue was first presented to the court as the debtors' having received an inheritance from the employer's trust.

[243] *Id.* at 56. It is, of course, the sheerest nonsense to refer to COD "income" as "property." Indeed, it was the early inability of the courts to conceive of income in terms other than "the gain derived from capital, from labor, or from both combined," Eisner v. Macomber, 252 U.S. 189, 207 (1920), that initially excluded COD from the definition of income. *See, e.g.*, Meyer Jewelry Co. v. Comm'r, 3 B.T.A. 1319, 1322 (1926). *See generally* 1 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 7.1 (3d ed. 1999) (noting difficulty of defining "income" within the confines of *Eisner* definition). Of course, one could borrow from the logic of cases such as *Harris v. Balk* and characterize the creditor's claim as property which is transferred to the obligor where the debt and the claim somehow merge; but this is just a variation on the freeing-of-assets logic of *Kirby Lumber*, which Bittker and Lokken criticize. Similarly, however, it is nonsense not to consider COD to be income. COD must be considered income in bankruptcy for the same reason it is considered income in taxation: (primarily) because borrowing is not considered income. James v. United States, 366 U.S. 213, 219 (1961) (stating that borrowing is not income

forgiveness of debt or sale of the residence generated the income or acted as the realization event for that income.[244] The forgiveness of debt, the court noted, "*resulted in* the a tangible asset as the proceeds of the Palm Springs property."[245] Because a chapter 13 estate includes after-acquired property, "the forgiveness of debt *as realized by* the proceeds" are estate property unless exempt."[246] Ultimately, the court decided the property must be made available to creditors and held, therefore, that the "forgiveness of indebtedness *as represented by* the proceeds of sale is property of the estate and must be accounted for"[247] under a modified plan that provides unsecured creditors with at least as much as they would receive in a liquidation conducted on the date of modification. The court therefore granted the motion to modify.

The debtor clearly experienced an accession to wealth during the term of the plan and that accession to wealth ultimately took the form of money. The question, of course, was what, if anything, to do about it. The court had the option of

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for tax purposes); *In re* Stones, 157 B.R. 669, 670 (Bankr. S.D. Cal. 1993) (stating that bona fide loan does not constitute income).

However, the bankruptcy discharge is itself COD, which, but for an exception in section 108, would be income, unless there is some reason to consider the insolvency exception somehow inherent in COD income (And does this necessarily include bankruptcy?). And if government benefits should be considered income, *see, e.g.*, Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L.J. 431, 439 (1991), why not the bankruptcy discharge?

[244] As to which should be considered the realization and recognition event, dividing the accounting periods between the cancellation of indebtedness and subsequent sale may be useful. Consider what would happen under income tax law if a taxpayer bought property the morning of December 31 by executing a promissory note and executing a mortgage against the property. That evening, the lender cancels the indebtedness and the next day the taxpayer sells the property for an amount equal to the face amount of the now-forgiven note. The taxpayer would have income from the cancellation of indebtedness in the year ending December 31. In the year beginning January 1, the taxpayer's basis in the property being unaffected (I.R.C. § 108(e)(5) only applies to reduce tax attributes where income is excluded and, because of the reduction in tax attributes, effectively deferred), the taxpayer would recognize no gain. If the taxpayer sold on January 1 for more than her basis, she would have additional gain but the gain would be unrelated to the COD income in the previous year.

The same analysis would be useful in *Profit*, although there is no need to divide the accounting periods. The debtors were forgiven indebtedness of $146,000 and therefore had income in that amount. Subsequently, they sold the property on which the debt was forgiven and realized proceeds of $168,000. This liquidated increase in value represents income of an additional $22,000. The entire $168,000, which represents an increase in value in that amount of the debtors' accumulation during the relevant accounting period, is thus included as income but without uncertainty as to whether the cancellation of indebtedness or gain from sale caused the income.

Another possibility, urged initially by the debtors in *Profit*, is that they received a bequest or inheritance on the death of the debtor-husband's employer. Under the case law regarding gifts and inheritances as income, the outcome would be easy to predict if the gift or inheritance were received within three years of the commencement of payments under the plan. Under the lump-sum approach, the opposite result would obtain. In any event, because the *Profit* court employed section 1325(a)(4) in a manner to capture income even though beyond the three years, the result is the same under all approaches. The *Profit* court's approach thus has the virtue of consistency, even if the consistency arises at the expense of the possible redundancy of section 1325(b).

[245] *In re Profit*, 269 B.R. at 56 (emphasis added).

[246] *Id*. (emphasis added).

[247] *Id*. at 59 (emphasis added).

characterizing the matter as governed by the rule, expressed in section 1325(b), that a debtor must devote all disposable income during the first three years of the plan to repaying creditors. The court also had the option of applying the rule of section 1325(a)(4) that the plan must pay an amount to unsecured creditors at least equal to what they would receive in liquidation.

If the forgiveness of debt and subsequent sale resulted in "income," there would be no basis for modifying the plan because the income was received more than three years into the plan period. Many courts also hold that the disposable income requirement is not applicable to plan modifications.[248] They do so on the basis that section 1329(b) applies the requirements of section 1325(a) but not subsection (b) to the plan as modified. The *Profit* court appears to reject that reasoning on the ground that section 1329(b) incorporates section 1322(a), which requires the debtor to submit income to the trustee sufficient to execute the plan.[249] Following *Burgie*, the court found that the value of the house, received as a "lump asset" on forgiveness of the debt and sale of the house rather than as a "stream of payments,"[250] could not constitute income.[251]

The *Profit* court proceeded to apply the liquidation analysis and found that, without modification, the plan would not provide to unsecured creditors at least what they would receive on liquidation. In effect, the court did not merely apply the liquidation test to the modified plan but also (and in spite of its statement that confirmation orders are *res judicata*) used the motion to modify as an occasion to revisit the requirements for confirmation of the original plan, applying the liquidation test to the facts as they existed in 2001 rather than as they existed in 1996 on the effective date of the plan.

The re-application of the liquidation test in 2001 had the same general effect as applying the disposable income test. Indeed, many courts see re-application as

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[248] *See, e.g.*, *In re* Forbes, 215 B.R. 183, 191 (Bankr. 8th Cir. 1997) (stating Congress omitted disposable income requirements for post-confirmation plan modification); *see also In re* Sounakhene, 249 B.R. 801, 804–05 (Bankr. S.D. Cal. 2000) (collecting cases). *See generally* KEITH M. LUNDIN, 2 CHAPTER 13 BANKRUPTCY § 6.45 at 6-134 to 6-135 (2d ed. 1994).

[249] *See In re Profit*, 269 B.R. at 56–57 (finding that proceeds from sale of property were not earnings or income for purposes of § 1322(a)(1)).

[250] The "lump sum" and "stream of income" distinction is of no economic significance. Assume the debtors had self-financed their buyer's purchase of the Palm Springs property and had received a note instead of cash. They certainly would have had an expected stream of payments that, with whatever interest rate they charged, would have equaled the value of the lump-sum payoff. The court could treat the two differently, notwithstanding their economic equivalence. Alternatively, the court could treat as income the entire value of the note regardless of the payment schedule, which would require the debtors to negotiate the note (at some discount, however) and receive the cash.

[251] A somewhat analogous case in chapter 12 is *In re* Ogle, 261 B.R. 22 (Bankr. D. Idaho 2001). In *Ogle*, the debtors' plan was confirmed with terms that left all estate property vested in the trustee and that required payment "in full" of their secured creditor's claims. Because the plan did not define "in full," the debtors' plan was construed to require payment of post-petition interest, which more than doubled the secured creditor's claim. The court held that the claim had to be paid with interest at the federal post-judgment interest rate and further that appreciated but unsold property could be liquidated to satisfy the claim.

"promot[ing] the 'ability to pay' policy of chapter 13,"[252] which is a fully reasonable conclusion; reapplying the liquidation test is precisely the same as determining Haig-Simons income.[253] If an increase in the value of the debtor's property will support modification based on the application of the liquidation test as of the date of modification, the same result is achieved as if income were defined to include any value accumulated by the debtor and therefore requiring modification based on the debtor's failure to devote all disposable income to the plan. Section 1325(a)(4), re-applied at the date of modification, captures income (in the form of realized appreciation) that courts exclude from 1325(b) because it is either a "lump sum" or because it violates the "debtor's bargain." It is consistent, however, with Simons's description of how income should be calculated under his definition of income: "the result obtained by adding consumption during the period to 'wealth' at the end of the period and then subtracting 'wealth' at the beginning."[254]

There are two major differences in the reaching income at modification through the best interests rather than best efforts test. The first is that, although 1325(b) makes no distinction between exempt and non-exempt sources of income,[255] the liquidation test necessarily respects the exemptions that protect property from liquidation. For considering property gains as effective income under 1325(a)(4), therefore, there is no national standard as there was designed to be under 1325(b).[256] Debtors in Florida or Texas, for example, would therefore fare much better than debtors from Pennsylvania or Massachusetts in an application of 1325(a)(4) at modification of a plan following the sale of appreciated exempt property – and their creditors *vice versa*.

Second, the use of the liquidation test at modification allows the trustee or creditors to reach income that would otherwise be beyond the temporal scope of the best efforts test. The best efforts or disposable income test requires a debtor to commit to the plan only disposable income during the 36-month period beginning with the first plan payment. The best interests or liquidation test has no such

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[252] *In re* Nott, 269 B.R. 250, 254 (Bankr. M.D. Fla. 2000); *see also* Barbosa v. Solomon (*In re* Barbosa), 235 F.3d 31, 41 (1st Cir. 2000) (affirming plan modification and stating "to allow the Debtor to keep the proceeds from the sale . . . effectively defeats Congress' [sic] intention to expand the 'ability-to-pay' standard forward throughout the duration of the plan."), *aff'd*, 236 B.R. 540, 556 (Bankr. D. Mass. 1999) (effectively re-applying the liquidation test to plan modification within the good faith requirement and stating "in view of congress's [sic] intent in enacting chapter 13 to encourage debtors to *repay their debts to the best of their ability*, it would be anomalous for this Court to determine that the Debtor can retain the excess proceeds from the sale of the Property without satisfying their unsecured claims.").

[253] The apparent difference would be that the court would not include in the calculation the sum of the debtors' consumption during the relevant period. This difference is only apparent, however, because the Bankruptcy Code permits reasonable consumption to be deducted from the calculation of disposable income. Another difference, which is more real, is that the courts which re-apply the liquidation test do not include all of the debtor's property.

[254] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 50; *see also* William D. Andrews, *A Consumption-Type of Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1136 (1974).

[255] *See* cases cited *supra* note 155.

[256] *See, e.g.*, *In re* Green, 103 B.R. 852, 853 n.1 (W.D. Mich. 1988); *In re* Stein, 91 B.R. 796, 802 (Bankr. S.D. Ohio 1988); Karen Gross, *Preserving a Fresh Start for the Individual Debtor: the Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59, 134 (1986).

temporal limitation and may be applied at any time until completion of the plan, which gives creditors and trustees up to an additional two years in which to reach gains in the value of estate property. The use of the best interests or liquidation test of section 1325(a)(4) to require modification of a confirmed plan effectively expands the concept of income to include transactional and lump-sum gain (subject to allowable exemptions) rather than periodic income and extends the period during which creditors can access this income to five, rather than three, years.[257]

Perhaps the most significant difference between the disposable income test and the re-application of the liquidation test is the role of the realization criterion. Increases in the value of property cognizable under section 1325(a)(4) are not limited, however, to sale proceeds of appreciated property. Applying the liquidation test at the time of modification would have the same result, based on the debtors' increased equity in the Palm Springs property, whether they sold it or not. Because liquidation under chapter 7 is not limited to cash, unsold appreciated property would equally support modification under the liquidation test, bringing the logic of *Profit* into direct conflict with the reasoning of *Trumbas*, which holds that unrealized appreciation cannot support modification. The Eighth Circuit has held, therefore, that cancellation of indebtedness results in disposable income based, not on the sale of the property securing the debt, but rather on the increase in the debtor's equity in the collateral.[258] And, although the realization criterion may, for courts adhering to it, coherently be applied in defining income under section 1325(b), there is no discernable way to apply it to modification based on unrealized gains when the trustee seeks to modify based on section 1325(a)(4). Some courts eliminate this problem by refusing to apply the liquidation test after the effective date of the plan; such a refusal, however, results in the debtor's having income – the accumulation of value – that cannot be reached by creditors. This may explain why the court emphasized that the forgiveness of debt, which increased value of the debtor's store of property rights, was "realized by" and "represented by" and "resulted in" cash proceeds. Some courts eliminate this problem by refusing to apply the liquidation test after the effective date of the plan; such a refusal, however, results in the debtor's having income – accumulation of value – that cannot be reached by creditors. In any event, however, *Profit* illustrates Simons's

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[257] It is also not clear whether reasonable and necessary expenses for support and maintenance are relevant to the effective income recognized under section 1325(a)(4). Although Judge Lundin in *In re* Perkins, 111 B.R. 671, 673–74 (Bankr. M.D. Tenn. 1990), required netting of transactional gain (for income taxes) under the feasibility test, there is authority that adverse tax consequences are irrelevant to the definition of income. It is conceivable that a court could declare all gain income and leave the debtor to her own devices as to how to deal with the IRS. Also relevant here, especially in hypothetical income situations, is the extent to which the court will make corollary assumptions. *See, e.g.*, *In re* Weinhoeft, 275 F.3d 604, 606 (7th Cir. 2001) (refusing exemption for any portion of debtor's settlement with employer for wrongful discharge that would have been contributed by employer to pension fund had debtor remained employed); *In re* Alabama Land and Mineral Corp., 257 B.R. 78, 81–82 (Bankr. N.D. Ala. 2000) (holding bank must be considered to have issued certificate of deposit to debtor which it was contractually obligated to issue but not considering that bank retained possession of certificate and therefore perfecting its security interest).

[258] Berger v. Pokela (*In re* Berger), 61 F.3d 624, 626–27 (8th Cir. 1995).

point that there may be gain without realization and realization without gain but one, not both, must be the essential characteristic of income.

One problem that arises immediately with the re-application of the liquidation test is the proper role of depreciation. Some courts consider depreciation in this context, refusing to modify confirmed plans for depreciation[259] and as justification for declining to modify for appreciation.[260] These courts, which refuse to modify based on depreciation, just as those that refuse to modify based on appreciation, regard "[a]ppreciation or depreciation value of an asset initially scheduled in a Chapter 13 case [as] an intrinsic benefit or risk of ownership with the increase or decrease in value constituting nothing more than an incident of ownership."[261] That is, appreciation represents income the debtor may retain and depreciation represents loss the debtor must absorb and neither may have any effect on the amount debtors must repay to their creditors. Including appreciation and depreciation in a calculation of disposable income would require coordination with the bankruptcy rules regarding changes in value of encumbered property. Generally, the risk of post-petition depreciation in collateral falls on the debtor. If a creditor is oversecured, the debtor loses equity; if the creditor is undersecured, the debtor must make "adequate protection" payments equal to the amount of the decline in value.[262] On the other hand, post-petition appreciation inures to the benefit of the debtor when the creditor's interest in the property has been capped by a determination under section 506(a) unless the creditor has acted to increase the value of the property; appreciation of collateral that is not subject to bifurcation benefits the debtor only to the extent the value to which the property appreciates exceeds the creditor's claim.[263] Permitting a debtor to deduct or recognize depreciation would be appropriate only if two conditions were met. First, depreciation could be included as a deduction in the disposable income calculation only to the extent the debtor

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[259] *In re* Linden, 174 B.R. 769, 771–72 (C.D. Ill. 1994) (refusing to modify confirmed chapter 12 plan for "paper losses" such as depreciation (citing *In re* Coffman, 90 B.R. 878, 886 (Bankr. W.D. Tenn. 1988)); *see also In re* Meeks, 237 B.R. 856, 861–62 (Bankr. M.D. Fla. 1999) (stating debtor's proposed modification is not permitted and debtor must suffer any resulting depreciation).

[260] *See, e.g.*, *In re* Jacobs, 263 B.R. 39, 46–47 (Bankr. N.D.N.Y. 2001) (stating that appreciation bears no consequence on debtor's ability to pay); *In re* Walker, 153 B.R. 565, 571 n.3 (Bankr. D. Or. 1993) (discussing effect of appreciation).

[261] *In re Jacobs*, 263 B.R. at 46–47 (citing *In re* Trumbas, 245 B.R. 764, 767 n.6 (Bankr. D. Mass.2000) and *In re* Euler, 251 B.R. 740 (Bankr. M.D. Fla. 2000)).

[262] *See, e.g.*, James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of The Relationship Between The Fifth Amendment And The Bankruptcy Clause*, 96 HARV. L. REV. 973, 978 (1983) (describing possible techniques for providing adequate protection); Kaaran E. Thomas, *Valuation of Assets in Bankruptcy Proceedings: Emerging Issues*, 51 MONT. L. REV. 126, 149–50 (1990) (discussing depreciation and market value). *But see* Dean P. Wyman, *May I Have My Balance Please? Allocation of Payments in Bankruptcy Cases*, 100 COM. L.J. 132, 140–41 (1995) (arguing adequate protection payments may not equal amount of depreciation).

[263] *See* 11 U.S.C. § 1322(b)(2). The proposed bankruptcy reform legislation would drastically limit debtors' ability to bifurcate claims and, therefore, would significantly alter the "debtor's bargain." *E.g.*, Bankruptcy Reform Act of 2001, S. 420, 107th Cong. §§ 306, 309 (1st Sess. 2001) (amending 11 U.S.C. § 1325).

actually bore the economic risk of loss of the depreciation.[264] Second, allowing a deduction for depreciation would be appropriate only if the expense were reasonably necessary for the maintenance or support of the debtor and her dependents.

A further difficulty with this approach is the very reason the Internal Revenue Code contains a provision for current accrual of original issue discount. Return on an investment is essentially the same regardless what form it takes. Had the debtors in *James* or *Burgie* instead invested in instruments with interest payable at fixed intervals over the plan period and equal over time to the gain realized on sale of their houses, the courts would have had very little difficulty in classifying the yield as income. Similarly, if the debtors purchased instruments with original issue discount, bankruptcy courts would probably be sophisticated enough to find the debtors had income on maturity of the instruments even if not as the yield accrued.

b. Realized gain is income to the extent of gain

Some courts, on the other hand, treat realized gain as income relevant to chapter 13 debtor's ability to repay their creditors.[265] This is consistent with most of the chapter 12 cases that have addressed the issue;[266] the omission of transactional gain from farm income would present such glaring hole few would fail to see it. Under a realized gain approach, the calculation of gain is essentially the same as it is in tax law. Courts would calculate the property value as of the beginning of the plan period would effectively serve as the property's basis; gain would be the excess of the amount realized on sale or disposition over that amount. There are courts, however, that are hold realized proceeds and gain to be disposable income but on terms very different from the simple formula suggested by tax law.

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[264] *See, e.g.*, Edward J. Buchholz, *Substantiality under Section 704(b) – Some Forgotten Issues and Some Ancient Concepts Revisited*, 19 VA. TAX REV. 165, 255–56 (1999) (discussing "curative allocation" of risk in partnerships); Sang I. Ji, *Nonrecourse Financing of Real Property: Depreciation Allocation and Full Recapture to Minimize Deferral and Eliminate Conversion*, 29 COLUM. J.L. & SOC. PROBS. 217, 228–33 (1996) (analyzing depreciation and economic risk and propriety of permitting mortgagor to take depreciation deductions on basis of nonrecourse debt); Christine Rucinski Strong and Susan Pace Hamill, *Allocations Attributable to Partner Nonrecourse Liabilities: Issues Revealed by LLCs and LLPs*, 51 ALA. L. REV. 603, 646–47 (2000) (commenting on depreciation and economic risk of loss); Daniel Shaviro, *Risk-Based Rules and the Taxation of Capital Income*, 50 TAX L. REV. 643, 693–95 (1995) (discussing "at-risk rules" and economic loss).

[265] *See, e.g.*, *In re* Suratt, Civ. No. 95-6183-HO, 1996 WL 914095 (D. Or. 1996); s*ee also* Shelley v. Kendall (*In re* Shelley), 184 B.R. 356, 359 (B.A.P. 9th Cir. 1995) (holding that "gross income" for purposes of California's homestead exemption excludes the cost of goods sold); Cheriton v. Fraser (*In re* Marriage of Cheriton), 111 Cal. Rptr. 2d 755, 768 (Cal. Ct. App. 2001) (holding income from stock options must be included for ability to pay child support at the latest when stock sold for a gain).

[266] *In re* Bircher, 241 B.R. 11 (Bankr. S.D. Iowa 1999); *In re* Barnett, 162 B.R. 535 (Bankr. W.D.Mo.1993); *see also In re* Stottlemyre, 146 B.R. 234, 236 (Bankr. W.D. Mo. 1992) (stating disposable income should be computed based on actual income and expenses incurred rather than based on projected value of income that debtor hopes to receive).

c. Income Not Limited to Gain

Finally, some bankruptcy courts hold that amounts realized are income in the full amount of the proceeds received, that is, with or without gain during the relevant period. Thus, *In re Solis*[267] holds that the entire value of the assets of a doctor's medical practice was to be included in income. The opinion does not specify what the assets were worth at any time during the case prior to the sale for $40,000, although the court indicates that the debtor's plan "effectively stripped the medical practice of creditors' liens."[268] Assuming the assets were not completely valueless at the effective date of the plan (which would have permitted some liens to continue to attach)[269] the gain from the sale of the assets would have been something less than the entire amount realized.[270]

One major problem with considering all of the proceeds as income is that the debtor may not actually have realized any profit on the transaction. In fact, the property may have depreciated during the period in which the debtor is required to account for disposable income. Again to quote Simons: "One may gain without realizing and realize without gaining; and if either is essential to the existence of income, the other must be excluded."[271]

This problem is illustrated by *In re Kerr*,[272] which holds that proceeds are not included within calculation of disposable income to the extent they are exempt. The opinion suggests, however, that proceeds in excess of the allowed exemption would be included. It is important to note, however, that *Kerr* did not involve any income, even under the broad Haig-Simons definition. The value of the debtor's property at the beginning of the case was $80,000; the price at which the debtors sold it the next year was $70,000. The debtors, therefore, realized a loss during that period of $10,000. There was simply no income from the sale that could be attributed to the bankruptcy period. Indeed, the case perhaps more properly raises the issue whether the debtors should have been allowed to reduce their disposable income by $10,000. Under Haig-Simons, a loss due to market changes would be an allowable offset against income. Likewise, a loss due to physical deterioration would also be

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[267] 172 B.R. 530 (Bankr. S.D.N.Y. 1994).

[268] *Id*. at 531.

[269] 11 U.S.C. § 506(a) (2000).

[270] It is possible that the debtor valued the assets at zero in his plan, that no creditors objected to the valuation, and that the debtor sold the practice for what it had always been worth. Only under this circumstance would the entire amount realized be "income." However, although the court was relatively incensed at the debtor's "cynical, inequitable, and manipulative use of the bankruptcy process" and attempted "perversion" of the good faith and disposable income requirements, *In re Solis*, 172 B.R. at 533, the court's remedy simply transferred the value of the assets from secured creditors to unsecured creditors. If the debtor's low valuation artificially diminished the value of the collateral securing their liens, it also artificially turned that same value into income which was transferred to unsecured creditors. If, therefore, the debtor's ability to keep the proceeds would be unfair to unsecured creditors, surely the unsecured creditors' receiving the proceeds is unfair to the secured creditors.

[271] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 84.

[272] 199 B.R. 370, 375 (Bankr. N.D. Ill. 1996).

allowable.[273] The latter, however, would not be proper unless the debtor were also required to include in-kind income from the consumption of the asset.[274] To the extent any increase in the fair market value of the asset is reflective of the increase in the discounted perpetual rental value of the property,[275] courts are effectively imputing rental to the owner of the asset for a period far exceeding the plan period and requiring them to use that income to repay creditors.

Bankruptcy courts' treatment of transactional gain is surprisingly inconsistent in comparison to tax law's virtually universal acknowledgment that realized gain is equal to the difference between amount realized and the economic value of investment in an asset. While most courts deny that transactional gain can be income, many struggle with ways to make the value of gain available to creditors. Others, in deference to the "debtor's bargain," simply turn their backs on those values. Still others impinge on the "debtor's bargain" by treating all sale proceeds as income. The majority of cases however, seem to permit debtors to retain the value of appreciated assets, which works the same form of discrimination in favor of debtors with capital[276] and in favor of mortgage lenders.

B. Proposal: Income Includes Transactional Gain

Under *Glenshaw Glass*, a clearly realized accession to wealth over which the debtor has control is income. There is no question under the tax law that a realized gain on the sale, exchange, or other disposition of property is income in the absence of an exclusion or deferral. There are, however, such exclusions and deferrals in the Tax Code. The exclusion for the sale of a principal residence is one prominent example of an exclusion; the deferral of gain on the exchange of "like-kind" properties is an example of appreciation not being included in income until a

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[273] *See* Fred B. Brown, *"Complete" Accrual Taxation*, 33 SAN DIEGO L. REV. 1559, 1665 (1996) (discussing depreciation due to physical deterioration).

[274] *Id*.; *see also* Richard A. Epstein, *The Consumption and Loss of Personal Property Under the Internal Revenue Code*, 23 STAN. L. REV. 454, 458–59 (1971). *See generally* SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 116–19 (asserting that homeowner should accrue income equal to rental value of home). "In-kind" consumption income is also discussed, *supra* note 150 and accompanying text.

[275] If the fair market value of an asset rises by x, the present value of all future rental rises by x.

[276] To the extent bankruptcy's operating definition of income provides a windfall in favor of those who own appreciated property, most often in the form of homes, there is discrimination in favor of those who own homes. Home ownership in bankruptcy largely correlates to the same variables as home ownership in the general population. The statistics developed by Professors Sullivan, Warren, and Westbrook in the Consumer Bankruptcy Project reveal that a smaller percentage of African-American and Hispanic debtors own homes than do white debtors, although homeowning debtors are more likely to be non-white. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 231–36. Home ownership rates in bankruptcy increase with debtor age. *See* Ed Flynn & Gordon Bermant, *Filers Most Likely in 25-44 Age Range*, AM. BANKR. INST. J., Dec./Jan. 2002, at 28. Among debtors, the median income of homeowners is over 150% of the median income of renters. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 215. The windfall may fall, therefore, more on whites than non-whites, more on the elderly and middle-aged than the young, and more on (by bankruptcy standards) the affluent than the less fortunate. *See generally* SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 115 (1938); Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751, 774–76 (1996).

subsequent and different realization event. Another exclusion, perhaps less commonly known, is of certain capital gains for foreign taxpayers, who need not include in their U.S. income the gain from the sale or exchange of shares in a domestic corporation.[277] This exclusion results from the fact that the relevant definitions of income under subchapter N are limited to income that is effectively connected to a trade or business in the United States and income from a U.S. source that is fixed or determinable annual or periodical (sometimes referred to as "FDAP" income). Because investment in a domestic corporation is not considered effectively connected to a trade or business,[278] because the sale of personal property by a nonresident alien is "sourced" outside the U.S.,[279] and because transactional gain is not FDAP,[280] the foreign taxpayer is not considered – by the United States, at least – to have income. This result derives, however, from two specific rules that limit income to certain sources and kinds. The Bankruptcy Code contains no such limitations to the definition of income, nor does it specify any exclusions or deferrals. It simply requires income (less certain expenses) to be used to fund the plan. There appears to be no reason, therefore, to interpret the term "income," as used in section 1325(b) any less inclusively than the Supreme Court did in *Glenshaw Glass*.

In fact, there appears to be no textual reason why unrealized appreciation should necessarily be excluded from income in chapter 13. The Bankruptcy Code, unlike the Tax Code, does not contain a specific realization requirement. Nor is the inclusion of unrealized appreciation necessarily inconsistent with the other requirements for access to government "social welfare" programs. Farmers are routinely required to execute "shared appreciation agreements" as a condition of the Farm Service Administration's writing off a loan.[281] Similarly, appreciating assets can render a recipient of federal assistance ineligible for continued participation in certain programs.[282]

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[277] BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 65.1.3, at 65-11 (3d ed. 1999); JOEL D. KUNTZ & ROBERT J. PERONI, US INTERNATIONAL TAXATION ¶ A1.04[3] (2002). If the shares of stock were considered a "U.S. real property interest," however, the result would be different. *See* I.R.C. §§ 897(c)(1)(A)(ii), 897(c)(1)(B), 897(c)(2)–(5) (2000). In addition, the rules for the sale of partnership interests are different because partners are considered engaged in a U.S. trade or business to the same extent as the partnership. *See* I.R.C. § 875(1); Rev. Rul. 91-32, 1991-1 C.B. 107. *See generally* BITTKER & LOKKEN, *supra* this note, ¶ 67.6.2.3, at 67-130; Paul C. Lau & Sandra L. Soltis, *Planning for Foreign Corporations Using Partnerships to Take the Plunge Into U.S. Markets*, 94 J. TAX'N 105 (2001); William W. Bell & David B. Shoemaker, *Revenue Ruling 91-32: Right Result for the Wrong Reasons*, 9 J. P'SHIP TAX'N 80 (1992).

[278] *See, e.g.*, Linen Thread Co. v. Comm'r, 14 T.C. 725, 736 (1950).

[279] I.R.C. § 865(a)(2) (2000).

[280] Treas. Reg. §§ 1.1441-2(b)(1)(i), 1.1441-2(b)(2)(i) (as amended 2000).

[281] *See generally* Susan A. Schneider, *Shared Appreciation Agreements: Confusion and Mismanagement Threatens Family Farmers*, 7 DRAKE J. OF AGRIC. L. 107, 109–16 (2002).

[282] *See, e.g.*, 45 C.F.R. § 233.20(a)(3)(i)(B) (2002) (describing eligibility for AFDC in terms of the value of reserved assets). It should be noted, however, that the regulation makes an exception for the "home which is the usual residence of the assistance unit." *Id.* § 233.20(a)(3)(i)(B)(1).

The realization requirement, although susceptible to theoretical objections (and, as Simons showed, by no means necessary to the definition of income), essentially substitutes for an annual accounting period the period during which the taxpayer owns the property in question. If a taxpayer buys property in year one for $100 and disposes of it in year 5 for $500, the taxpayer includes in year 5 the gain attributable to the entire period. Bankruptcy could work the same way but the accounting period would have to be limited by the terms of the statute. Section 1325 specifies that income during the plan period must be counted, and expenses during the plan period deducted. Retaining the realization requirement, appreciation attributable to the plan period, therefore, could and should be included.[283]

One major objection that could be leveled against this proposal is that it may seem unfair to some to include the portion of post-petition appreciation that represents equity the debtor has acquired during the pendency of the bankruptcy case. In tax law, for example, an owner may deduct from the amount realized the amount of her unrecovered investment – her basis – in property in calculating her gain on its disposition. The difference in my proposal results from bankruptcy's and tax's apparently different capitalization rules. In tax law, owners must capitalize, rather than expense, acquisition costs; generally, that no deduction is available for payment of mortgage principal.[284] Because chapter 13 debtors, however, may currently deduct acquisition costs from their disposable income, rather than charging acquisition costs to a capital account to be recovered later, there is no unrecovered investment for purposes of the disposable income test.[285]

Two objections could be raised that my proposal does not go far enough. First, why should unrealized appreciation be excluded from the calculation of disposable income? Second, why should any part of the proceeds representing pre-petition appreciation not be included? With regard to the first, I confess to have adopted the realization criterion relatively arbitrarily in light of Simons's teaching that "[o]ne may gain without realizing and may realize without gaining; and, if either is essential to the existence of income, the other must be excluded."[286]

With regard to the second, the answer depends on the degree of one's commitments to the realization requirement and to the relevant accounting period. If the goal of the disposable income test is to capture income (defined as growth in value) during the relevant period, then only post-petition appreciation should be included. That is, the debtor should be treated as accruing gain equal to the pre-petition appreciation during the pre-petition period.[287]

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[283] On the difference between a pure accrual system and a realization tax system, see, for example, Michael J. McIntyre, *An Inquiry into the Special Status of Interest Payments*, 1981 DUKE L.J. 765, 779–80 (1981).

[284] *See* I.R.C. §§ 161, 263, 263A. *But cf.* I.R.C. § 179.

[285] *See* William A. Andrews, *A Consumption-Type Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1149 (1974) (discussing treatment of capital transactions on "a simple cash flow basis" under consumption-type personal income tax).

[286] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 84.

[287] This presents the problem, however, of a switch in accounting methods – from pure accrual to realization – and allowing the debtor to keep the value of appreciation that accrued when the very debts she

If one is committed to the realization requirement, there may be no good reason to adhere closely to the three-year accounting period. The realization rule is effectively an extension of any given accounting period (whether, as in tax, an annual accounting period or one defined in some other way) to the period beginning on acquisition and ending on disposition.[288] If the effect of the realization requirement is to defer the inclusion of gain until the end of *that* period, all the gain during that period should be included. In this case, pre-petition gain should be included.[289]

If it is thought unfair to include pre-petition unrealized gain, I might respond that it need be excluded no more than post-petition unrealized gain need be excluded. If pre-petition unrealized gain is assigned to the period before the case commences, why should post-petition unrealized gain be assigned to the period after the debtor completes her plan and the case is closed? What part of unrealized gain is to be assigned to the plan period itself? To eliminate this whipsaw effect on creditors, it seems we must relax the realization requirement.

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is seeking to walk away from also accumulated; this problem is ameliorated, however, by the liquidation test.

[288] Tax scholars sometimes speak of income "bunching" to refer to the effect of imposing annual accounting and the realization requirement. *See, e.g.*, Jeff Strnad, *Taxation of Income From Capital: A Theoretical Reappraisal*, 37 STAN. L. REV. 1023, 1043 (1985). Income attributable to prior years' appreciation is "bunched" in the year of realization. "Bunching," however, is the appropriate term only if one assumes the annual accounting period is somehow fixed or given. If the realization requirement is itself seen as altering the normal accounting period, there is no "bunching" of gains from many periods into one; there is only the realization of gain during the period beginning with acquisition and ending with disposition. In other words, it is the price (made more dear, perhaps, by progressive tax rates) for deferral.

[289] *Burgie* could be interpreted as saying a debtor is not enriched when she exchanges a house worth $*x* for *x* dollars. This would not be incorrect. There is no gain at the very instant of realization. Rather, the gain at realization is a measure of the appreciation that has occurred during the extended period the realization requirement imposes. The choice, then, is one of accounting periods – *der Augenblick* or something slightly longer over which gain is theoretically possible.

Although "not incorrect," such a position as described above would be distinctly unhelpful. Income is impossible without the introduction of time. Time, in turn, introduces the possibility of changes in circumstances or changes in knowledge one or the other of which is necessary for value to change. It is lack of knowledge of the future that results in a present valuation's differing from a future one; time itself, therefore, imposes an information cost without which all valuations would be perfect and, therefore, the same. RONALD H. COASE, THE FIRM, THE MARKET AND THE LAW 15 (1988). Although logically true, this is, of course, a silly discussion because in a hypothetical world without transaction costs, there would also be no space, *see* David Gray Carlson, *Secured Lending as a Zero-Sum Game*, 19 CARDOZO L. REV. 1635, 1644 (1998), making it somewhat difficult to divide the universe into separate "property." It is nonetheless important to note if only to eliminate the understanding of realization with which I started this footnote.

III. MORTGAGES AND IMPUTED RENTAL INCOME

For what is the land but the profits thereof?[290]

The second set of problems arises when a debtor does *not* sell his or her residence. The realization requirement creates a distortion between those who cash out their investment and those who do not. Each of the last three of my proposals deals with debtors who continue to own their homes during a bankruptcy case.

A. Imputing Rental Income to the Homeowner

First, I propose rental income be imputed to homeowners. This is no doubt a proposal that will generate considerable resistance, in part because it is counterintuitive.[291] It is somewhat counter-intuitive to suggest homeowners have income from their homes. Tax experts, however, generally accept the idea. Henry Simons, who is generally regarded as beginning serious discussion in the United States about the definition of income, advocated income include both earned income and the value "when property is employed directly in consumption uses."[292] The first type would include "the value of goods and services produced within the household," which Simons acknowledged was very problematic and which he dismissed somewhat casually.

"Income from consumers' capital,"[293] however, should be included to avoid "egregious discrimination"[294] and "serious inequity."[295] Since Simons, most tax policy experts accept that the rental value of an owner-occupied home is income to the resident,[296] although there are practical and political obstacles to requiring

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[290] Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1017 (1992) (quoting 1 EDWARD COKE, INSTITUTES, ch. 1, § 1 (1st Am. ed. 1812)) (quotation marks and alteration in original omitted).

[291] It also blurs the distinction, the clarity of which is apparently central to consumer bankruptcy law, between assets and income. *See, e.g.*, *In re* Jacobs, 263 B.R. at 48 ("[A]n asset is just that, an asset, and cannot become post-petition income by virtue of its transmutation into cash"); *In re* Rogers, 65 B.R. 1018, 1021 (Bankr. E.D. Mich. 1986) (observing that creditors cannot require sale and liquidation of an automobile under a chapter 13 plan that satisfies "best interests of creditors" test "since the car represents wealth, not income" but that the acquisition cost may provide the grounds for objection under the disposable income test because "[i]t's the *payment* – not the possession of an asset – that is material in an objection under § 1325(b).").

[292] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 112.

[293] *Id*. at 113.

[294] *Id*. at 112.

[295] *Id*. at 114.

[296] Victor Thuryoni argues the point this way:

> Consider taxpayer A who lives in a house worth $100,000 with a rental value of $10,000 per year. Assume that there is no depreciation. Taxpayer B owns an identical house, also worth $100,000, but B has had to move. Instead of selling her old house, B rents it out for $10,000 and uses the rent to pay rent on an identical house in her new location. There is no problem in concluding that B has rental income of $10,000. A is really in the same economic position as B was in before the move. B's resources did not increase as a result of the move: B's rental income merely allows her to live rent free in her new residence, which is what she did before the move. A and B are therefore

homeowners to pay tax on such income. At the time the current Bankruptcy Code was adopted, however, the idea was accepted widely enough that most European income tax laws taxed homeowners on either an estimated or presumed rental value or on a rental value based on a percentage of assessed property tax value[297] – and had done so for a considerable time.[298]

Moreover, states have incorporated the concept into their own income tax schemes. Wisconsin's original income tax, enacted in 1912, included in income the rental value of all owner-occupied residences. The Wisconsin Supreme Court upheld the law against constitutional attack and described the provision in the following terms:

> economic equals and should be considered as having the same income. B's income from homeownership takes the form of cash; A's is imputed in the sense that it does not take the form of observable cash flow.

Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 83–84 (1990). Michael McIntyre makes a similar point:

> Consider C and his tax clone D, each of whom owns a lake front cottage, which each rents out every summer for $1,000. Assume also that one summer C and D want to vacation at the lake themselves. C rents a cottage identical to his own from a neighbor for $1,000, and continues to rent out his own cottage for $1,000. D decides, instead, not to rent his cottage, but to use it himself. If C could deduct his $1,000 rental payment he could use it to offset his $1,000 rental income and end up in exactly the same tax position as D. Assuming it is desirable to equalize the tax treatment of those who rent and otherwise similarly situated taxpayers who enjoy imputed income from their own assets, D should be taxed on his imputed income or C should be given his deduction, even though C's rental payments for a summer vacation constitute personal consumption.

Michael J. McIntyre, *An Inquiry Into The Special Status of Interest Payments*, 1981 DUKE L.J. 765, 767 n.9 (1981); *see also* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 537 (5th ed. 1998). Moreover, the position is not limited to academics. In the late 1970s, the Treasury Department recognized that homeowners who live in their homes incur an opportunity cost equal to the foregone rental value of their homes. By the same token, however, they receive an implicit return equal to the rental value of the same home. The Tax Policy Staff of the U.S. Treasury summarized the economics of owner-occupied housing thus:

> An owner-occupier may be thought of as a landlord who rents to himself. On his books of account will also appear maintenance expenses and taxes, and he will equally experience depreciation in the value of his housing asset. What do not appear are, on the sources side, receipts of rental payments and, on the uses side, net income from the dwelling. Viewed from the sources side, this amount may be regarded as the reward that the owner of the dwelling accepts in-kind, instead of the financial reward he could obtain by renting to someone else.

DAVID F. BRADFORD, BLUEPRINTS FOR BASIC TAX REFORM 77–78 (2d ed. 1984).

[297] *See* Paul E. Merz, *Foreign Income Tax Treatment of the Imputed Rental Value of Owner-Occupied Housing: Synopsis and Commentary*, 30 NAT'L TAX J. 435, 436–37 (1977) (showing table of foreign countries and method used to tax homeowners on rentals). For more recent status, *see, e.g.*, HUGH AULT, COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS 81, 100, 173–74 (1997); Moris Lehner, *The European Experience With a Wealth Transfer Tax: A Comparative Discussion*, 53 TAX L. REV. 615, 662 (2000) (noting Netherlands' treatment of imputed rentals).

[298] *See, e.g.*, Corke v. Fry, 32 Scot. Law Rep. 341. Of course, the reason the "netting" described above does not apply under these tax systems is that "personal" income, whether in the form of money or consumption, is taxable but neither "personal" opportunity cost nor other personal expenses is generally deductible. The mortgage interest deduction reverses this formula, allowing the deduction of a personal expense without including the personal income it produces.

> The clause was doubtless inserted in an effort to equalize the situation of two men each possessed of a house of equal rental value, one of whom rents his house to a tenant, while the other occupies his house himself. Under the clause in question, the two men with like property are placed upon an equal footing, and in no other way apparently can that be done.[299]

In 1980, the voters of Massachusetts found another way it could be done or at least approximated. In that year, they approved by referendum a "renter's deduction, a deduction allowed, in computing a renter's State income tax liability, of one-half of the rental paid for the taxpayer's principal residence."[300] In ruling on the constitutionality of "Proposition 2_," the Massachusetts Supreme Court recognized the discrimination against renters that arises from not imputing income to homeowners:

> Although practical considerations no doubt justify the failure to tax the fair rental value of residential real estate to its owner-occupant, it is clear that the homeowner receives a tax-free benefit from the use of the equity in his home. If the taxpayer had invested his assets instead in securities, savings, or other property, he would expect to generate taxable income (assuming no other exemption). A person with $50,000 invested in his home pays no annual State income tax with respect to the benefit realized from that investment, whereas a home renter who also has $50,000 but invests it in stock, for example, will be taxed on the annual income from that investment.[301]

Some critics have responded that imputing rental income to homeowners would discriminate against homeowners in favor of owners of other consumer durables. They ask in essence, why not impute rental income from other imputed items, such as cars, clothes, and coffee cups?[302] Simons anticipated the criticism and responded

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[299] State *ex rel*. Bolens v. Frear, 134 N.W. 673, 691 (Wis. 1912).

[300] Mass. Teachers Ass'n v. Secretary of Com., 424 N.E.2d 469, 473 n.5 (Mass. 1981).

[301] *Id*. at 490.

[302] *See* Morrison v. Comm'r, 9 B.T.A. 1273 (1928); s*ee also* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 947–48 (1967) (noting criticism of failure to tax imputed income from household furnishings, etc., but acknowledging it would not be easy to put value on items or enforce compliance); Fred B. Brown, *"Complete" Accrual Taxation*, 33 SAN DIEGO L. REV. 1559, 1582–83 (1996) (observing that there is no reason, in terms of income, to stop at housing and suggesting that pure accrual income tax would include value of all consumer items, but rejecting idea as invasive of privacy); Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L. REV. 431, 458 (1991) (arguing that consistency would require imputing rent from all consumer goods and from rent control laws); Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 84 (1990) (arguing income should be imputed from use of all consumer durables but rejecting the idea out of concerns for administrative convenience and suggesting "tax equity would not suffer if smaller items . . . were excluded").

that some "sort of exclusion or exemption gives rise to only a fortuitous sort of discrimination and does not really facilitate evasion. The opportunities for tax avoidance by changing one's form of receipts are meager indeed . . . ."[303] Consumer choice as to whether to purchase a coffee cup or other consumer items would probably not be affected much because there is little elasticity – but there is court supervision – in the decision to purchase or consume certain necessary consumer durables.

Just as tax policy presents a choice of either allowing an inequity between homeowners and renters or ameliorating the inequity, so too bankruptcy policy presents similar choices and alternatives. One effect of imputing rental income to homeowners would be to minimize the benefit of bankruptcy laws in states with generous homestead exemptions. If Florida, for example, has homestead exemption laws that would allow a chapter 13 debtor to retain an expensive home (because it does not enter liquidation analysis), imputing the rental on that house and permitting the debtor to deduct from disposable income as a reasonable expense only a reasonable rental would effectively deprive the debtor of the homestead by requiring the debtor to turn over the excess rental value. If a reasonable rental were $500 per month, then that annual rental of $6000 would cap the value of the debtor's residence at $100,000.[304] Assuming a composition plan, the debtor would have a choice. The debtor could liquidate the value of the house in order access the imputed income. On the other hand, the debtor could lease it out for $60,000, obtain a lease on a smaller house for $6,000 for three years, and, upon the completion of her plan, move back into her expensive house. By minimizing the value of bankruptcy to debtors such as Bowie Kuhn or John Connally, imputing rental income would both eliminate inequity between homeowners and renters and also remove one area of bankruptcy law that is targeted as abusive.

One objection to imputing rental income to homeowners is, as in tax, that the administrative burden of imputing rental income would be too great;[305] however, bankruptcy courts are already actively involved in valuing and overseeing the valuation of debtors' assets.[306] The "coffee cup" objection[307] certainly appears here

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[303] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 51.

[304] Assuming a 6% rate of return. Assuming a rate of 8%, the value would be capped at $75,000. Determining the appropriate rental rate of return should not prove any more difficult than determining the appropriate "cram down" rate on undersecured loans.

[305] *See* DAVID F. BRADFORD, BLUEPRINTS FOR BASIC TAX REFORM 78 (2d ed. 1984) (explaining that taxing imputed rental income would severely complicate tax compliance and administration); Michael J. Graetz, *Implementing a Progressive Consumption Tax* 92 HARV. L. REV. 1575, 1615 (1979) (discussing that nature of income from imputed rent makes such income difficult to administer). *See generally* COMPREHENSIVE INCOME TAXATION 197 (Joseph A. Pechman ed.1977).

[306] Because chapter 13 debtors cannot "cram down" mortgages on a principle residence, most contention valuation issues do not involve homes. *See* Jean Braucher, *Getting It for You Wholesale: Making Sense of Bankruptcy Valuation of Collateral after Rash*, 102 DICK. L. REV. 763, 776 (1998). Nonetheless, bankruptcy courts routinely value homes, whether by stipulation or trial, for determining, for example, whether a judicial lien impairs an exemption. *See, e.g.*, *In re* Higgins, 159 B.R. 212 (S.D. Ohio 1993); *In re* Rehbein, 49 B.R. 250 (Bankr. D. Mass. 1985).

[307] *See supra* note 302 and accompanying text.

also but the objection is a version of the "paradox of the heap."[308] It says if you cannot be absolutely accurate there is no point in even trying to remove the beam from one eye if there is a mote in the other.[309] If the goal is to do better, the Bankruptcy Code could set an arbitrary dollar limit – $10,000, $30,000, or $50,000 – for assets the implicit return on which cannot be ignored. The Bankruptcy Code could require consideration of the implicit return on any property with a readily ascertainable rental value. Finally, it could impute rental income to any property that constitutes a significant percentage of the debtor's gross estate.

Apart from theoretical "fairness" arguments for rental income imputation, there are arguments from existing law that make the idea plausible. Rental value is central to the determination of property value,[310] particularly in partition[311] and property tax cases[312] and for other purposes.[313] Courts routinely employ a

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[308] Also known as "Wang's paradox." *See generally* MICHAEL DUMMETT, TRUTH AND OTHER ENIGMAS (1978).

[309] *See Luke* 6:41 (King James). Or because the exterminator would be unable to remove every single ant from the kitchen walls, there is no point in trying to remove the elephant from under the table.

[310] PAUL A SAMUELSON, ECONOMICS 599–600 (10th ed. 1976). Samuelson explains how "capital goods get priced in the market at their 'capitalized rate.'" Value is equal to permanent annual receipts divided by the interest rate. Rental value can thus be seen as essentially interest earned on the asset's market value. *Id*. at 599 n.2. What is perhaps conceptually troubling for this paper, therefore, is that the income to be earned on an asset is already considered in performing the liquidation test. If an asset is assigned a fair market value for purposes of liquidation, the market will (or should) have determined that asset's permanent annual receipts, discounted over time, in producing its market price. To this extent, the "disposable income" test should be entirely irrelevant to any capital income. It is relevant to labor income, however, because humans are not free to sell themselves into slavery and therefore cannot effectively liquidate the capitalized value of their labor. *See id*. at 599 n.2. Seen from this perspective, perhaps the "disposable income" test should apply only to that value which is not ascertainable under the liquidation test, viz., income from labor. If so, discrimination between capital and labor in applying the disposable income test is not an instance of horizontal inequity. And including implicit rental within the disposable income test is at best unnecessary and at worst unfair. On the other hand, if the "disposable income" test is essentially a means of capitalizing the value of labor, this perhaps suggests there is some force behind the arguments that chapter 13 is a form of peonage. *See* Karen Gross, *The Debtor as Modern Day Peon: a Problem of Unconstitutional Conditions* 65 NOTRE DAME L. REV. 165 (1990).

[311] *See, e.g.*, Kessler v. Kessler, No. H-90-29, 1991 WL 355144 (Ohio Ct. App. 1991).

[312] *See, e.g.*, New Eng. Tel. & Tel. Co. v. Bd. of Assessors, 468 N.E.2d 263, 268–69 (Mass. 1984); Matter of Seagram & Sons v. Tax Comm., 200 N.E.2d 447, 448 (N.Y. 1964). *But see* Lyman Lumber Co. v. County of Hennepin, No. TC-10176, 1992 WL 154140, at *3 (Minn. Tax 1992) (refusing to give weight to imputed income approach for valuing lumber storage buildings). Because many retail stores pay base rental and percentage rental based on sales, imputed rental approach may be modified where rental for similar property would typically be calculated in whole or in part based on retail sales. *See, e.g.*, Montgomery Ward & Co., Inc. v. County of Hennepin, No. TC-7428, 1991 WL 96258 (Minn. Tax May 31, 1991); Montgomery Ward & Co., Inc. v. County of Hennepin, No. TC-7428, 1991 WL 45721, at *2 (Minn.Tax Mar. 19, 1991); Montgomery Ward & Co., Inc. v. County of Hennepin, 450 N.W.2d 299, 308 (Minn. 1990).

[313] *See* Cier Indus. Co. v. N.Y.S. Div. of Housing and Cmty. Renewal, 517 N.Y.S.2d 660, 663 (Sup. Ct. 1987) (accepting findings of department that applicant for hardship exception to rent control regulation understated income by not including rental value of owner-occupied apartments). *But see* Saunooke v. United States, 806 F.2d 1053, 1056 (Fed. Cir. 1986) (rejecting Native American nation members' theory of imputing rental from owner-occupied "smoke shop" in order to allocate business income to category of income "directly derived" from land and therefore exempt from federal income tax); Dillon v. United States, 792 F.2d 849 (9th Cir. 1986) (holding income from "smoke shops" operating on trust land not exempt from federal income taxation).

capitalization-of-earnings approach for determining the value of property to be partitioned or taxed.[314] Similarly, where property cannot be partitioned, courts require one cotenant to compensate an ousted cotenant based on the fair rental value of the property.[315]

Bankruptcy and family courts, in determining "ability to pay," routinely impute income to individuals who are underemployed equal to the difference between what they could earn and what they actually earn.[316] In doing so, they adopt a strict accrual vision of income from human capital, consistent with the Haig-Simons definition,[317] that they are generally unwilling to apply to income from capital. Further, they impute income to those whose family members, especially spouses, earn income that they may share.[318] Some even impute income to individuals if their

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[314] *See* Crossland Fed. Sav. Bank by F.D.I.C. v. LoGuidice-Chatwal Real Estate Inv. Co. 159 B.R. 413, 418–19 (S.D.N.Y. 1993) (holding property value would be determined based on capitalized net income); New England Tel. & Tel. Co. v. Board of Assessors, 468 N.E.2d 263, 268–69 (Mass. 1984) (employing capitalization of income approach); Saratoga Harness Racing, Inc. v. Williams, 697 N.E.2d 164, 167 (N.Y. 1998) (accepting comparable lease income method as valid in determining property value); Bd. of Sup'rs of Fairfax County v. HCA Health Servs. of Va., Inc., 535 S.E.2d 163, 168 (Va. 2000) (estimating hospital's value using income capitalization analysis).

[315] *See, e.g.*, Newman v. Chase, 359 A.2d 474, 477 (N.J. 1976) (requiring, in lieu of partition, non-debtor spouse to pay co-tenant, who was judgment creditor of debtor spouse, the fair rental value of interest from which co-tenant had been ousted).

[316] *See In re* Wilson, 270 B.R. 290, 294–95 (Bankr. N.D. Iowa 2001) (holding debtor did not qualify for "undue hardship" discharge of student loans because her earning capacity exceeded her current earnings); Farrish v. United States Dept. of Education (*In re* Farrish), 272 B.R. 456, 462–63 (Bankr. S.D. Miss. 2001) (same); *In re* Baker, 274 B.R. 176, 199, 201 n.27 (Bankr. D.S.C. 2000) (holding alimony debt non-dischargeable due in part to voluntary underemployment); *In re* Klause, 181 B.R. 487, 494–97 (Bankr. C.D. Cal. 1995) (imposing punitive damages based on earning capacity rather than actual earnings); *In re* Florio, 187 B.R. 654, 656–58 (Bankr. W.D. Mo.1995) (holding marital property division non-dischargeable due in part to underemployment); Wilson v. Mo. Higher Educ. Loan Auth. (*In re* Wilson), 177 B.R. 246, 250 (Bankr. E.D. Va 1994) (holding student loans non-dischargeable due in part to underemployment); Little v. Little, 975 P.2d 108, 112–14 (Ariz. 1999) (affirming refusal of decrease in child support payments for non-custodial parent who wished to return to school); Grady v. Grady, 747 S.W.2d 77, 78–79 (Ark. 1988) (discussing court's ability to impute income to spouse who voluntarily resigns from employment); Nimtz v. Nimtz, No. CN94-06190, 1995 WL 806816, at *9 (Del. Fam. Ct. 1995) (imputing income to underemployed custodial parent); Honderick v. Honderick, 984 S.W.2d 205, 212–13 (Mo. App. 1999) (imputing income to unemployed custodial parent); Brooks v. Brooks, 992 S.W.2d 403, 407 (Tenn. 1999) (imputing income to underemployed non-custodial parent). *But see, e.g.*, Thomas v. Thomas, 989 S.W.2d 629, 636 (Mo. App. 1999) (refusing to impute income to custodial parent who was unemployed due to desire to stay at home and take care of children).

[317] *See* Lewis Kaplow, *Human Capital Under an Ideal Income Tax*, 80 VA. L. REV. 1477, 1513 (1994) (discussing Haig-Simons definitions of income in context of taxation of human capital).

[318] *See In re* Bottelberghe, 253 B.R. 256, 262–63 (Bankr. D. Minn. 2000) ("The Court agrees that in order to make an accurate determination of the debtor's disposable income, all of the nondebtor spouse's income and expenses must be disclosed and must be included in the calculation."); *In re* Carter, 205 B.R. 733, 736 (Bankr. E.D. Pa. 1996) (discussing consideration of spouse's income to be applied to the basic needs of the debtor); Eastman v. Eastman-Veres, 690 A.2d 494, 496 (Me. 1997) (declining to modify alimony payments because, despite ex-spouse having lost job, ex-spouse's savings and other benefits were sufficient). *See generally* Robert B. Chapman, *Coverture and Cooperation: The Firm, the Market, and the Substantive Consolidation of Married Debtors*, 17 BANKR. DEV. J. 105, 114–16, 120–21 (2000) (collecting cases).

spouses are underemployed.[319] Finally, they impute rental income to one spouse, who has occupancy of the marital residence, in determining what amount is required to equalize the distribution to the other spouse.[320]

State courts also impute income, for "ability to pay" purposes in the family law context, from underutilized assets.[321] Some courts are willing to impute rental income to an individual who pays less than market rental value for accommodation. The Supreme Court of Indiana has held that, for purposes of determining ability to pay child support, a non-custodial parent's living in a residence owned by a trust of which he was a beneficiary and his sister was trustee constituted "regular and continuing payments made by a family member" and supported imputing income to him.[322] On the other hand, the Wisconsin Court of Appeals has held that residential rental income could not be imputed to a non-custodial parent even though he lived rent-free in a farmhouse because the farmhouse was owned by a partnership and his 50% interest in the partnership did not give him "control" or "directing or restraining dominion" over the farmhouse.[323] The court declined to address, however, the issue whether the farmhouse could have been considered an unproductive asset that could give rise to imputed rental had it been held directly by

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[319] *See In re* Miller, 254 B.R. 200, 203–04 (Bankr. N.D. Ohio 2000) (denying debtor hardship discharge of loan because debtor and debtor's underemployed husband had optimistic earning potential); *see also In re* White, 243 B.R. 515, 517 n.4 (Bankr. N.D. Ala. 1999) (denying to reconsider order that denied discharge of student loans based on non-debtor wife's income when, in six months between hearing and entry of order, debtor's wife was laid off from employment). *But cf. In re* Moreland, 2002 WL 31478797 (Bankr. W.D. Va. Oct. 31, 2002) (refusing to dismiss chapter 7 case for substantial abuse where the record showed the debtor's spouse ran a child care business in their home but "charges significantly less than is needed to generate enough revenue to permit the business to break even"). One academic has argued that income should be imputed to individuals who do not engage in market labor but rather raise children. Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1618–19 (1996) (observing that women who perform non-market labor are excluded from certain public benefits and advocating that income be expanded to include the value of unpaid household services to require person who performs labor to pay tax on value of services). Note that routine income imputation to spouse whose occupation is domestic caretaker would effectively rewrite section 109(e), which contemplates that only one spouse needs to have regular income for both spouses to qualify for chapter 13 eligibility.

[320] *See, e.g.*, Simeone v. Simeone (*In re* Simeone), 214 B.R. 537, 548 (Bankr. E.D. Pa. 1997) (holding, in equitable distribution proceeding tried by bankruptcy judge, that the "rental value of the Debtor's use," *e.g.*, husband's rent-free use of marital property for residence and business and the net rentals realized by him on those properties, constituted secured claim by wife against husband and must be considered in making the equitable distribution award).

[321] *See In re* Marriage of Dacumos, 90 Cal. Rptr.2d 159, 161 (Cal. App. 1999) (affirming imputation of rental income to noncustodial parent for determining ability to pay child support); Whitmire v. Whitmire, 591 N.W.2d 126, 128 (N.D. 1999) (imputing, for purposes of determining ability to pay child support, income to non-custodial parent equal to fair rental value of property transferred to related party for no consideration); *see also* Sien v. Sien, 889 P.2d 1268, 1275 (Okla. Ct. App. 1995) (limiting income imputation to fair rental value of property).

[322] Glass v. Oeder, 716 N.E.2d 413, 417 (Ind. 1999).

[323] Weis v. Weis, 572 N.W.2d 123, 125 (Wis. Ct. App. 1997). The court also declined to consider the fact that the husband's brother was the other 50% partner, giving rise to income from a family member.

the parent.[324] Even so, it must be acknowledged that courts are loath to impute rental to owner-occupiers.[325]

Another argument for imputation of rental income is that bankruptcy law forbids the consumption of estate property's value for the sole benefit of the debtor or trustee. *In re Szekely*[326] clearly states that a chapter 7 trustee may charge debtors the fair market rental value of the debtor's residence.[327] *Szekely* holds, however, that the debtors cannot be charged rental for occupancy if the charges would impair Illinois's exemption for the "estate of homestead." The question was essentially whether the debtors should receive a "windfall" in the form of consumption at the expense of unsecured creditors[328] or whether the debtors should be required to pay the expenses of their own support even if requiring them to do so would hinder their ability to find substitute accommodation and thereby frustrate the purpose of the homestead exemption.[329] The debtors sought a "windfall" in the form of the full exemption amount *and* an amount ($4800) equal to their consumption of the fair rental value of the residence. Under Illinois law, however, the debtor has an "estate of homestead," which is a present possessory interest, which must not be surrendered until the homestead exemption amount is tendered. Because the rental would have impaired this protected interest, the bankruptcy court, which ordered the debtors pay the rental charge, was reversed.

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[324] *Id*. at 125 n.1.

[325] *See, e.g*., Payne v. Payne, No. 18025, 1998 WL 972294, at *4 (Va. Cir. Ct. Aug. 3, 1998) (declining to impute rental to custodial parent for owner-occupied residence), *opinion supplemented on reconsideration*, 1998 WL 957327, at *3 (Va. Cir. Ct. Dec. 30, 1998). *But cf*. Fleet v. Rhode (*In re* Fleet), 122 B.R. 910, 917–18 (E.D. Pa. 1990). *Fleet* is a fraudulent conveyance action in which the defendant homeowner-wife sought credits against the judgment for the value of improvements she had made to the property which had been fraudulently conveyed to her. The district court adopted a recommendation of the bankruptcy judge that she was entitled to the credits but that those credits were offset by rental imputed to her while she lived there rent-free. Because the conveyance was set aside, the court did not impute income to an "owner" in any absolute or pure sense.

[326] 936 F.2d 897 (7th Cir. 1991).

[327] *Id*. at 900; *see also In re* Ament, 77 B.R. 439, 440–41 (Bankr. D. Del. 1987) ("[T]he Code is clear that some compensation must be made to the bankruptcy estate when that estate is being diminished, such as by the debtor's continued use of the property.").

[328] *In re Szekely*, 936 F.2d at 901.

[329] *Id*. at 900. Viewed from a slightly different perspective, hinted at by Judge Posner, *Id*. at 902, the question is allocating the costs of acquiring funds pending the transformation of an illiquid asset into money. In order to pay them the homestead exemption amount and thereby cut off their right to stay in the residence, the trustee would have had to borrow funds or liquidate other estate assets to pay the debtors. Either option would impose transaction and opportunity costs on the estate. On the other hand, had the court held that rental charges prior to the trustee's tendering the exemption amount could reduce the amount of the exemption, the burden would be shifted to the debtors to seek some form of financing to enable them to move, to avoid incurring the costs, and to preserve the exemption amount. This alternative imposes hardship on the debtors, who may have significant difficulty "arrang[ing] for substitute housing without the assistance that Illinois meant for [them] to have through the homestead exemption." *Id*. Although Judge Posner is often accused of elevating coldly-calculated efficiency above everything else, he wrote that "[t]he hardship to the debtor should have the greater weight in decision" in order that the aim of the homestead exemption not be "blunted." *Id*. Of course, this result may be efficient, because the cost of funds to the trustee is lower than the cost of funds to the debtor and because the creditors who suffer the loss are able to spread the cost through adjustments in prices and interest rates.

The court distinguished Illinois's homestead "estate" from other states' "humbler designation 'homestead exemption'" and found Illinois's term was "not an archaic sonority but denotes a right to possession."[330] In the absence of a homestead "estate" (as under other states' laws), therefore, it is likely the court would have reached a different result. And in the absence of a homestead exemption, it is clear that the trustee may charge the debtor rental for the use of the residence included in the bankruptcy estate.[331]

One problem that arises is that, although *Szekely* clearly indicates that a trustee *may* charge a debtor rental for use of estate property, a line of cases – *United States ex. rel. Peoples Banking Co. v. Derryberry (In re Miller)*,[332] *In re Peckinpaugh*,[333] and *In re Hartley*,[334] – hold the trustee is under no *obligation* to do so. In *Derryberry*, the court held a chapter 7 trustee is under no duty to lease debtor's home pending liquidation and sale and it would, therefore, be improper to remove the trustee for failure to collect rental from debtor who lived (virtually) rent-free in residence for 30 months. The court cited no authority for the proposition that the trustee has no such duty nor did the court provide any significant analysis of the issue; it merely stated: "Clearly § 704 does not specifically create a duty to lease nonrental property and the duty to close an estate quickly is not compatible with finding rentors [*sic*] and trying to sell property burdened with leases and tenancy rights."[335] Although the trustee in *Derryberry* neither closed the estate quickly nor rented the property, and the failure to perform the duty to close the estate quickly may reasonably be said to create the duty to lease,[336] the court declined to recognize a duty to lease that is even contingent on an extended period of administration. Further, although 541(a)(6) includes within estate all rentals from estate property, the court assumed implicitly that these are actual, not imputed, rentals.[337]

In *Peckinpaugh*, decided on the same day, the same judge held the same trustee had not breached his fiduciary duty with respect to two farms within the estate by failing to lease one for an unspecified period during 1981 and failing to obtain the best rental price for either farm for an unspecified duration 1982 and 1983. *Peckinpaugh*, however, provides some reasoning behind the holding that the trustee

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[330] *In re Szekely*, 936 F.2d at 901.

[331] Given that exempt income is generally required to be included in the disposable income calculation, there does not seem to be any reason why income from an exempt asset should be excluded; the Seventh Circuit's discussion of Illinois's homestead exemption might, therefore, fairly be ignored by those whose primary concern is the debtor's ability to pay debts from future income.

[332] 50 B.R. 870, 872–73 (Bankr. N.D. Ohio 1985); *cf*. *In re* Federowicz, No. 88-3536, 1989 WL 200942, at *6 (D.N.J. Aug. 7, 1989) (finding no error in bankruptcy court's decision not to remove a chapter 11 trustee for failure to collect rental from tenants in debtor's property because, to the extent trustee may have had duty to collect rental from existing tenants, the trustee made reasonable efforts but distance and lack of funds in the estate excused trustee from actually collecting rentals), *aff'd*, 897 F.2d 521 (3d Cir.1990).

[333] 50 B.R. 865 (Bankr. N.D. Ohio 1985).

[334] 50 B.R. 852 (Bankr. N.D. Ohio 1985).

[335] *Derryberry*, 50 B.R. at 873.

[336] *See, e.g.*, *In re* Accomazzo, 226 B.R. 426, 429 (D.Ariz.1998) (finding duration of administration relevant to whether trustee breaches duty of care in not investing estate property).

[337] *Derryberry*, 50 B.R. at 873.

has no duty to lease. First, according to *Peckinpaugh*, the duty to invest money is discretionary. Second, the trustee's duty to manage other assets runs primarily to unsecured creditors;[338] the claimant in *Peckinpaugh* (and in *Derryberry*) was a secured creditor; the duty to a secured creditor is limited to that of custodian.

This line of cases is clearly at odds, however, with "the duty to maximize the value of the estate."[339] Other bankruptcy rules require the trustee to obtain, whether by action or forbearance,[340] a return on estate property. In other words, the estate is entitled to rent,[341] which may include rental payments. Section 345 requires (although it employs merely permissive language) the trustee to deposit money in an interest-bearing account.[342] This requirement is part of the trustee's broader fiduciary duty to the estate and its creditors.[343] To the extent the trustee owes a

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[338] *See* Falconbridge U.S., Inc. v. Bank One Illinois (*In re* Vic Supply Co., Inc.), 227 F.3d 928, 931 (7th Cir. 2000) (stating trustee's duty is to increase recovery of unsecured creditors); *see also In re* Droumtsekas, 269 B.R. 463, 466 (Bankr. M.D. Fla. 2000); *In re* Monzon, 214 B.R. 38, 42 (Bankr. S.D. Fla. 1997).

[339] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352 (1985) (discussing various duties of trustees including maximizing value of estate); I.R.S. v. Luongo (*In re* Luongo), 259 F.3d 323, 340 n.3 (5th Cir. 2001) (explaining trustee's duty to maximize estate for purpose of distribution to creditors); Myers v. Martin (*In re* Martin), 91 F.3d 389, 394 (3d Cir. 1996) (stating trustee has duty to advance interests of estate). *In re* Moon, 258 B.R. 828, 838 (Bankr. N.D. Fla. 2001), for example, holds that a trustee's compensation may be reduced for failing to maximize return by investing settlement proceeds in a low-interest money market account. To the extent the trustee owes a fiduciary duty to creditors, *e.g.*, *In re* Melenyzer, 140 B.R. 143, 154 (Bankr. W.D. Tex. 1992), failure to seek or receive a return from potentially income-producing assets may be a breach of that duty.

[340] *See* Louisiana World Exposition v. Fed. Ins. Co., 858 F.2d 233, 246 (5th Cir. 1988) (explaining trustee has authority to bring action for damages on behalf of debtor); Freeman v. Seligson, 405 F.2d 1326, 1333 (D.C. Cir. 1968) (stating trustee has duty to institute necessary litigation to maximize estate); *cf*. Martino v. Assco Assoc., Inc. (*In re* SSS Enter., Inc.), 145 B.R. 915, 917 (Bankr. N.D. Ill. 1992) (granting chapter 7 trustee appointed after chapter 11 conversion new two year limit to pursue actions); Sapir v. Green Forest Lumber Ltd. (*In re* Ajayem Lumber Corp.), 145 B.R. 813, 817 (Bankr. S.D.N.Y. 1992) (holding trustee need not bring preference actions which would harm interests of estate in continuing business relationships advantageous to reorganization).

[341] "Economic rent" is defined as "the return to a unique factor used in production in excess of the amount which that factor (human or nonhuman) could earn in its next best alternative employment." THE MCGRAW-HILL DICTIONARY OF MODERN ECONOMICS (3d ed. 1983); *see also* PAUL A SAMUELSON, ECONOMICS 562 (10th 1976).

[342] *See* 11 U.S.C. § 345(a) (1994); *see also* Columbia Gas Tran. Co. v. Columbia Gas Sys. Inc. (*In re* Columbia Gas Sys. Inc.), 33 F.3d 294, 301–02 (3d Cir. 1994) (holding § 345 is mandatory requirement). *But cf*. E.F. Hutton S.W. Prop. II, Ltd. v. Union Planters National Bank (*In re* E.F. Hutton S.W. Prop. II, Ltd.), 953 F.2d 963, 974 (5th Cir. 1992) (holding trustee not liable where funds were held outside interest-bearing account only for short period of time and while settlement regarding those funds was imminent). *Columbia Gas Systems* was overruled by the 1994 amendment that added section 345(b), which permits investment in other than FDIC-insured institutions but does not abrogate the basic rule that money must be invested in some form with a reasonable rate of return. *See, e.g.*, *In re* Moon, 258 B.R. 828, 837–38 (Bankr. N.D. Fla. 2001) (discussing § 345 and whether trustee can be held liable for leaving funds in non-interest bearing account); *In re* Koch, 195 B.R. 794, 795 (Bankr. M.D. Fla. 1996) (holding trustee can be held liable for negligently investing estate assets in non-interest bearing account).

[343] *See, e.g.*, Kalyna v. Swaine (*In re* Accomazzo), 226 B.R. 426, 429 (D. Ariz. 1998) (stating that trustees have fiduciary duty to conserve assets of estate).

fiduciary duty to the estate and its creditors, that duty includes requirements to invest property prudently[344] and to avoid self-dealing.[345]

I submit, therefore, that it is not beyond the pale within current bankruptcy law, to apply *Szekely* to chapter 13 cases and to require the debtor to charge himself or herself rental for the use of estate property. Under *Szekely*, rental could be charged to both chapter 7 and chapter 13 debtors. Three further objections may be interposed here. The first is that the debtor is statutorily authorized to remain in possession of estate property.[346] On the other hand, the debtor is also vested with the powers of a trustee to "use, sell, or lease property."[347] With those powers may go the fiduciary duties of a trustee. Merely because the debtor remains in possession does not mean the home is not estate property; it merely means the debtor ousts the estate from possession – should the estate be compensated for that ouster?[348]

Yet, fiduciary obligations in chapter 13 cases operate somewhat differently than in cases under other chapters. First, although trustees generally owe their fiduciary duty to unsecured creditors, chapter 13 trustees' fiduciary duties extend to both secured and unsecured creditors.[349] Second, in chapters 7 and 11, there is rarely any doubt who holds the powers and fiduciary obligations of the trustee;[350] in chapter 13, however, there is considerable and seemingly interminable disagreement about which powers of the trustee the debtor is authorized to exercise.[351] And although chapter 13 debtors are sometimes referred to as having fiduciary obligations to their creditors,[352] some courts instead acknowledge the inherent conflict between debtor

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[344] *See, e.g.*, *In re* Consupak Inc., 87 B.R. 529, 545 (Bankr. N.D. Ill. 1988) (discussing trustee's duty to invest funds of estate prudently).

[345] *See* Lopez-Stubbe v. Rodriguez-Estrada (*In re* San Juan Hotel Corp.), 847 F.2d 931, 950 (1st Cir. 1988) (upholding imposition of surcharge for self-dealing by bankruptcy trustee); United States v. Herzog, 644 F.2d 713, 716 (8th Cir. 1981) (affirming criminal conviction of bankruptcy trustee for embezzlement and self-dealing); *see also* Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc., 828 F.2d 239, 242 (4th Cir. 1987) (upholding removal of debtor in possession as trustee following acts of self-dealing); *In re* Herberman, 122 B.R. 273, 288 (Bankr. W.D. Tex. 1990).

[346] 11 U.S.C. § 1306(b) (2000).

[347] *Id*. §§ 363, 1306.

[348] *See* Kohn v. Hursa (*In re* Hursa), 87 B.R. 313, 321 (Bankr. D. N.J. 1988) (discussing marital property constituting property of estate); *In re* McKean, 81 B.R. 9, 11 (Bankr. W.D. Tex. 1987) (denying plan confirmation where plan did not include as income co-tenant's one half share of house payments and cure of arrearages).

[349] *See, e.g.*, Andrews v. Loheit (*In re* Andrews), 49 F.3d 1404, 1407–08 (9th Cir. 1995) (stating that primary objective of chapter 13 trustee is to serve interests of all creditors, not just unsecured creditors); Tower Loan of Miss., Inc. v. Maddox (*In re* Maddox), 15 F.3d 1347, 1355 (5th Cir. 1994) (suggesting that chapter 13 trustee has similar role to chapter 7 trustee in serving interests of all creditors).

[350] Under chapter 11, where the DIP has the role of trustee, a trustee may be appointed where the DIP grossly breaches its duty. *See, e.g.*, *In re* Intercat, Inc., 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000) (listing factors in court's determination to appoint trustee, e.g., misconduct, conflict of interest, self-dealing).

[351] *See, e.g.*, *In re* Driver, 133 B.R. 476, 480 (Bankr. S.D. Ind. 1991) (holding chapter 13 debtor lacked standing to assert trustee's lien avoidance powers).

[352] *See, e.g.*, *Matter of* Edwards, 962 F.2d 641, 642 (7th Cir. 1992) (explaining that chapter 13 debtor may retain possession of property as fiduciary of creditors).

and creditors that prevents chapter 13 debtors from exercising trustee functions.[353] If the debtor may use estate property, under section 1303, as a trustee would, it is perhaps not unreasonable to impose on the debtor the obligation to use the property for the benefit of the estate. And if the debtor appropriated estate property solely for her own use, such self-dealing would breach her duty to the estate and would be liable.[354]

Second, some may say that equating the chapter 7 trustee's duty to maximize the return on estate property runs counter to the basic policy that chapter 13 provides a debtor with the option of keeping property and devoting future labor to repayment of debt – the so-called "debtor's bargain."[355] However, chapter 13 is, on its face, not about labor but about income. And courts have no problem requiring the debtor to devote non-onerous income to repayment of creditors. Insisting on the distinction here merely discriminates against those whose income is derived from the sweat of their brows.

Third, imputing rental income from exempt property may eviscerate state exemption policies. However, *Szekely* is consistent with the notion that even exempt income must be used to fund the plan. Many courts include within the section 1325(b) calculation income that falls outside the estate – either because it is exempt or even because it does not belong to the debtor.[356]

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[353] *See, e.g.*, Davis v. Victor Warren Properties, Inc. (*In re* Davis), 216 B.R. 898, 903 (Bankr. N.D. Ga. 1997) (holding chapter 13 debtor did not have standing to pursue pre-petition lawsuit precisely because of conflict of interest and both the power and incentive to "destroy the value of those claims by mishandling the suits"); *see also In re Driver*, 133 B.R. at 480 (concluding that chapter 13 debtor was not intended to have similar duties and powers as trustee); *cf*. *In re* Jernigan, 130 B.R. 879, 887 (Bankr. N.D. Okla. 1991) (holding that if debtor exercises trustee's avoiding powers, debtor must do so as a fiduciary).

[354] *See* Jackson v. Levy, 2000 WL 124822, at *7 (S.D.N.Y. Feb. 2, 2000) ("[A] debtor-in-possession's fiduciary obligation to its creditors includes refraining from acting in a manner that could damage the estate or waste its assets"); *see also* G.G. BOGERT & G.T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 191 (2d ed. 1979) ("If a beneficiary is also a trustee of his own trust . . . and . . . if he steals trust funds, or causes damage to the trust estate in other ways, his share under the trust, whether in his own hands or those of a transferee, will be taken by the court in order to make good the loss"). *But see* Spicer v. Woodhouse (*In re* Woodhouse), 17 B.R. 275, 278 (Bankr. S.D. Ohio 1982) (declining to adjudicate question of chapter 13 debtors' post-petition defalcation inasmuch as it related to discharge).

[355] *See* McDonald v. Burgie (*In re* Burgie), 239 B.R. 406, 410 (Bankr. 9th Cir. 1999) (explaining debtor's bargain is that post-petition disposable income does not include pre-petition property or its proceeds).

[356] *See In re* McNichols, 249 B.R. 160, 171 (Bankr. N.D. Ill. 2000) (including within debtor-wife's income property of non-debtor husband used for children's visits to hair salons); *In re* Carter, 205 B.R. 733, 736 (Bankr. E.D. Pa. 1996) (stating non-debtor spouse's income must be included in calculation of disposable income even though it is not property of estate). *Compare* Gamble v. Brown (*In re* Gamble), 168 F.3d 442, 445 (11th Cir. 1999) (reversing bankruptcy court order requiring net proceeds from sale of the debtors' residence held by trustee to be "safeguarded and preserved in the event of a dismissal, in order to permit those claims to attach" and holding that once property is determined exempt, it ceases to be property of estate and debtor "may use it as his own"), *with In re* Stephens, 265 B.R. 335, 338–39 (Bankr. M.D. Fla. 2001) (holding proceeds of debtor-wife's workers compensation settlement are income which must be devoted to plan even if they are later determined to be exempt). *But see, e.g.*, *In re* Nahat, 278 B.R. 108, 114–15 (Bankr. N.D. Tex. 2002) (refusing to include non-debtor's spouse's earnings in disposable income calculation because under state community property law debtor lacked property interest in them); *cf.* Solomon v. Cosby (*In re* Solomon), 67 F.3d 1128, 1132 (4th Cir. 1995) (holding the debtor has no income

B. Imputing Income to Regulate Mortgage Expenditures

The second and third of my proposals address homeowners with encumbered residences. Each of these proposals turns on a particular understanding of the *timing* aspects of income and deductions. Consumer bankruptcy is a timing problem. Prior consumption results in present debts that exceed present assets. The disposable income requirement adds a future element, requiring the present liquidation of future earning capacity; means-testing would expand this element to all liquidation cases.

Chapter 13 presents two accounting issues relevant to timing. The first is whether to apply a cash-receipts-and-disbursements or accrual accounting method. The second is how to match income and expenses for the relevant accounting period. With respect to the first, the disposable income requirement contains language that suggests the appropriateness of a cash receipts and disbursements method, other language that suggests the use of something like an accrual method, and both of which indicate that some combination of the two is part of the design. Section 1325(b), for example, refers to income "received"[357] but also requires the court to project the income that is to be received.

An example perhaps applicable to average debtors involves tax refunds. Generally, tax refunds received during the plan period are included in calculating plan income.[358] This is so even if the refund is of taxes withheld from wages earned pre-petition.[359] Income in this context is accounted for on a cash receipts rather than an accrual method. Symmetry would suggest that a refund received after completion of the plan, even if of taxes withheld from wages earned during the plan period, be excluded from plan income. At the back end of plans, however, there is some possibility for manipulation.[360] Some courts are willing, therefore, to look not at "the date the tax refund is issued back or regurgitated by the IRS" but rather "when the money is earned and the period it is being withheld from."[361] The divergent rules present a conflict between a cash method of accounting at the beginning of a plan period and an accrual method at the end, which may extend to

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unless it is actually received and refusing to allow hypothetical income to be used to calculate disposable income).

[357] *See, e.g.*, *Solomon*, 67 F.3d at 1132.

[358] *In re* Abner, 234 B.R. 825, 826 (Bankr. M.D. Ala. 1999).

[359] *In re* Freeman, 86 F.3d 478 (6th Cir. 1996); *see also In re* Gillespie, 266 B.R. 721, 727 (Bankr. N.D. Iowa 2001); *cf., e.g.*, *In re* Barowsky, 946 F.2d 1516 (10th Cir. 1991) (including post-petition refund of taxes in chapter 7 estate based on proportion of income earned pre-petition from which taxes were withheld).

[360] Conceivably, a debtor could defer filing her tax return for the third year or decrease the number of exemptions claimed on her W-4 and increase the size of a refund due after discharge. A reduction in take-home pay would not reduce the amount of money the debtor would have at her disposal but would rather reduce the amount of disposable income available to creditors. And although the refunds for the first two years would be used to pay creditors, the refund for the third year would be the debtor's. She would have effectively deferred her income and thus preserved it for her own use.

[361] Midkiff v. Dinivent (*In re* Midkiff), 271 B.R. 383, 387–88 (B.A.P. 10th Cir. 2002).

more than three years the period during which the debtor is obligated to commit all disposable income to the plan.

With respect to the matching of income and expenses, the heuristic I am employing, the Haig-Simons definition of income does not specify the period that is most appropriate for the measurement of an increase in wealth.[362] Simons did, however, suggest that commitment to annual accounting – or to any "water-tight accounting period" – was perhaps misguided.[363] Nonetheless, both tax law and bankruptcy law have adopted accounting periods. Tax law employs annual accounting; under chapter 13, income and expenses must be matched for the three to five years of the plan; the remaining disposable income is committed to payment of past debts. This structure suggests that the relevant accounting period is the entire plan period, although as a concession to individual budgetary customs bankruptcy courts place heavy reliance on the calendar month for projecting disposable income.

The disposable income requirement contains language that suggests the appropriateness of a cash receipts and disbursements method, other language that suggests the use of something like an accrual method. Taken together, the provision seems to indicate that some combination of the two is part of the design. Section 1325(b), for example refers to income "received"[364] but also requires the court to project the income that is to be received.

Future savings presents one of the most difficult issues in consumer bankruptcy. To what extent should a debtor be allowed to lay aside for future consumption at the expense of paying for past consumption? Life insurance premiums during the plan period, for example, have generated precedent that provides no bright-line tests but suggests that life insurance premiums are not deductible in determining disposable income to the extent of any savings component. [365] Or assume, for example, that participation in an employee stock option plan is merely a non-cash form of income,[366] which must be used to satisfy the disposable income requirement, may a debtor participate? May a debtor exercise an option? If so, is the strike price

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[362] *See* Jeff Strnad, *Periodicity and Accretion Taxation: Norms and Implementation*, 99 YALE L.J. 1817, 1860 (1990) (stating Haig-Simons does not provide guidance in choosing period for accretion taxation).

[363] HENRY SIMONS, FEDERAL TAX REFORM 59–60 (1950). Closely related to the definition of income is the method of accounting employed for determining where income arises. Simons is not always clear when he is constructing a definition of income and when he is addressing timing issues. Unrealized appreciation may, for example, be excluded from the definition of income or may be excluded from strict accrual treatment and thus attribute entirely to the period which encompasses the sale.

[364] *See* Solomon v. Cosby (*In re* Solomon), 67 F.3d 1128, 1132 (4th Cir. 1995) (holding debtor has no income unless it is actually received).

[365] *See In re* Smith, 207 B.R. 888, 890 (B.A.P. 9th Cir. 1996) (disapproving blanket rule disallowing deduction for life insurance premiums, distinguishing life insurance products with retirement component from those "intended to legitimately protect the debtor's dependents from destitution if the debtor were to die" and requiring case-by-case analysis); *see also In re* Heffernan, 242 B.R. 812, 817 (Bankr. D. Conn. 1999) (disallowing portion of life insurance premiums, as representing savings, in determining whether petition was substantial abuse).

[366] *See In re* Crippin, 877 F.2d 594, 597 (7th Cir. 1989) (concluding employee stock ownership plan was not simply contract to purchase stocks but an "alternative form of compensation to straight wages.").

deductible as necessary for support or maintenance?[367] May a debtor defer recognizing any value received until the stock is sold? For most debtors, to quote Simons out of context, "[t]he opportunities for . . . avoidance by changing the form of one's receipts are meager indeed," but where they exist, there should be a relatively simple answer to whether the receipt should be included as income and when.

An example perhaps more readily available to average debtors involves tax refunds. Generally, tax refunds received during the plan period are included in calculating plan income.[368] This is so even if the refund is of taxes withheld from wages earned pre-petition.[369] Income in this context is accounted for on a cash receipts rather than an accrual method. Symmetry would suggest that a refund received after completion of the plan, even if of taxes withheld from wages earned during the plan period, be excluded from plan income. At the back end of plans, however, there is some possibility for manipulation.[370] Some courts are willing, therefore, to look not at "the date the tax refund is issued back or regurgitated by the IRS" but rather "when the money is earned and the period it is being withheld from."[371] The divergent rules present a conflict between a cash method of accounting at the beginning of a plan period and an accrual method at the end, which may extend to more than three years the period during which the debtor is obligated to commit all disposable income to the plan.

Another common example involves pensions. Bankruptcy courts are frequently called on to decide whether a debtor may contribute to a pension or may repay a pension loan. In the latter cases, all courts examine repayment of pension loans under the disposable income test, determining whether the repayment of the loan is reasonable and necessary for the debtor's maintenance and support.[372] These courts,

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[367] *See In re* Festner, 54 B.R. 532, 533 (Bankr. E.D.N.C. 1985) (finding weekly deductions for voluntary retirement program, stock purchases, and monthly payments toward satisfaction of loan were not necessary for maintenance or support of debtor).

[368] *See In re* Abner, 234 B.R. 825, 826 (Bankr. M.D. Ala. 1999) (holding debtor's non-exemptible tax refunds reasonably expected to be received in future months were included in disposable income).

[369] *See* Freeman v. Schulman (*In re* Freeman), 86 F.3d 478, 479 (6th Cir. 1996) (holding tax refund not automatically exempt even if pre-petition); *cf.* Barowsky v. Serelson (*In re* Barowsky), 946 F.2d 1516, 1517–18 (10th Cir. 1991) (including post-petition refund of taxes in chapter 7 estate based on proportion of income earned pre-petition from which taxes were withheld).

[370] Conceivably, a debtor could defer filing her tax return for the third year or decrease the number of exemptions claimed on her W-4 and increase the size of a refund due after discharge. A reduction in take-home pay would not reduce the amount of money the debtor would have at her disposal but would rather reduce the amount of disposable income available to creditors. Although the refunds for the first two years would be used to pay creditors, the refund for the third year would be the debtor's. The debtor would have effectively deferred her income and thus preserved it for her own use.

[371] Midkiff v. Dunivent (*In re* Midkiff), 271 B.R. 383, 387–88 (B.A.P. 10th Cir. 2002).

[372] *See* Harshbarger v. Pees (*In re* Harshbarger), 66 F.3d 775, 777 (6th Cir.1995) (affirming district court's holding that expenditure was not reasonably necessary for debtors support); *In re* Padro, 252 B.R. 809, 812 (Bankr. M.D. Fla. 2000) (holding debt payments could not withstand assessment of reasonableness and necessity).

however, confuse payment of an expense with repayment of a debt.[373] One court has suggested a more satisfying method of resolving these cases; *In re Helms*[374] adumbrates an approach under which the court must decide whether repaying a pension loan in full unfairly discriminates against other creditors.[375]

The former cases, in which the debtor seeks to make contributions to a retirement fund, are also examined under the disposable income test,[376] although courts are divided, however, on the circumstances that would make the contributions necessary in cases in which the contributions are "mandatory" as conditions of the debtor's employment.[377] Although the costs of producing income are generally deductible under both accounting and tax rules, the costs of the "mandatory" retirement contributions will likely be recaptured by the debtor after the plan period.[378] Like the pension loan repayment cases, therefore, they present a timing problem. The debtor effectively places funds beyond the reach of creditors currently and enjoys the use the funds after her debts are discharged.

Bankruptcy courts seem to have no difficulty holding "pension plans and stock purchases may be a wise investment which enhance an individual's financial security, but the debtor is not entitled to acquire them at the expense of unpaid creditors."[379] The same timing problem presents itself with great frequency – although it is rarely seen as such – when the debtor pays her mortgage. Debtors'

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[373] *See In re Padro*, 252 B.R. at 812 (holding debt payments could not withstand assessment of reasonableness and necessity); *In re* Humphrey, 165 B.R. 508, 510 (Bankr. M.D. Fla. 1994) (holding debtor's repayment of secured loan on investment property was not reasonable and necessary expense for maintenance and support). For an example of how a 401(k) loan might appear as a hybrid pension loan and credit card debt, *see*Dept. of Labor, Opinion No. 95-17A, Pens. Plan Guide (CCH) P 19,983T, 1995 WL 406911 (June 29, 1995).

[374] 262 B.R. 136 (Bankr. M.D. Fla. 2001).

[375] *Id*. at 141.

[376] *See, e.g.*, Feldmann v. Feldmann (*In re* Feldmann), 220 B.R. 138, 145 (Bankr. N.D. Ga. 1998) (holding voluntary payments to 401K were not necessary living expense and therefore not deductible from disposable income); *In re* Cavanaugh, 175 B.R. 369, 373 (Bankr. D. Idaho 1994) (finding because payments to 401K were voluntary, contribution must be considered disposable income); *In re* Fountain, 142 B.R. 135, 137 (Bankr. E.D. Va. 1992) (considering debtor's payment to pension fund part of disposable income); *In re* Festner, 54 B.R. 532, 533–34 (Bankr. E.D.N.C. 1985) (asserting debtor's plan did not include all disposable income because among other defects, debtor did not include voluntary payments to retirement plan).

[377] *Compare In re* Tibbs, 242 B.R. 511, 521 (Bankr. N.D. Ala. 1999) (finding "mandatory" contributions, which are condition of debtor's employment, are reasonable and necessary for debtor's maintenance and support), *with In re* Mendoza, 274 B.R. 522, 525 (Bankr. D. Ariz. 2002) (holding "mandatory" contributions are not necessary for debtor's maintenance and support), *and In re* Nation, 236 B.R. 150, 154–55 (Bankr. S.D.N.Y. 1999) (same). Courts also differ on precisely what test to apply. *Compare In re* Mills, 246 B.R. 395, 401 (Bankr. S.D. Cal. 2000) (applying case-by-case analysis), *and Tibbs*, 242 B.R. at 516 (same), *with In re* Heffernan, 242 B.R. 812, 818 (Bankr. D. Conn. 1999) (adopting per se rule), *and In re* Watkins, 216 B.R. 394, 396 (Bankr. W.D. Tex. 1997) (same).

[378] The court in *In re Johnson*, 241 B.R. 394 (Bankr. E.D. Tex. 1999), stated:

> While it is true that the debtor's contribution in each instance results in an increase of exempt assets protected from the reach of creditors under Texas law, one cannot escape the simple distinction that the mortgage payment is a return of money borrowed from a third-party source, while the pension repayment is a return of money to oneself.

Id. at 401.

[379] *In re* Festner, 54 B.R. 532, 533 (Bankr. E.D.N.C. 1985).

paying of mortgages presents a timing distortion because the debtor enjoys current income after the completion of the plan and discharge of unpaid debts. Anecdotal evidence suggests homeowners in bankruptcy are allowed to choose higher consumption levels relating to accommodation and are relatively unsupervised in that choice by trustee or court. Renters, however, are much less free and much more supervised. The courts carefully supervise the amounts spent for rental.[380] The disposable income test in chapter 13 (and the substantial abuse standard in chapter 7, to the extent it incorporates the disposable income test)[381] requires expenses deducted in determining disposable income to be "reasonably necessary to be expended for maintenance and support of the debtor or a dependent."[382] Rental payments clearly fit within the concept of an expense and can easily be analyzed as reasonable necessary or not. Mortgage payments, however, are somewhat more problematic. Although most courts will examine the reasonableness of a mortgage payment,[383] a significant minority adhere to the principle that the payment of an allowed secured claim may not be questioned under the disposable income analysis (because the debtor is devoting the income necessary to pay that claim to the plan) but may be examined only under the notion of "bad faith."[384] The majority, however, reject this "plain language" reading of section 1325(b) because it would,

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[380] *See In re* Buntin, 161 B.R. 466, 468 (Bankr. W.D. Mo. 1993) (finding substantial abuse where debtors proposed to spend $550 each month on housing, when current housing cost them only $350 for family of two adults); Unites States Trustee v. Wray (*In re* Wray), 136 B.R. 122, 125 (Bankr. W.D. Pa. 1992) (finding substantial abuse where debtors were spending $722 per month on rental and utilities for family of two); *In re* Nolan, 140 B.R. 797, 803 (Bankr. D. Colo. 1992) (finding substantial abuse where debtor had "excessive expenses" for rental and home maintenance).

[381] *See, e.g.*, Stuart v. Koch (*In re* Koch), 109 F.3d 1285, 1288 (8th Cir. 1997) (finding substantial abuse standard in chapter 7 cases involves hypothetical chapter 13 proceeding).

[382] 11 U.S.C. § 1325(b)(2) (2000).

[383] *See, e.g.*, *In re* Roselle, 274 B.R. 486, 490 (Bankr. S.D. Ohio 2002) (holding debtor's $1809 mortgage payment was not reasonably necessary for debtor's support or maintenance and that debtor could reduce expenses by moving into an apartment); *In re* Beckel, 268 B.R. 179, 182 (Bankr. N.D. Iowa 2001) (holding chapter 7 debtors' payment of $1207 in mortgage payments and $510 in utility payments were unreasonable in light of IRS standards providing for $834 for housing and utilities); Walton v. Smith (*In re* Smith), 229 B.R. 895, 899 (Bankr. S.D. Ga. 1997) (holding chapter 7 debtor's attempt to continue paying mortgage of $1695 was evidence of bad faith); *In re* Duncan, 201 B.R. 889, 896 (Bankr. W.D. Pa. 1996) (finding substantial abuse where chapter 7 debtor paid $4550 in mortgage and property taxes on residence); *In re* Kitson, 65 B.R. 615, 621 (Bankr. E.D.N.C. 1986) (refusing to confirm chapter 13 debtors' plan where debtors budgeted for $1925 home mortgage expense); *In re* Jones, 55 B.R. 462, 467 (Bankr. D. Minn. 1985) (refusing to confirm chapter 13 debtor's plan where debtor budgeted $989 in home mortgage expense).

[384] *See, e.g.*, *In re* Jones,119 B.R. 996, 1004–05 (Bankr. N.D. Ind. 1990) (dismissing chapter 13 case for bad faith where debtor sought to retain automobile and pay secured claim in full with small payment to unsecured creditors). *But see In re* Nolan, 140 B.R. 797, 803 (Bankr. D. Colo. 1992) (holding that payment of a mortgage on residential property was not a necessary expense). Some of these cases, whether decided under "good faith" or "disposable income," suggest that the nature and value of the item to be retained—rather than the problem of acquisition indebtedness – is most significant in determining the debtor's bad faith. *E.g., In re* Rogers, 65 B.R. 1018, 1022 (Bankr. E.D. Mich.1986) (holding debtor did not satisfy disposable income test where plan called for debtor to retain a Corvette upon which a large secured claim was owed and to relinquish a Chevrolet Cavalier, and noting that "the debtor is pampering her own psyche at the expense of her unsecured creditors"). One judge has observed that judges in some cases may have been influenced by the debtors' attempt to retain red cars. *In re* Cordes, 147 B.R. 498, 501 n.3 (Bankr. D. Minn. 1992).

in effect, reward debtors with large secured debt.[385] In either case, many courts allow amounts for mortgage payments that would be unthinkable for rental payments.[386]

The significant difference between the amounts renters and homeowners pay for accommodation[387] may perhaps be explained by owners' having more dependents and thus requiring expensive additional space or may perhaps be attributable to courts' tolerance for higher mortgage payments whether examined under "good faith" or "disposable income." The Bankruptcy Reform Act of 2001 would codify the distinction between rental payments, which are subjected to administrative guidelines and to "reasonable and necessary" limitations,[388] and mortgage payments, which are not.[389] Professor Charles Jordan Tabb has observed this distinction and its possibility for "moral hazard and perverse incentives."[390] Because all contractually-owed amortized payments on secured debt are allowed, whether reasonable or necessary, they could be challenged or denied, an inquiry as to their reasonability or necessity or the circumstances of their being incurred "could only be raised in a general good faith assessment."[391]

Although the Bankruptcy Reform Act of 2001 distinguishes mortgage debt from other housing expenses, bankruptcy courts do not always observe an absolute distinction between a debt and an expense. The preferred solution, for example, to prevent chapter 13 debtors from confirming plans under which they will repay 401(k) loans in full but pay other unsecured debt only in part is to call the repayment of the 401(k) loan an unreasonable or unnecessary expense.[392] The

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[385] *See, e.g.*, *In re* Brooks, 241 B.R. 184, 186 n.1 (Bankr. S.D. Ohio 1999); *In re* Hedges, 68 B.R. 18, 20 (Bankr. E.D. Va.1986); s*ee also* Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 24–25 (2001).

[386] *Compare In re* Burgos, 248 B.R. 446, 450–51 (Bankr. M.D. Fla. 2000) (refusing to dismiss for bad faith where debtors monthly mortgage payment was $2,641.27 on house valued at $275,000), *and In re* Presley, 201 B.R. 570, 575 (Bankr. N.D. Fla.1996) (considering $1267 mortgage payment in Gainesville, Florida, reasonable and necessary), *and In re* Gillead, 171 B.R. 886, 892 (Bankr. E.D. Ca. 1994) (finding $1,733 mortgage payment in Sacramento, California, was reasonable and necessary), *with In re* Nolan, 140 B.R. 797, 803 (Bankr. D. Colo. 1992) (finding rental payments of $1320 per month for a condominium in Denver unreasonable).

[387] *See* Ed Flynn & Gordon Bermant, *The Class of 2000*, AM. BANKR. INST. J., Oct. 2001, at 20.

[388] Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 102(a) (1st Sess. 2001) (adding new § 707(b)(2)(A)(I)(ii)(I) & (V)).

[389] *Id*. (adding new § 707(b)(2)(A)(iii)(I)(aa)).

[390] Tabb, *supra* note 385, at 27; *see also* Judge Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177, 204 (1999) (discussing the same "maneuver" but finding it "implausible"). Tax scholars often address the same issue, although in different terms. *See, e.g.*, Michael J. McIntyre, *An Inquiry into the Special Status of Interest Payments*, 1981 DUKE L.J. 765, 801 (arguing an unlimited interest deduction "creates a negative income tax for high bracket taxpayers who borrow to finance the purchase of appreciating assets").

[391] Tabb, *supra* note 385, at 27.

[392] *See, e.g.*, *In re* Esquivel, 239 B.R. 146, 149 (Bankr. E.D. Mich. 1999). This solution is predicated on the view that such transactions are not true debts, a sensible enough view but one which raises some problems under ERISA and the Tax Code; *see also* Robert B. Chapman, *Why "ERISA-Qualified" is Nonsense Upon Stilts: The Tax and Bankruptcy Treatment of § 457 Plans*, 39 WILLAMETTE L. REV. (forthcoming 2003).

problem with this relatively simple solution is that repayment of debt is almost *never* an expense reasonably necessary to the maintenance or support of the debtor or a dependent. Debtors can survive quite well without repaying credit cards, for example. Nevertheless, bankruptcy courts sometimes scrutinize debt repayment as if it were an expense; this option will be foreclosed for excessive mortgage payments under the Bankruptcy Reform Act's means-testing provisions.

My proposal, to impute income to every homeowner equal to the fair rental value of the home, addresses the timing aspect of consumer bankruptcy and addresses equity concerns arising from precluding review of mortgage expenditures – and does so without requiring recourse to the amorphous rules of good faith. Each debtor to whom income was imputed would also be allowed an expense equal to the lesser of the amount of imputed income or the maximum amount allowable as a reasonable and necessary expense of housing.

Imputing rental income to debtors and allowing them a reasonable imputed rental expense addresses two problems for debtors with mortgages. First, it addresses the problem of debtors' acquiring an asset for future consumption while failing to pay for past consumption – in essence pre-paying rent while skipping out on a credit card bill. Second, it provides a way to eliminate debtors' making an unwise investment by pre-paying rental expenses in excess of the market rate.

1. Debtors should not be allowed to pay their mortgages

First, my proposal prevents debtors from saving for the future before paying for the past. In defense of the home mortgage interest tax deduction, Professor Snoe advances the justification that although homes are an investment, homeowners are otherwise denied a deduction for "personal" investment costs.[393] This observation is useful in bankruptcy law, where homes are equally an investment but debtors are generally not allowed to invest before they repay their debts.[394]

Many commentators have discussed debtors' desire to keep their homes.[395] Homes, however, are not merely an asset. Debtors, just as anyone else, derive many emotional benefits from home ownership and under a utility-based definition of income, those benefits would constitute "psychic income."[396] Nor are homes

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[393] Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L. REV. 431, 453 (1991). *But see* Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347, 1359–61 (2000) (observing that tax law generally limits investment deduction to amount of investment income).

[394] *E.g.*, *In re* Lindsey, 122 B.R. 157, 158 (Bankr. M.D. Fla. 1991) ("Although investments may be financially prudent, they certainly are not necessary expenses for the support of the debtors or their dependents").

[395] *See, e.g.*, Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 528 (1993); *see also* Roberta F. Mann, *The (Not So) Little House on the Prairie*, 32 ARIZ. ST. L.J. 1347, 1390 (2000).

[396] *In re* Rogers, 65 B.R. 1018, 1022 (Bankr. E.D. Mich. 1986) (holding debtor did not satisfy disposable income test where plan called for debtor to retain Corvette upon which large secured claim was owed and to relinquish a Chevrolet Cavalier and criticizing debtor for "pampering her own psyche").

merely an asset that underlies individuals' and families' hopes and dreams. Home-ownership, as opposed to mere occupation of a home, is also an item of consumption. And, under an economic-value definition of income, the rental value of an owner-occupied residence is income.[397] Professor Dickerson has advocated restricting a debtor's ability to engage in consumption that provides the debtor with psychic benefit but which does not provide a "direct, tangible, economic benefi[t] to the debtor."[398] A reasonable application of this restriction would entitle a court to ask whether ownership, as opposed to mere occupation, provides the debtor with an economic benefit; a corollary question would be whether this is a benefit the debtor should be able to keep.

There has been considerable debate about whether debtors should be allowed to keep their homes. Bankruptcy cases in Florida[399] and Texas[400] call attention to potential abuse of unlimited homestead exemptions that allow debtors to retain and consume the value of a home at the expense of their creditors.[401] The same phenomenon occurs, however, when debtors are allowed to retain their ability to continue funding a home purchase. This second phenomenon, if it is a problem at all, is compounded when the cost of servicing the interest on the outstanding principal balance exceeds the rental value of the home. For these debtors, therefore, who are paying primarily interest, the amount of their mortgage payments should somewhat approximate and could be limited to the fair rental value of their homes. One solution is to impute rental. That solves all three problems.

The effort to keep one's house, understandable or not, has an effect on other creditors. It must be remembered, however, that trying to "keep one's house" in bankruptcy is often not exactly that but rather trying to keep acquiring clear title. Paying to acquire clear title reduces repayment of other creditors. Allowing full payment for a house is, therefore, another instance of whatever inequity there is in permitting full payment of secured creditors at the expense of unsecured creditors.[402] For the homeowner, the mortgage payment includes an amount for current occupancy of the house – an amount roughly equal to the product of the

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[397] *See* discussion *supra* Part III.A.

[398] A Mechele Dickerson, *Lifestyles of the Not-So-Rich or Famous: The Role of Choice and Sacrifice in Bankruptcy*, 45 BUFF. L. REV. 629, 642–43 (1997).

[399] *See, e.g.*, Bank Leumi Trust Co. of N.Y. v. Lang, 898 F. Supp. 883, 887 (S.D. Fla. 1995) (exempting home valued at $522,000 and recently purchased when debtors moved from New Jersey); *In re* Primack, 89 B.R. 954, 958–59 (Bankr. S.D. Fla. 1988) (exempting home worth $450,000 recently purchased when debtors moved from Colorado).

[400] The most famous Texas homestead case is perhaps that of former governor and candidate for U.S president John Connally. *See* JAMES RESTON, JR., THE LONE STAR: THE LIFE OF JOHN CONNALLY (1989).

[401] *See generally* G. Eric Brunstad, Jr., *Bankruptcy and the Problems of Economic Futility: a Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499, 583–84 (2000); A. Mechele Dickerson, *Bankruptcy Reform: Does The End Justify The Means?*, 75 AM. BANKR. L.J. 243, 265–66 (2001).

[402] *See, e.g.*, Lucian A. Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1643–49 (1991); Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436 (1997); *see also* Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1899 (1994) (defining "security" as "an agreement between A and B that C take nothing.").

interest rate and the value of the house.[403] Payment of a twenty- or thirty-year mortgage is essentially equivalent to pre-paying the cost of accommodation consumption for the rest of time[404] – precisely a "hidden" form of "savings." This hidden savings can be captured for benefit of unsecured creditors by imputing rental income to debtors and limiting the payment for accommodation to the cost of current accommodation.

In bankruptcy, not only do the definitions of income and of expenses matter, just as they do in tax, but other issues that are important in tax are important in chapter 13 also. Two crucial concepts are timing and the matching of income and expense. Tax law distinguishes between currently deductible expenses and capital expenditures. Provided a current expense meets the criteria for deductibility (as a necessary business expense or as an expense associated with profit-seeking), such an expense may be subtracted from current income. A capital expenditure, however, cannot reduce current income. It has been a foundation of tax law since the inception of the income tax – and its administration on an annual basis – that the acquisition cost of a long-lived asset may not offset income in the current accounting period.[405] Rather, the cost must be capitalized to offset income over a longer period. As a cost with greater temporal benefit, it must reduce income over the period in which it contributes to income. As a standard law school casebook explains, allowing a current deduction for a capital expenditure "would result in excessive mismatching of income and the expenses that produced that income.

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[403] *See* Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 85 (1990); *see also* PAUL A. SAMUELSON, ECONOMICS 599–600 (10th ed. 1976); Anthony P. Polito, *Borrowing, Return of Capital Conventions, And The Structure of The Income Tax: An Essay in Statutory Interpretation*, 17 VA. TAX REV. 467, 487 n.40 (1998) (arguing that "[i]nterest payments are the equivalent of rent for the creditor's portion of the property and principal amortization is the equivalent of a progressive repurchase of the property interest"). *See generally* Penn Central Transp. Co. v. City of New York, 377 N.Y.S.2d 20, 35 (App. Div. 1st. Dept. 1975) (holding for purposes of Fifth Amendment compensation for takings, "figures of rent and interest on the value of the property are economic equivalents"), *aff'd*, 42 N.Y.2d 324, 366 (1977), *aff'd*, 438 U.S. 104 (1978). Professor Polito's characterization is, as he points out, inconsistent with *Crane v. Commissioner*, 331 U.S. 1, 6–10 (1947). It is also at odds with the principle of bankruptcy law, reflected in *Whiting Pools* and other turnover cases, that a secured lender "owns" nothing of the collateral and the debtor is entitled to use, sell, or lease the property in spite of the secured lender's security interest (even a possessory one). Nonetheless, the economics of a mortgage remain that the mortgagor pays in part for current occupancy (rental) and in part for the fee interest. This "rental" amount, in addition to being considerably less than the rental paid by the renter, may also be heavily subsidized by the government through interest being deductible. I.R.C. § 163(h)(2)(D) & (3). However, given that most home-owning debtors have relatively low incomes, SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 215, and would not benefit from deduction itemization, the vast majority probably reap no significant benefit from the tax expenditure for mortgage interest. *See* Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347, 1359–61 (2000).

[404] Net of certain costs that are usually included in rental (more like a triple-net lease for infinity – net of taxes, insurance, (and maintenance) – and with an unrestricted right to sublease.

[405] *See, e.g.*, INDOPCO v. Comm'r, 503 U.S. 79, 86–87 (1992); Comm'r v. Idaho Power Co., 418 U.S. 1, 12 (1974); Comm'r v. Lincoln Savs. and Loan Ass'n, 403 U.S. 345, 354 (1971); United States v. Hilton Hotels, 397 U.S. 580, 583 (1970); Woodward v. Comm'r, 397 U.S. 572, 574–75 (1970); Comm'r v. Tellier, 383 U.S. 687, 689–90 (1966); Helvering v. Winmill, 305 U.S. 79, 84 (1938).

Indeed, it is the matching of current expenditures with future benefits that is at the heart of the capitalization requirement."[406] Consequently, the acquisition cost of property with a limited useful life may be recovered through the depreciation deduction over the period of the property's useful life. Alternatively, the acquisition cost of non-depreciable property may be recovered only on disposition of the asset by subtracting the adjusted basis from the amount realized in determining gross income.[407] These rules do not derive merely from the technicalities of the Tax Code but, according to the Supreme Court, from "accounting and taxation realities"[408] and from "[a]ccepted accounting principles and established tax principles."[409]

The Tax Code allows a current deduction, therefore, for current rental payments[410] but requires capitalization of advance rental payments[411] just as it does for acquisition costs.[412] Deduction-versus-capitalization is of great importance in tax law because of its annual accounting rules. In chapter 13, however, it is of no less significance; chapter 13 has only three accounting periods: the eternity of time before the plan period, the plan period itself, and the eternity of time after the plan period. To the extent chapter 13 a tax, the tax is imposed only during the plan period. The matching of income and expenses during a given accounting period, therefore, takes on perhaps even greater significance.

The purchase of a residence can be seen as pre-paying rental for forever.[413] Depending on the period of amortization, interest rates (the risk-free rate and risk premium), rate of appreciation, and the relative scarcity of residential property for sale or lease in the local market, the amount of mortgage payments may be higher or lower than rental for the same property. Where rental is higher, unsecured creditors subsidize the debtor's choice to consume income the property could generate. Where mortgage payments are higher, however, unsecured creditors subsidize the debtor's – and the debtor's spouse's and dependents' and heirs' – maintenance and support after the plan period.

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[406] J. MARTIN BURKE & MICHAEL K. FRIEL, TAXATION OF INDIVIDUAL INCOME 266 (6th ed. 2002).

[407] Here, I am not referring to property that is non-depreciable because it fails the trade or business test; that has no application to an analogy to 1325(b), which does not distinguish between business and personal expenses. Rather, I mean non-depreciable because it has (theoretically) an infinite useful life.

[408] *Idaho Power Co*., 418 U.S. at 10.

[409] *Id*. at 12.

[410] I.R.C. § 162(a)(3) (2000). Of course, under the tax rules, the rental expense must be an ordinary and necessary expense in the carrying on of a trade or business. The trade-or-business requirements would not be relevant to deductibility under bankruptcy's disposable income test, which specifically permits the deduction of personal expenses. The issues bankruptcy and tax have in common, therefore, are whether the expense is "necessary" (as interpreted under the Tax and Bankruptcy Codes, respectively) and whether the expense is ordinary or extraordinary, which raises the timing issue. Bankruptcy law, like tax law, distinguishes to some extent between ordinary and extraordinary expenses. *See e.g.*, *In re* Briscoe, 16 B.R. 128, 130 (Bankr. S.D.N.Y. 1981).

[411] *E.g.*, Wolan v. Comm'r, 184 F.2d 101, 104 (10th Cir. 1950); Wiseman v. Comm'r, T.C. Memo 1987-364, 53 T.C.M. (CCH) 1432, T.C.M. (P-H) ¶ 87,364 (1987); *see also* Treas. Reg. § 1.162-11(a).

[412] *E.g.*, Treas. Reg. § 1.263(a)-2(a).

[413] PAUL A. SAMUELSON, ECONOMICS 599–600 (10th ed. 1976).

Assuming that mortgage costs include acquisition cost that is economically the same as pre-paying rental expenses forever, allowing or requiring a debtor to pay a mortgage in full without modification creates an asymmetry by including in the calculation of disposable income only three years of income but something more in what is effectively deducted as an expense. Just as income tax rules require acquisition costs and pre-paid rental costs under long-term leases to be capitalized rather than expensed currently,[414] bankruptcy law should require acquisition costs to be amortized over the shorter of the useful life of the property or deferred until the end of the debtor's holding period in order to avoid "excessive mismatching of income" and prevent "hidden savings" at the expense of creditors.

The "savings" aspect of mortgage payments, which raises the same issue as deferred compensation cases,[415] is illustrated by *In re Elrod*.[416] The debtors in *Elrod* attempted to confirm a plan under which they accelerated payment of their mortgage to "increase their equity in the mortgaged property more rapidly."[417] The increase in mortgage payments reduced the payments to unsecured creditors. Although the court confirmed the plan, it raises the question: At what rate is it appropriate for debtors to acquire equity at the expense of unpaid creditors. No court would allow a renting debtor to modify a plan, reducing payments to unsecured creditors, to allow her to buy a house.[418] To allow a debtor to make principal payments that increase her equity and constitute "hidden savings" is inconsistent with courts' treatment of renters and of employees who wish to defer their compensation, saving for retirement, rather than repay their creditors. Nonetheless, bankruptcy law and state exemption law is very protective of the "right to make mortgage payments in the future and thus create a future equity."[419]

To the extent that the debtor is effectively expensing a portion of her "maintenance and support" for the rest of her life, permitting her to do so at the expense of current creditors is inconsistent with the purpose of the disposable income test, which is sometimes understood to require payment to unsecured

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[414] *E.g.*, *Wolan*, 184 F.2d at 104; *Wiseman*, T.C. Memo 1987-364, 53 T.C.M. (CCH) 1432, T.C.M. (P-H) ¶ 87,364; (1987); *see also* Treas. Reg. § 1.162-11(a).

[415] *See supra* notes 165–68 and accompanying text.

[416] 270 B.R. 258 (Bankr. E.D. Tenn. 2001).

[417] *Id*. at 260.

[418] *See* Arnold v. Weast (*In re* Arnold), 869 F.2d 240, 244 (4th Cir. 1989) (affirming bankruptcy court's modification increasing plan payments based in part on holding that debtor may not deduct from disposable income $1700 per month in mortgage payments for addition to house acquired during chapter 13 plan period); *In re* Edwards, 190 B.R. 91, 95 (Bankr. M.D. Tenn. 1995) (approving chapter 13 debtor's motion to incur debt to purchase house in part because no creditor under the plan would be adversely affected); *In re* Anderson, No. 587-03218, 1989 WL 222971, at *6 (Bankr. N.D. Cal. Sept. 8, 1989) (approving trustee's motion to modify plan by increasing payments to unsecured creditors by amount of net equity realized on sale debtor's residence and denying debtor's motion to modify to reduce plan payments by increase in amount of mortgage on larger new house); *In re* Thurmond, 41 B.R. 464, 465 (Bankr. D. Or. 1983) (denying chapter 11 debtor-in-possession's motion to incur debt to acquire residence where purchase could adversely affect successful reorganization).

[419] *See In re* Ricks, 40 B.R. 507, 508 (Bankr. D. Col. 1984) (allowing debtor to exempt value of aggregate interest in property exceeding amount of equity (citing *In re* Chesanow, 25 B.R. 228 (Bankr. D. Conn. 1982)).

creditors of all income less only expenses for maintenance and support during the life of the plan.[420] The purchase of a house is equivalent to permitting the debtor to deduct from disposable income an amount she would need to pay rental for some portion of her life after the completion of the plan, a contingency fund no court would countenance. To the extent the expense creates an asset with a useful life that extends significantly beyond the period of the plan, the debtor should not be permitted currently to deduct the portion allocable to future maintenance and support.[421] Rather, the debtor should be required to capitalize and amortize the expense over the useful life of the asset – in other words, lease it.[422] In sum, repayment of mortgage principal, or acquisition cost, is not necessary solely for current maintenance and support, but is rather future savings at expense of creditors.[423]

However, reducing the deduction by the amount of principal in excess of market rental would run afoul of several provisions of chapter 13 designed both to allow debtors to remain in their (unpaid-for) homes and to ensure full payment to residential lenders. Section 1322(b)(2), for example, prohibits a debtor from modifying the rights of a secured creditor holding a claim secured only by the debtor's principal residence. One option would be, therefore, to require the debtor to surrender the home as a condition for confirmation. Apart from the fact that many debtors choose chapter 13 specifically to keep their homes, section 1322(b)(5) specifically provides debtors with the ability to maintain payments on "any

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[420] *Compare In re* Lindsey, 122 B.R. 157 (Bankr. M.D. Fla.1991) (refusing to allow debtor to make payments on non-income producing investment property), *and In re* Festner, 54 B.R. 532, 533 (Bankr. E.D.N.C. 1985) (refusing confirmation to plan which provided debtor could purchase voluntary retirement benefits and IBM shares, enhancing debtor's future security "at the expense of unsecured creditors"), *with In re* Tibbs, 242 B.R. 511 (Bankr. N.D. Ala.1999) (holding amounts of debtor's mandatory contribution to Alabama teachers' retirement system not included in disposable income because they were necessary for debtor to retain his job).

[421] *See* Treas. Reg. 1.461-1(a)(1). The notion that expenses of any given period should be chargeable against the income of the same period is a relatively old one. *See, e.g.*, GIOVANNI BOTERO, THE WORLDE, OR AN HISTORICALL DESCRIPTION OF THE MOST FAMOUS KINGDOMES AND COMMON-WEALES THEREIN 196 (Robert Johnson, trans., 1601) (mentioning "[p]aying the expence of one yere with the income of another").

[422] Judge Jones and Professor Zywicki mention a possible "maneuver" debtors might try in order to avoid the effect of proposed means-testing and therefore liquidate under chapter 7 rather than repay creditors in chapter 13. A debtor, they suggest, "could deliberately incur secured debt, for instance by buying a new car, in order to inflate monthly expenses and have less income to satisfy the $50 test." Judge Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177, 204 (1999). The strategy is "implausible," however, because the collateral would still be subject to the secured debt in chapter 7. The strategy does not seem entirely undesirable from a debtor's point of view. Every dollar spent on purchase-money secured debt does more than reduce the payment to unsecured creditors; if a chapter 13 debtor has to pay all disposable income to creditors, the debtor lacks that amount regardless where it goes. In addition, however, every dollar spent on purchase-money secured debt provides the debtor with something – equity – which the debtor would not have if the same amount were paid on items the debtor already owns or has consumed. From a debtor's point of view, chapter 13 is much more attractive if it is a court-supervised installment sale contract for new stuff rather than court-supervised repayment plan for old stuff. It is not unreasonable, therefore, to suggest that debtors' ability to acquire equity should be limited or regulated.

[423] *See* SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 220 (describing home equity as "the single biggest source of personal wealth" for most Americans).

unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due." Because the debtor may not reduce monthly payments and because the debtor may continue to make monthly payments, there is no room for leverage against a debtor who wishes her unsecured creditors to subsidize her mortgage. In addition, removing a debtor's ability to keep her home by curing an arrearage, reinstating, and remaining current on her mortgage would eliminate a "major reason" debtors use chapter 13 – to retain and use collateral.[424] Moreover, the basic premise of this argument – that all disposable income must be applied to payment of unsecured creditors – is flawed. Section 1325(b)(1)(B) requires disposable income to be devoted to plan payments, some or all of which may be paid to secured creditors and, therefore, some of which may finance the debtor's accommodation needs decades hence at the expense of current creditors. Consequently, imputing rental to homeowners raises problems that create unresolvable conflicts with the text and structure of chapter 13.

The inequity of this structure is illustrated by courts' treatment of gain from the sale of a residence. Most courts do not consider transactional gain to be income for purposes of 1325(b).[425] Assume that a debtor pays $10,000 to acquire equity – to reiterate, prepaying rental – during the plan period. In the 36th month of the plan, the debtor sells the neither appreciated nor depreciated property and recovers that $10,000. The debtor still has the same current earnings to allow the debtor to place a roof over her head – the value of the equity is not needed for that – plus the $10,000 back. The $10,000 was not, in fact, used as a reasonable and necessary expense of maintenance and support but was instead diverted around the repayment of unsecured creditors. The acquired equity was a savings during the bankruptcy case. Even without imputing rental, it is obvious that some of the debtor's income was used neither to repay unsecured creditors nor for current expenses. But the text and structure of chapter 13 create this opportunity for savings.

Professor Alvin Warren observes that elimination of the capitalization requirement would convert the income tax into a "cash flow" tax.[426] Under a cash-

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[424] *See* Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 528 (1993) (explaining the reasons for filing under chapter 13).

[425] *See, e.g.*, *In re* Burgie, 239 B.R. 406, 409–10 (B.A.P. 9th Cir. 1999) (examining § 1325(b)(1) and (2) to determine whether the balance of sale proceeds constitutes disposable income); *In re* Jacobs, 263 B.R. 39, 48–49 (Bankr. N.D.N.Y. 2001) (describing "best interest" test of § 1325); *In re* Profit, 269 B.R 51, 56 (Bankr. D. Nev. 2001) (discussing application of § 1325 with respect to modification of income), *rev'd on other grounds*, 283 B.R. 567 (B.A.P. 9th Cir. 2002) (holding debtors had completed plan payments and modification was abuse of discretion because it required plan to exceed 60 months); *In re* Fitak, 92 B.R. 243, 250–51 (Bankr. S.D. Ohio 1988) (discussing the disposable income test under § 1325(b). This result is mitigated in courts which will entertain motions to modify a plan based on a change in the application of the liquidation test. *See, e.g.*, Berger v. Pokela (*In re* Berger), 61 F.3d 624, 626–27 (8th Cir. 1995). Considering the difference between the amounts realized on hypothetical liquidations on two different dates is precisely a measure of (nonexempt) income.

[426] Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax is Exempt Under a Cash Flow Tax?*, 52 TAX L. REV. 1, 1 (1996).

flow tax, some or all income from capital is effectively exempt.[427] To the extent chapter 13 does not contain a capitalization requirement, it may be more accurately be characterized as requiring disposable cash flow, not disposable income, be devoted to repaying debts – except that, as I have already discussed, bankruptcy courts exclude certain cash flows from that requirement.[428] As a result, both the income needed to acquire equity in the asset and the appreciation in value of the asset are exempt from repayment to unsecured creditors. To the extent that in chapter 13, both income from capital and income for the acquisition of capital are excluded, it is highly inaccurate to describe chapter 13's touchstone as the "ability to pay."

2. Debtors should not be allowed to buy "underwater property"

According to *The Fragile Middle Class*, between one-fifth and one-quarter of all debtors have no equity in their homes.[429] Many of these debtors owe more on their mortgages than the homes are worth, that is, they are "underwater."[430] Generally, debtors are prohibited from modifying even underwater mortgages on their homes; that is, they may not "strip down" the mortgage by bifurcating the claim into secured and unsecured portions.[431] To keep their homes, therefore, they

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[427] *Id*.; *see also* Robert A. Green, *Justice Blackmun's Federal Tax Jurisprudence*, 26 HASTINGS CONST. L.Q. 109, 127 (1998).

[428] *See* discussion *supra* Part II.A.2.a. Under "cash flow" tax proposals that permit current expensing of asset acquisition cost, all proceeds on the disposition of the asset are included in the cash flow subject to the tax. *See, e.g.*, Warren, *supra* note 426, at 2–3 (explaining that "[o]n future disinvestment, all proceeds will be taxable because the cost of the investment has already been deducted, so basis will be zero"); Richard L. Doernberg, *A Workable Flat Rate Consumption Tax*, 70 IOWA L. REV. 425, 440 (1985); George K. Yin, *Accommodating the "Low-Income" in a Cash-Flow or Consumed Income Tax World*, 2 FLA. TAX REV. 445, 454, 457 (1995).

[429] *See* SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 221, 354 n.76.

[430] The term "underwater" is generally used to refer to the excess of the amount of a given debt over the value of the collateral securing it. *See* Dewsnup v. Timm (*In re* Dewsnup), 502 U.S. 410, 424 (1992) (Scalia, J., dissenting) ("The distinctive feature of the United States' approach is that it seeks to avoid invalidation of the so-called 'underwater' portion of the lien by focusing not upon the phrase 'allowed secured claim' in section 506(d), but upon the prior phrase 'secures a claim'"); Margaret Howard, *Multiple Judicial Liens in Bankruptcy: Section 522(f)(1) Simplified*, 67 AM. BANKR. L.J. 151, 165 (1993) (discussing the *Dewsnup* decision and § 522(f)(1)); Margaret Howard, *Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy*, 65 AM. BANKR. L.J. 373, 411 (1991) (addressing a third party lien that was completely underwater). It is also used to refer to shareholders' residual claims against insolvent entities. Lynn M. LoPucki and William C. Whitford, *Bargaining Over Equity's Share in The Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 158 (1990) (stating where the debtors were insolvent and the equity interests were so underwater, they had no entitlement); Lawrence Ponoroff, *Exemption Impairing Liens under Bankruptcy Code Section 522(f): One Step Forward and One Step Back*, 70 U. COLO. L. REV. 1, 23 n.105 (1999) (defining underwater liens); Kermit Roosevelt III, *Understanding Lockups: Effects in Bankruptcy and the Market for Corporate Control*, 17 YALE J. ON REG. 93, 126 (2000) (stating that when company is insolvent maximizing revenue will not help management or shareholders because of the underwater status of the equity stake).

[431] Nobelman v. American Savs. Bank, 508 U.S. 324, 332 (1993) (holding that proposed bifurcation of the bank's claim into secured and unsecured portions is in violation of section 1322(b)(2)). *See generally* Daniel C. Fleming and Marianne McConnell, *The Treatment of Residential Mortgages in Chapter 13 after*

must pay their mortgage according to its stated amortization. For many underwater debtors, however, the principal and interest payments will exceed what it would cost to rent the same property. Although debtors may enjoy some emotional or other satisfaction from retaining their homes, that satisfaction comes at the expense of unsecured creditors. Professor Dickerson's argument that debtors should not be allowed to make lifestyle choices that provide them with psychic benefits but do not produce a tangible economic gain to creditors seems particularly appropriate in such cases.[432] And courts are sometimes willing to deny debtors the right to pay for collateral if "the debtor is pampering her own psyche at the expense of her unsecured creditors"[433]

It is no surprise that debtors, whether homeowners or renters, are generally in worse financial positions than the population generally. Nor is it surprising that debtors who own homes are frequently in far worse economic shape than their non-

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Nobelman, 2 AM. BANKR. INST. L. REV. 147 (1994) (discussing the *Nobelman* decision); Jane Kaufman Winn, *Lien Stripping after Nobelman*, 27 LOY. L.A. L. REV. 541 (1994) (same). Most of the debate on undersecured mortgages has focused on completely underwater junior mortgages and whether the anti-modification provision of § 1322(b)(2) applies. *See* Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 288–89 (5th Cir. 2000) (demonstrating split of authorities). For partially undersecured mortgages, there seems to be little disagreement that the anti-modification rule applies. This statement is true, however, with two important qualifications. The first is that the claim must be secured only by the principal residence. Lenders who acquire a security interest in rents or proceeds, for example, are excluded. *See, e.g.*, Hammond v. Commonwealth Mortgage Corp. of America (*In re* Hammond), 27 F.3d 52 (*3d* Cir.1994) (allowing bifurcation of mortgage that created security interest in debtor's personal property in addition to debtor's principal residence); *In re* Loper, 222 B.R. 431, 435 (D. Vt. 1998) (stating that debtor cannot modify payment and interest terms for the unsecured component without modifying terms of secured component, which is prohibited under § 1322(b)(2)). *But see In re* Vincente, 260 B.R. 354, 361 (Bankr. E.D. Pa. 2001) (holding debtor could not modify residential mortgage which also covered rents); *In re* Johnson, 269 B.R. 246, 250 (Bankr. M.D. Ala. 2001) (holding that a mortgage on the real estate on which trailer sat, but not on the trailer itself, was not subject to anti-modification rule); *In re* Halperin, 170 B.R. 500, 501–02 (Bankr. D. Conn.1994) (holding security interest which extended to rents, royalties, oil and gas rights, profit, stock, and fixtures received protection of § 1322(b)(2)); *In re* Harris, 167 B.R. 813, 814 (Bankr. D.S.C. 1994) (stating that rents and fixtures are part of debtor's principal residence and do not exclude residence from protection under § 1322(b)(2)); *In re* Hirsch, 166 B.R. 248, 255 (Bankr. E.D. Pa.1994) (demonstrating mixed interpretations of prohibited bifurcation under § 1322(b)(2)). Second, there is some question whether § 1322(b)(2) applies to all claims secured by a principal residence or only for acquisition indebtedness so secured. Several courts have held that home-equity mortgages are not subject to the anti-modification rule. *In re* Bagne, 219 B.R. 272, 277 (Bankr. E.D. Cal. 1998) (holding that § 1322(c)(2) allows debtor to modify home equity loan by use of § 1325(a)(5) in situation where final payment on loan falls due before end of debtor's term); *In re* Lam, 211 B.R. 36, 39 (B.A.P. 9th Cir. 1997) (concluding that *Nobelman* prohibits debtors from removing unsecured lien regardless of fact that lien was totally unsecured as differentiated from partially unsecured situation in *Nobelman*). *See generally In re* Bartee, 212 F.3d 277, 292-95 (5th Cir. 2000) (discussing applicability of § 1322(b)(2) and § 1322(c)(2) in various situations).

[432] A. Mechele Dickerson, *Lifestyles of the Not-So-Rich or Famous: The Role of Choice and Sacrifice in Bankruptcy*, 45 BUFF. L. REV. 629, 642–43 (1997). Professor Dickerson also argues, however, that debtor consumption should be limited to forms the federal government subsidizes. *Id*. at 641. The federal government subsidizes the purchase of homes of up to $1,000,000 in cost under 26 U.S.C. § 163(h)(3)(B)(ii).

[433] *In re* Rogers, 65 B.R. 1018, 1022 (Bankr. E.D. Mich.1986) (holding debtor did not satisfy disposable income test where plan called for debtor to retain a Corvette upon which a large secured claim was owed and to relinquish a Chevrolet Cavalier).

debtor counterparts.[434] *The Fragile Middle Class* finds that debtors ordinarily have much less equity in their homes, with the median debt-to-value ratio in 1991 approaching ninety per cent as compared to the national ratio of less than sixty per cent.[435] Almost one in four debtors (22.57%) have no equity.[436] Similarly, *The Fragile Middle Class* finds that seven in ten debtors exceeds FNMA's guidelines for housing expenditures[437] and concludes that homeowner debtors – who are "loaded up with inescapable mortgage obligations," carry non-mortgage debt more than twice that of other homeowners, and have incomes one third lower than other homeowners[438] – may simply have tried to hard to acquire a home, certification of membership in the middle class, and may be using bankruptcy primarily to keep it.[439]

These findings are supported by findings derived from statistics collected by the Executive Office of U.S. Trustees. In a study of no-asset chapter 7 cases closed in 2000,[440] Ed Flynn and Gordon Bermant found that the average monthly cost of owner-occupied residences (including mortgage principal and interest, utilities, and repairs and maintenance) in no-asset chapter 7 cases (about 99% of all chapter 7 cases) is nearly double ($1,157) the average cost of housing for renters ($669).[441] Those averages break down for owners as $812 for mortgage, $289 for utilities, and $57 for repairs and maintenance.[442] Even excluding utilities and maintenance, debtor-homeowners' average mortgage payments are 172% the average amount of

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[434] SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 214–19.
[435] *Id*. at 219–20.
[436] *Id*. at 221, 354 n.76.
[437] *Id*. at 218–19.
[438] *Id*. at 219.
[439] *Id*. at 220.
[440] No asset cases account for approximately 99% of chapter 7 cases. ED FLYNN & GORDON BERMANT, EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES, INCOMES, DEBTS, AND REPAYMENT CAPACITIES OF RECENTLY DISCHARGED CHAPTER 7 DEBTORS 2 (1999).
[441] Ed Flynn & Gordon Bermant, *The Class of 2000*, AM. BANKR. INST. J., Oct. 2001, at 20–21, 33 (examining sample of 1,931 no-asset chapter 7 cases closed in 2000). Mr. Flynn has generously provided me with the following breakdown of debtor housing costs by percentile.

PERCENTILE*	OWNERS	RENTERS
10%	$478	$225
20%	$651	$356
30%	$797	$468
40%	$903	$554
50%	$1,054	$645
60%	$1,209	$717
70%	$1,386	$800
80%	$1,575	$910
90%	$1,931	$1,116
95%	$2,311	$1,342

* Percent of debtors with total monthly housing costs below the indicated amount.
E-mail from Ed Flynn, Executive Office for U.S. Trustees, to Robert B. Chapman, Visiting Professor of Law, Willamette University College of Law (Dec. 3, 2001) (on file with author).
[442] E-mail from Ed Flynn to Robert B. Chapman, *supra* note 441.

debtor-renters' rental payments.[443] Renters pay an average of $473 for rental, $182 for utilities, and $14 for repairs and maintenance.[444] In nearly every aspect of consumption related to providing a roof over their heads, homeowners consume more than renters.[445]

Apart from what homeowners actually spend on housing is the question of equity. Many debtors have considerable equity; others are somewhat deeply underwater. *The Fragile Middle Class* reveals that about four per cent of the homeowner debtors in the study reported no mortgage.[446] The spread of homeowner equity in the sample appears to be what statisticians call "skewed to the right."[447] In other words, given that the average is almost $17,000 but the median only $5500, the high end must have some big numbers in it.[448] And indeed it does, although not

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[443] *Id*. Flynn and Gordon's study included in the cost of owner-occupied housing mortgage payments, repairs, and utilities. For comparison with renters, repairs are properly included because lessors incur repair costs (albeit with some reduction for economies of scale) and pass those costs on the renters. Utilities are more problematic because some rental leases include utility costs in rental and some exclude them. In 1997, the latest year for which statistics are available, the national median cost of owner-occupied units, excluding repairs and utilities, was $534 and the national median cost of renter-occupied units was $549.

[444] E-mail from Ed Flynn to Robert B. Chapman, *supra* note 441.

[445] *See*, *e.g*., Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L.J. 431, 468 (1992) (explaining expenditures incurred by homeowners and renters).

[446] SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 354 n.85. The authors correctly point out, however, that the failure to list a mortgage may not mean the debtor does not have one; it may mean, on the contrary, that the debtor has one but intends to pay it "outside the plan." Some judges abhor this phrase. Legend has it that Chandler Watson, first a bankruptcy referee and then a bankruptcy judge in the Northern District of Alabama, reproved attorneys who spoke of payments "outside the plan" by reminding them that payments outside the plan were fraudulent. Critics of the term prefer the more accurate term "direct payments," which means essentially the same thing. *See, e.g.*, *In re* Roberts, 226 B.R. 240, 241 (Bankr. D. Idaho 1998) (stating "direct payments" are often incorrectly called payments "outside the plan"); *In re* Pickering, 195 B.R. 759, 768 (Bankr. D. Mont. 1996) (explaining that use of term "outside" in reference to plan may be both "misleading" and "dangerous" (citing KEITH LUNDIN, CHAPTER 13 BANKRUPTCY § 4.51 (2d ed. 1991)); *In re* Ford, 179 B.R. 821, 822–23 (Bankr. E.D. Tex. 1995) (discussing high degree of ambiguity when using term "outside the plan"); *In re* Aberegg, 121 B.R. 553, 554 (Bankr. N.D. Ind. 1990) (using "direct payments" and "outside of plan" interchangeably in discussion); *In re* Citrowske, 72 B.R. 613, 615–16 (Bankr. D. Minn. 1987) (discussing misleading definition of "outside the plan" and how term has come to be synonymous with "direct payments"); *In re* Ilich, No. 2-87-03060, 1987 WL 49350, at *4 n.1 (Bankr. S.D. Ohio Dec. 17, 1987) (stating "outside the plan" to be "improper bankruptcy terminology" as opposed to use of term "direct payments" (citing Norton, 1984 Ann. Sur. Bankr. L. at 2 (1984))); *In re* Hankins, 62 B.R. 831, 836 (W.D.Va.1986) (stating "outside the plan" should not be used in terms of Bankruptcy Code). *See generally In re* Foster, 670 F.2d 478, 486–88 (5th Cir. 1982) (describing rules for debtor's acting as disbursing agent under plan); *In re* Land, 82 B.R. 572, 578 (Bankr. D. Colo. 1988) (same). How one thinks of such payments may, however, affect how one calculates—or describes the calculation of—disposable income. Where payments are made directly or "outside the plan" (that is, not devoted to payments under the plan as required by § 1325(b)), they must be deducted as reasonable and necessary for maintenance and support; where they are made through the plan, they need not. *See supra* notes 383–387 and accompanying text.

[447] The amounts at the first, second, and third quartiles of $1,000, $5,500, and $20,528, respectively. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS, *supra* note 38, at 353 n.73.

[448] Anecdotal evidence suggests, however, that some debtors do have significant equity in their homes. *See, e.g.*, *In re* Lehman, 205 F.3d 1255 (11th Cir. 2000) (valuing equity at $30,000); Matter of Mendoza,111 F.3d 1264 (5th Cir. 1997) ($40,000 equity); *In re* DeRosear, 265 B.R. 196, 218 (Bankr. S.D. Iowa 2001) ($45,000 equity); *In re* Shirzadi, 269 B.R. 664, 667 (Bankr. S.D. Ind. 2001) ($60,000 equity); *In re* Kamen, 231 B.R. 275, 276 (Bankr. N.D. Ohio. 1999) ($25,000 equity); *In re* Fracasso, 210 B.R. 221, 221 (Bankr. D.

to the degree that the numbers above might suggest. Including "negative equity,"[449] the mean ($5666) falls much closer toward the median. Still, the 90th and 95th percentiles of debtor-homeowners' equity are $24,962.60 and $44,800. The top five cases, outliers all, are $450,000, $175,300, $137,500, $135000, and $110,000.

At the low end, The Consumer Bankruptcy Project included debtors whose mortgage indebtedness exceeded their home value. A very small percentage of debtors responded that they were underwater; the fifth percentile of equity was $4905. But among those who did identify themselves as being underwater, some were very deep. The bottom five were underwater by $387,795, $162,905, $103,376, $100,000, and $64,465. For these debtors, paying their mortgage would be much more costly than renting the same house.

3. Effect on Creditors

The preference bankruptcy law shows to homeowners by not imputing rental income to them harms unsecured creditors. Unsecured creditors receive no benefit from the yield from expensive but exempt houses as they would if the debtor held other investment property of equal value. Under *Nobelman*,[450] debtors may not modify or "strip down" their residential mortgages. For debtors whose disposable incomes are less than mortgage payments, *Nobelman* is an anti-debtor rule. For those who disposable incomes are enough to pay mortgage but not repay creditors in full, however, *Nobelman* is an anti-unsecured creditor rule. Finally, unsecured creditors subsidize debtors' payment of mortgages on underwater property by losing the value they would realize if the debtors were required to surrender the property and rent instead.

Making a debtor surrender property would give the secured lender the benefit of its bargain because their risk is limited by value of property, which is the most they

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Mass. 1997) ($70,000 equity), *rev'd* 222 B.R. 400 (Bankr. 1st Cir. 1998), *aff'd* 187 F.3d 621 (1st Cir. 1999); *In re* Murphy, 178 B.R. 13, 14 (Bankr. S.D. Fla. 1995) ($190,000 equity); *In re* Heath, 188 B.R. 17, 18 (Bankr. D.S.C. 1995) ($36,000 equity); *In re* Donato, 170 B.R. 247, 255–56 (Bankr. D.N.J. 1994) ($798,000 equity); *In re* Williams, 109 B.R. 36, 38 (Bankr. E.D.N.Y. 1989) ($27,000 equity). It is tricky to rely on debtors' representations about the value of property, as is illustrated in the case of *In re Duncan*, 201 B.R. 889, 892 (Bankr. W.D. Pa. 1996), in which the debtor scheduled the residence with a value of $375,000 and scheduled mortgages totaling approximately $351,000. In earlier correspondence to creditors, however, debtor asserted the realty was "conservatively" valued at $483,000.00 and that "$500,000.00 would not be unrealistic." *Id*.

In addition, where a debtor owns an undivided interest in property (as is common with married debtors filing separately), will the debtor list the value of the residence or the interest in the residence and will the debtor list the entire mortgage amount?

Finally, whether $30,000 of equity is significant depends on where the debtor lives. In Washington County, Florida, it may be tremendous and in Washington, D.C., it may be negligible. Or even within Washington, D.C., it may be negligible on the 500 block of East Capitol Street but more significant on the 5000 block.

[449] A significant number of the debtors in the study had either no equity or owed more on their homes than the homes were worth. Each case was coded as zero, rather than negative, equity.

[450] Nobelman v. American Savs. Bank, 508 U.S. 324, 331–32 (1993).

would be guaranteed to recover if the debtor *chose* to surrender the property.[451] Certainly, the secondary market is propped up by bankruptcy's re-writing state law to give secured creditors more than benefit of their bargain.

In all three situations discussed above, debtors are rewarded, at unsecured creditors' expense, for consumption decisions that involve home ownership. The reward is not linked to the decision or necessity to obtain shelter or a particular form of shelter but rather the decision to obtain "title" by incurring secured debt. As much as any other aspect of bankruptcy policy, therefore, the definition of income may "provid[e] a perverse incentive for debtors to take on substantial secured debt prior to bankruptcy"[452] or cause a debtor to "lay heavy bets on the future to become a homeowner."[453]

4. Conclusion

Imputing rental income to debtors who own their homes would have three virtues. First, it would maximize recovery by unsecured creditors. Second, it would reduce the need to consider in terms of good faith – which necessarily involves the judge in aesthetic judgments about what sort of consumption is appropriate or inappropriate, necessary or luxurious, fitting or unseemly[454] – the sorts of judgments that may be influenced by judges' attitudes about the "American dream."[455] The aesthetic judgment would instead be made by policymakers who

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[451] Where the debtor exercises unfettered discretion to surrender or were the debtor required to surrender, depreciation is a risk to the secured lender, just as under state law. The lender can bargain around this result by including debt/value ratio as event of default. On such a default, the lender could foreclose. The debtor could still file bankruptcy, of course, and prevent the sale but the debtor's filing would essentially force the debtor to effect a stop-loss. The only imposition on the secured lender would be supervision cost.

[452] Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*,18 BANKR. DEV. J. 1, 24 (2001).

[453] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 115.

[454] *See* Linda J. Rusch, *Bankruptcy as a Revolutionary Concept: Good Faith Filing and a Theory of Obligation*, 57 MONT. L. REV. 49, 52 (1996) ("Lack of good faith or substantial abuse are code words for describing human behavior that runs counter to normative behavioral expectations founded on deeply held, but not much discussed, values and beliefs.").

[455] Class bias is a somewhat ignored aspect of a discourse in which race and gender bias inherent in or constructed within a judge's own racial or gendered identity is of keen interest to scholars and activists. *See* Theresa M. Beiner, *What Will Diversity on the Bench Mean for Justice?*, 6 MICH. J. GENDER & L. 113, 131–33 (1999) (arguing a judge's sex affects her perception of cases); John C. Coughenour, et al., *The Effects of Gender in The Federal Courts: The Final Report of The Ninth Circuit Gender Bias Task Force*, 67 S. CAL. L. REV. 745, 995 (1994) ("Factfinding is a place in which gender bias has a particularly pernicious role."); Dwight L. Greene, *Justice Scalia and Tonto, Judicial Pluralistic Ignorance, and the Myth of Colorless Individualsim in Bostick v. Florida*, 67 TUL. L. REV. 1979, 2050–51 (1993) (arguing that "[I]f the judiciary included adequate and authentic voices from currently underrepresented communities, the various experiences and perspectives of those communities might be incorporated into these institutions."); Judith Resnick, *On the Bias: Feminist Reconsideration of the Aspirations for Our Judges*, 61 S. CAL. L. REV. 1877, 1943 (1988) (observing that impartiality and objectivity are impossible); Carl Tobias, *Judicial Selection at the Clinton Administration's End*, 19 LAW & INEQ. 159, 183–84 (2001) (arguing for appointment of more female and minority judges to reduce bias in adjudication); Carl Tobias, *More Women Named Federal Judges*, 43 FLA. L. REV. 477, 484 (1991) (discussing a reduction of bias in adjudication through the appointment of more female judges); *see also* Ruth Bader Ginsburg, *Introduction to Women and the Law:*

either accepted or rejected the proposal. Third, the determination would be simplified to (a) actual rental value of house, minus (b) allowable rental value. The litigation costs of fighting over debtors' lifestyle choices may, therefore, be reduced.

CONCLUSION

Bankruptcy courts diverge from the Haig-Simons definition of income in their treatment of income from the sale and use of assets, especially residences. Haig-Simons marks-to-market continuously and requires recognition of income on an accrual basis as property increases; bankruptcy courts adhere to the realization criterion. More significantly, perhaps, however, bankruptcy courts do not agree on the quantum on income on the sale or exchange of an asset. Some, anxious to distinguish "income" from "assets," include none of the amount realized. Others, disregarding the difference between capital and return-of-capital, include the entire amount realized as income. Finally, some treat as income the economic growth in the debtor's rights in the asset during the relevant period.

Bankruptcy courts jealously guard against debtors' under-utilization of their labor and impute income to debtors based on what they could earn. Bankruptcy courts are not as attentive, however, to the under-utilization of property. The Haig-Simons definition of income suggests homeowners have income from the use of their homes. Bankruptcy courts, however, do not impute rental income to homeowners.

It is highly unlikely that either Congress or the courts will embrace the proposals advanced herein to impute rental income to homeowners or significantly limit homeowners' ability to acquire equity while obtaining a discharge from their unsecured debts. But why? There does not seem to be any significant restriction on courts' ability to interpret "income" other than their notions of what is "fair" and there is arguably more than a little unfairness in the disparate treatment of homeowners and renters. Implicit, however, in the notion of "imputed income" is a norm, a "should," a value judgment that some income should have been taken in money (and devoted to the plan) rather than consumed. Imputing income treats as

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Facing the Millennium Indiana Law Review 32 IND. L. REV. 1161, 1164–65 (1999). *But see* Laurence H. Silberman, *The D.C. Circuit Task Force on Gender, Race, and Ethnic Bias: Political Correctness Rebuffed*, 19 HARV. J.L. & PUB. POL'Y 759, 766 (1996) (opposing the project of the task force); Stephan Thernstrom, *Critical Observations on The Draft Final Report of The Special Committee on Race And Ethnicity to The D.C. Circuit Task Force on Gender, Race, And Ethnic Bias*, 1995 PUB. INT. L. REV. 119, 137 (1995) (criticizing the methodology of the task force). *See generally* Susan Moloney Smith, Comment, *Diversifying the Judiciary: the Influence of Gender and Race on Judging*, 28 U. RICH. L. REV. 179 (1994). Class bias on the bench is not entirely ignored. *See, e.g.*, Mark A. Graber, *The Clintonification of American Law: Abortion, Welfare, and Liberal Constitutional Theory*, 58 OHIO ST. L.J. 731, 806–07 (1997) (discussing class bias); Vicki C. Jackson, *Empiricism, Gender, and Legal Pedagogy: an Experiment in a Federal Courts Seminar at Georgetown University Law Center*, 83 GEO. L.J. 461, 481–82 (1994) (same). Class bias in judicial appointments simply has not offended or stirred the passions to the extent that gender and racial bias has. Nonetheless, if race and gender can affect adjudication through race bias and gender bias, one may reasonably expect class bias in a judiciary with relatively homogeneous economic attributes.

done what *ought* to have been done. Implicit in the rejection of imputing income is the notion that consumption is "income" but that the recipient or consumer *should* be able to do this or that without being charged with having used income to do it. Home ownership is so normal, so natural (at least once achieved), how could it be seen as income consumption? In taking a position for or against imputing income to homeowners, one must establish (or posit or assume) a baseline norm, just as Stanley Surrey did in assuming that deviations from his conception of an ideal tax base were "tax expenditures." Ultimately, just as in tax one "prefers the kind of taxation which he prefers,"[456] one also prefers the kind of bankruptcy she prefers. And as bankruptcy allocates loss and regulates individuals' lifestyles, one prefers allocation of loss and lifestyle regulation that comport with one's norms about where losses *should* fall and how people *should* live. Current bankruptcy law reflects norms that people should live in their own homes, should devote resources to continue acquiring equity in those homes, and should devote earned money income to repay their debts. Those who do are rewarded.

If the Haig-Simons definition of income were to be employed as a matter of liberal neutrality regarding individual choice, the distinctions that prevent transactional gain or imputed rental from being income would have to be abandoned. If, however, a definition of income is employed, as Simons employed his own, to achieve some desired result, the distinction between labor and property reflected in the bankruptcy definition of income is perhaps itself the goal. The fact that bankruptcy courts and commentators ignore these forms of income and choose instead to focus on earnings may suggest that bankruptcy's focus on income is less about "ability to pay" and more about the preservation of fragile middle-class or homeowner status and the proper social allocation of the fruits of labor. Despite the economic tone of recent bankruptcy policy debates, cast in terms of income, the participants have made little attempt to define what they are talking about. Bankruptcy reform may, like welfare reform, be less about money and more about the activities of the able-bodied and who owns the value of their labor.

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[456] SIMONS, PERSONAL INCOME TAXATION, *supra* note 1, at 15.