AMERICAN BANKRUPTCY INSTITUTE

2019 Hon. Eugene R. Wedoff Seventh Circuit Consumer Bankruptcy Conference

Savings in a Chapter 13

Hon. Eugene R. Wedoff (ret.), Moderator
Oak Park, Ill.

John M. Hauber
Office of the Chapter 13 Standing Trustee; Indianapolis

John W. Menn
Steinhilber Swanson LLP; Oshkosh, Wis.

CONCURRENT SESSION

2019

B. Chapter 13 Plans

§ 4.03 Reserve Fund in Chapter 13 Cases

(a) Statutory and Rules Amendments for a Reserve Fund.

(1) Section 1322(b) should allow a plan to provide —

(A) for contributions from the debtor to a reserve fund held by the trustee for the payment of nonrecurring necessary expenses of the debtor, with the amount of the fund limited, in the absence of unusual circumstances, to one month of the debtor's scheduled expenses; and

(B) for restoration of the fund by additional debtor contributions to the extent of any disbursements from the fund.

(2) Section 1325(b)(2)-(3) should allow a deduction from disposable income for contributions to a reserve fund under § 1322(b).

(3) The Federal Rules of Bankruptcy Procedure should provide —

(A) that to access the reserve fund the debtor shall file a notice setting out the funds reasonably needed to address a nonrecurring necessary expense; and

(B) that the trustee shall disburse the requested funds to the debtor fourteen days after filing of the debtor's notice in the absence of objection from the trustee or an unsecured creditor.

(4) Changes to the Official Forms and Local Forms.

(A) The official form for determining disposable income for an "above median" debtor should include a deduction for contributions to create a reserve fund.

(B) The official form for chapter 13 plans should include a separate paragraph for contributions from the debtor to a reserve fund.

(C) The Federal Rules of Bankruptcy Procedure should require that a local form include a separate paragraph for contributions from the debtor to a reserve fund.

(b) Best Interpretation of Current Law. The current provisions of chapter 13 should be interpreted to allow a debtor's plan to include a nonstandard provision for a reserve fund, held by the trustee, for payment of nonrecurring necessary expenses, subject to the following nonstandard plan provisions:

(1) The reserve fund must be limited to a reasonable amount — one month of the debtor's scheduled expenses in the absence of unusual circumstances.

(2) The debtor may make additional contributions of disposable income to restore any disbursements from the fund.

(3) The trustee will make disbursements from the reserve fund to the debtor on notice, setting out a reasonable amount needed to address a nonrecurring necessary expense, with the payment made in fourteen days of the filing of the notice in the absence of objection from the trustee or an unsecured creditor.

> (4) If the debtor's income is equal to or below the median specified in section 1325(b)(3), any contributions of disposable income remaining in the fund at the time the case terminates will be returned to the debtor.
>
> (5) If the debtor's income is above the median specified in section 1325(b)(3), any contributions of disposable income remaining in the fund at the time the case terminates will be paid on unsecured claims.

Background. Bankruptcy debtors are economically fragile, and their chapter 13 plans often teeter on the edge of feasibility. Car repairs, home repairs, and medical emergencies can put a chapter 13 plan in jeopardy when they put the debtor in the dilemma of missing a plan payment or failing to meet a crucial nonrecurring household need. For most households, financially draining unanticipated events are almost certain to occur during the three- to five-year life of a chapter 13 plan. Often, the only means of addressing these emergencies is through a modification of a chapter 13 plan, seeking reduced or waived payments. Such modifications cannot necessarily, despite the emergency, be speedily granted and carry additional costs for debtors, both in terms of time and additional attorney's fees.

Almost universally, financial management counseling services recommend that families seeking to stabilize their family budgets establish a fund to pay for unanticipated and nonrecurring expenses, thereby preventing a small problem from becoming a crisis. Indeed, the USTP mandates that the personal financial management courses required for an individual's discharge include discussions on the importance of "saving for emergencies."[48] An academic paper found that households that save for emergencies "experienced slightly less overall hardship and were less likely to report several specific hardships, such as food insecurity and having a phone disconnected, three years later."[49] An unpublished paper found that income earners in the bottom quintile on average experience unanticipated expenses of $2,000 annually.[50] Outside of academic research, a Wells Fargo website recommends an emergency fund and states that three to six months of salary is a reasonable size.[51] Dave Ramsey, a widely followed author and radio host who offers financial advice, suggests $1,000 is a good starter emergency fund and, for those holding a steady job, recommends a fund with three months of salary.[52]

48 28 C.F.R. 58.33(f)(2)(iv); *see also* 11 U.S.C. § 727(a)(11) (requiring a bankruptcy debtor to complete a personal financial management course as a condition of discharge).

49 Leah Gjertson, *Emergency Saving and Household Hardship*, 37 J. Family & Econ. Issues 1 (2016).

50 Stephen Brobeck, "The Essential Role of Banks and Credit Unions in Facilitating Lower-Income Household Saving for Emergencies," at 2 (2008), available at https://consumerfed.org/wp-content/uploads/2010/08/Essential_Role_of_Banks_June_2008.pdf.

51 *See* Wells Fargo Bank, "Saving for an Emergency," available at https://www.wellsfargo.com/financial-education/basic-finances/manage-money/cashflow-savings/emergencies/ (last visited Nov. 18, 2018).

52 *See* Dave Ramsay, "A Quick Guide to Your Emergency Fund," available at https://www.daveramsey.com/blog/quick-guide-to-your-emergency-fund (last visited Nov. 18, 2018).

Several commentators commended the example of the U.S. Bankruptcy Court for the Southern District of Texas, whose uniform local plan allows for an emergency savings fund.[53] In a law review article, Judge David Jones discussed this plan provision, including a random sample of pending cases to consider the effects of the provision.[54] (The provision had not been in effect long enough to have a sufficient sample of completed cases.) The data suggested that the pending cases with reserve funds were lasting longer in the process.[55] Judge Jones concluded:

> The savings program implemented in the Southern District of Texas is a practical tool for increasing the viability of chapter 13 plans. From an economic perspective, it provides a legal means of assisting debtors in dealing with financial shocks that inevitably occur during the term of a chapter 13 plan. . . .
>
> As demonstrated by the above study, the program's effects are not limited to providing an economic buffer. To the contrary, if properly implemented, the program serves as an incentive not only to debtors but to creditor constituents as well. A chapter 13 plan that runs its term is a positive impact on society. A debtor receives a discharge and goes on to immerse herself in the commercial world, while creditors minimize their losses with meaningful distributions.
>
> A proper implementation of the savings program is dependent upon sufficient and repeated exposure of debtors' counsel to the program and its benefits. First, this necessitates educational programs that involve interaction with the judiciary. Second, chapter 13 trustees must embrace the program and encourage its use. Finally, all members of the judiciary must be knowledgeable about the savings program and actively promote its use.[56]

The Commission debated the merits of a fund for nonrecurring expenses and concluded both that all stakeholders could benefit from a such a fund in a chapter 13 case and that debtors in chapter 13 should be allowed to propose the creation of such funds in their plans. Given the likelihood that nonrecurring expenses will be experienced at some point, the Commission prefers the term "reserve fund" to "emergency fund." A reserve fund would make it more likely that chapter 13 debtors will complete their plans and achieve a discharge, without the need for unnecessary and expensive modifications of their plans. By increasing completion rates, a reserve fund also would provide a greater recovery to creditors in the chapter 13 process.

---

53 U.S. District & Bankruptcy Court for the Southern District of Texas, Uniform Plan and Motion for Valuation of Collateral ¶ 22 (effective Dec. 1, 2017), http://www.txs.uscourts.gov/content/new-uniform-chapter-13-plan-plan-summary-and-related-documents-plan-modification-documents.

54 David R. Jones, *Savings: The Missing Element in Chapter 13 Bankruptcy Cases?*, 26 Am. Bankr. Inst. L. Rev. 243 (2018).

55 *See id.* at 256-67.

56 *Id.* at 271-72.

At the same time, it is not reasonable for a bankruptcy debtor to have a fund large enough to cover any contingency. The Commission discussed the appropriate size for a reserve fund and, given the wide variety of chapter 13 debtors, decided against a rigid amount. Rather, the Commission decided that in most cases one month of expenses as shown on Schedule J would be a reasonable figure for the reserve fund. Calculations from the 2016 data for the bankruptcy cases at FJC's Integrated Database[57] suggested that the mean figure on Schedule J is around $3,200, with a median figure of $2,700. These amounts are generally in line with the financial advice for the size of a reserve fund. But the Commission determined that the Schedule J amount should only be a starting point; the ultimate test should be reasonableness. Where unusual situations indicate that the Schedule J figure would be too low or too high, the figure should be subject to change.

The Commission discussed the best way of providing for reserve funds and concluded that statutory and rule amendments should expressly authorize the funds and provide for the means of using them. But the Commission also concluded that existing statutory provisions allow the creation of reserve funds, though they require different disposition of the funds depending on the debtor's income level.

Statutory Amendments. The Commission proposes an amendment to section 1322(b) that would allow, but not require, the debtor to make contributions from postconfirmation income to a reserve fund that would be held by the trustee and that would pay reasonable amounts for necessary nonrecurring expenses. To be an eligible use of the fund, it would not be enough just that the expense is nonrecurring; the expense would also need to be necessary. A debtor could use the fund to meet unanticipated expenses that threaten the ability of the debtor to maintain his or her chapter 13 case. Examples include home repairs, car repairs, or medical expenses. Any individual disbursement would need to be "reasonable," as would the overall size of the fund. As discussed above and in the absence of unusual circumstances, the Commission believes that one month of a debtor's scheduled expenses would typically be a reasonable amount. If the debtor used the fund, the debtor could replenish it. The trustee's custody of the fund would shield it from unnecessary uses or unreasonable payment amounts.

Although the Commission believes the existing statutory language authorizes the creation of a reserve fund, the cleanest implementation of a reserve fund would be through amending section 1325. The existing provisions do not provide clear guidance on how to avoid any conflict between a reserve fund and the disposable-income provisions of chapter 13 or on the disposition of the fund at the end of a case.

As a condition for confirmation, section 1325(b)(1) requires that a debtor's plan devote the debtor's disposable income to payments under the plan. Section 1325(b)(2) defines "disposable income" as "current monthly income"[58] less amounts reasonably necessary to be expended for the support and maintenance of the debtor and the debtor's dependents.[59] The Bankruptcy Code does not impose any

57 Federal Judicial Center, Integrated Database, https://www.fjc.gov/research/idb, (last visited Nov. 18, 2018).

58 "Current monthly income" is statutorily defined as the debtor's average monthly income for the six months preceding the filing of the bankruptcy petition. 11 U.S.C. § 101(10A).

59 The debtor also can subtract payments on a postpetition domestic support obligation, charitable contributions not exceeding 15% of gross income, and any business expenditures if the debtor is engaged in business. *Id*. § 1325(b)(2).

restrictions on the debtor's use of income that a debtor may expend for support and other allowed purposes, or "nondisposable income."

The Commission proposes that section 1325(b) should provide that in determining disposable income, there should be an additional deduction for contributions to a reserve fund. The deduction would be available to debtors who are both above and below the median income for their state. Under these amendments, contributions to the reserve fund would not be disposable income, thus any balance remaining in a reserve fund at the termination or conversion of the case would be returned to the debtor. The return of the reserve fund would encourage debtors to maintain the fund after the bankruptcy case concludes.

Rules and Form Amendments. The Commission believes that the best procedure for disbursements from a reserve fund would be through "negative notice," with the debtor filing a notice proposing a disbursement and the trustee disbursing the funds absent an objection. Accordingly, the Federal Rules of Bankruptcy Procedure should provide for the debtor to file a notice setting out the funds reasonably needed to address a nonrecurring necessary expense. Absent objection from the trustee or an unsecured creditor, the trustee must disburse the requested funds fourteen days later.

The Commission also recommends conforming amendments to the bankruptcy forms. First, Official Form 122C-2 should provide a deduction for contributions to a reserve fund in determining the disposable income of an "above median" debtor. Second, Federal Rule of Bankruptcy Procedure 3015.1, which sets out requirements for local chapter 13 plan forms, should require these forms to include a paragraph providing for debtor contributions to a reserve fund. Finally, the Official Form and the local forms for chapter 13 plans should be amended to include a paragraph providing for reserve fund contributions.

Best Interpretation of Existing Law — "Below Median" Debtors. The Commission believes that existing law is best interpreted as allowing a debtor to make contributions to a reserve account, but that the treatment of funds in the account depends on whether the funds are contributed from disposable or nondisposable income. In making this recommendation, the Commission intends no changes to the law regarding formal modification of the plan for reduced or waived payments. Section 1325(b)(1) allows a chapter 13 trustee or any unsecured creditor to require that disposable income be used to make payments on unsecured claims. As discussed above, section 1325(b)(2) defines disposable income as current monthly income less allowed deductions, including deductions for necessary support. How the allowed deductions are determined depends on whether the debtor's income is above or below the state median income for the debtor's size of household, as set out in section 1325(b)(3).

The court determines a "below median" debtor's deductions under section 1325(b)(2), which affords substantial discretion to the court to decide what are the reasonably necessary support expenses that can be deducted from current monthly income. Many courts start with the monthly expenses listed on Schedule J filed with the bankruptcy petition. Nonrecurring expenses are unanticipated in the sense that

one does not know when the expense will occur or the form that the expense will take. At the same time, however, nonrecurring expenses are virtually certain to occur. As the financial advice discussed above recognizes, budgeting for nonrecurring expenses is reasonably necessary. The Commission believes, therefore, that the best interpretation of § 1325(b)(2) would be to treat reasonable contributions to a reserve fund as allowed deductions from current monthly income, resulting in these contributions being treated as nondisposable income. If payments under the plan are completed with a balance of nondisposable income remaining in the reserve fund, the plan should provide for the balance to be returned to the debtor.

Best Interpretation of Existing Law — "Above Median" Debtors. The calculation of disposable income for above-median debtors diverges on how to determine the expenses that can be deducted from current monthly income.[60] Rather than allowing the court to determine the appropriate expense amounts, section 1325(b)(3) provides that section 707(b)(2)(A) and (B) determine the expenses for above-median debtors. These provisions are used in the chapter 7 means test and determine expenses, in part, under guidelines used by the Internal Revenue Service for the payment of delinquent taxes.[61] However, section 707(b)(2)(B) allows a court to find that a debtor may use current monthly income to pay for itemized expenses that are due to "special circumstances." The Commission believes that section 707(b)(2)(B) is best interpreted as allowing the creation of a reserve fund with disposable income and that this income may be used to pay a reasonable amount to cover necessary nonrecurring expenses, because these would be expenses arising from special circumstances. But if disposable income contributed to the fund is not required for the payment of such expenses, it would remain disposable, and the plan should provide, pursuant to § 1325(b)(1), that any balance of this income remaining in the fund after plan payments are completed will be paid on unsecured claims.[62] The Commission's recommendations about how "special circumstances" allow creation of a reserve fund in a chapter 13 case is not intended to take any position on whether the need for savings can be "special circumstances" in a chapter 7 case for purposes of rebutting the means test.

Best Interpretation of Existing Law — Additional Plan Provisions. To comply with section 1325(a)(3)'s confirmation requirement that the debtor propose the plan in good faith, the reserve fund needs to be in a reasonable amount. Absent unusual circumstances, a reasonable amount in the fund would be one month of expenses as scheduled by the debtor. Good faith also would require a reasonable mechanism for the debtor to access the fund. Consistent with its recommendation for a statutory amendment, the Commission believes a reasonable procedure would be the debtor's notice to creditors specifying the nonrecurring, necessary expense to be paid and a reasonable amount for the payment, all subject to the ability of the trustee or unsecured creditors to object.

60 *See id.* § 1325(b)(3).

61 For more background on the means test and the Commission's recommendations relating to the means test, see § 3.07 Means Test Revisions & Interpretations.

62 If the case is dismissed or converted with a balance in the fund, the trustee would be required to dispose of the balance consistent with sections 348 and 349 and the Supreme Court's decision in *Harris v. Viegelahn,* 135 S. Ct. 1829 (2015), regardless of contrary plan provisions.

consumers' postbankruptcy financial lives, that improvement would presumably be reflected in better credit scores and lower costs of credit for these consumers. Bankruptcy debtors would then be incentivized to take the course. By amending the Fair Credit Reporting Act to require the notation, Congress would be implementing a market-based rather than regulatory solution. The amendment would also provide an opportunity for research about the efficacy of financial management education.

§ 3.07 Means Test Revisions & Interpretations

(a) Reducing documentation requirements.

(1) The Bankruptcy Code should allow below-median-income debtors to provide documentation of income as follows:

(A) one or more payment advices, issued within 90 days before the petition date, showing the debtor's year-to-date income;

(B) a tax return or transcript for the calendar year preceding the year the petition is filed;

(C) a W-2 form issued by each employer for the tax year preceding the year the petition is filed; or

(D) other evidence of income received within 60 days before the petition date.

(2) The Bankruptcy Code should allow below-median income debtors to establish their safe-harbor status from the means test by providing the documentation in paragraph (1), without being required to calculate current monthly income (CMI).

(b) Excluding public assistance, government retirement, and disability benefits.

(1) The Bankruptcy Code should allow public retirement and disability benefits provided under government programs comparable to Social Security — including those for veterans, railroad workers, and state and federal civil servants — to be excluded from the CMI calculation in the same way that benefits received under the Social Security Act are excluded.

(2) The Bankruptcy Code should provide that the exclusion of public retirement and disability benefits from CMI for any debtor should be in the amount of the debtor's actual retirement or disability benefits capped by the maximum allowed Social Security benefit.

(3) The courts should interpret the calculation of CMI under existing law to exclude unemployment benefits that are "received under" the Social Security Act. Congress also should pass a clarifying amendment excluding such benefits.

(c) Interpreting "special circumstances" under the means test. Courts should interpret section 707(b)(2)(B)(i) to permit the debtor to establish special circumstances for purposes of rebutting the presumption of abuse even if the obligation at issue was incurred voluntarily. Congress also should pass a clarifying amendment to the same effect.

(d) Calculating reductions from current monthly income (CMI).

(1) The courts should interpret section 707(b) as follows in calculating the debtor's monthly expenses:

(A) For categories of expenses specified in the National Standards, deductions from CMI should be the amounts in the National Standards adopted by the Internal Revenue Service for its collection financial standards irrespective of the actual expenses incurred by a debtor.

(B) For categories of expenses specified in the Local Standards, deductions from CMI should be the debtor's actual expenses for transportation and housing capped by the amounts in the Local Standards as adopted by the Internal Revenue Service.

(2) Courts should interpret the calculation of the amounts "scheduled as contractually due" to secured creditors that may be deducted from a debtor's CMI pursuant to section 707(b)(2)(A)(iii) as being limited to payments to secured creditors whose claims are secured by property that is reasonably necessary for the maintenance and support of the debtor and the debtor's dependents.

(3) Congress should pass clarifying amendments to make the statutory language consistent with the recommended interpretations of existing law in paragraphs (1) and (2).

History of the Means Test. The means test was at the heart of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[116] The policy goal was to identify chapter 7 debtors who "can pay" and generally require those debtors, if they wanted bankruptcy relief, to file under chapter 13, which requires the debtor to devote all disposable income to repayment under a plan. The means test applies only to individual debtors whose debts are primarily consumer debts.[117]

The means test begins with section 707(b)(1). It provides that if the court finds a chapter 7 filing to be an "abuse," the court may dismiss the case or, with the debtor's consent, convert the case to one under chapter 13.

"Abuse," in turn, may be presumed under a complex statutory formula that requires data from various government agencies that the USTP helpfully compiles.[118] The first step in the formula is to determine the debtor's "current monthly income" (CMI), which is defined, basically, as the average of the debtor's

116 Pub. L. No. 109-8, 119 Stat. 23.

117 *See* 11 U.S.C. § 707(b)(1) (specifying court may dismiss a case for abuse for debtors whose debts are primarily consumer debts).

118 *See* U.S. Dep't of Justice, Census Bureau, IRS Data, and Administrative Expense Multipliers, https://www.justice.gov/ust/means-testing (last visited Jan. 20, 2019).

monthly income for the six months preceding the bankruptcy filing but excluding benefits under the Social Security Act. (CMI also excludes payments to victims of war crimes, and payments resulting from crimes against humanity or domestic terrorism.)

Next, CMI must be compared to the state median income for a household of the same size as the debtor's household. If the debtor's current monthly income is at or below the applicable state median, the debtor passes the means test and can file chapter 7.[119] Bankruptcy professionals use the terms "above-median debtor" and "below-median debtor" in specifying whether the debtor's CMI falls above or below the applicable median income.

An "above median" debtor goes through additional calculations, initially subtracting a list of expenses specified in section 707(b)(2)(ii). The list of expenses is long and detailed. Three expense categories are germane to the Commission's recommendation.

First, the debtor deducts "applicable monthly expense amounts specified under the National Standards and Local Standards" of the Internal Revenue Service (IRS). The IRS developed these standards as part of an internal guide to calculating repayment of delinquent tax debts by specifying set deductions from the taxpayers' income that should be allowed. For example, at the time of this writing, the National Standard for a debtor living alone allows the deduction of $647 per month for living expenses (food, housekeeping supplies, apparel & services, personal care products & services, and miscellaneous expenses) regardless of the debtor's actual expenses, which might be higher or lower than this amount.

Second under section 707(b)(2)(ii), the debtor also can deduct the actual expenses for "Other Necessary Expenses" as defined by the Internal Revenue Service. Examples of Other Necessary Expenses includes taxes, union dues, and certain child-care expenses.

Third, in addition to deducting amounts allowed by the IRS (and by a number of other statutory provisions), the means test allows the debtor to deduct payments on secured debts "contractually due" to secured creditors during the sixty months following the filing of the bankruptcy petition.

After deducting expenses from CMI, an above-median debtor multiplies the result by sixty to come up with the total amount the debtor could pay over a five-year chapter 13 plan. If the amount is (i) less than $8,175, or (ii) between $8,175 and $13,650 and less than 25% of the debtor's unsecured debts, the above-median debtor passes the means test and can file chapter 7.[120] (The amounts are adjusted every three years for inflation under section 104.)

---

119 This rule results from 11 U.S.C. § 707(b)(7), which specifies that no "judge, United States Trustee (or bankruptcy administrator, if any), trustee, or other party" may move to dismiss the case for failing the means test if the debtor is below the state median income. This part of the statute is not a model of clarity, as it refers to a motion under "paragraph (2)" — i.e., § 707(b)(2) — which only establishes the means-test calculations and does not provide the court with the substantive authority to dismiss, which instead comes from paragraph (1) — i.e., § 707(b)(1).

120 *See* 11 U.S.C. § 707(b)(2)(A)(i).

If an above-median debtor does not pass the means test, then a presumption of abuse arises that "may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative."[121] These additional expenses must be documented and be accompanied by a detailed explanation of the special circumstances.[122] If the debtor cannot establish special circumstances, the courts have split over whether to give primacy to the statutory language that the presumption may "only" be rebutted by special circumstances — leaving dismissal or conversion mandatory — or to give primacy to the discretionary language in section 707(b)(1) that the court "may" dismiss for abuse. [123]

The "means test" is the gateway into chapter 7, but its calculations are also critical for higher-income debtors in chapter 13. For all chapter 13 debtors, monthly income is calculated using the average, six-month prebankruptcy income calculation for "current monthly income."[124] The debtor then deducts amounts reasonably necessary for the support of the debtor or the debtor's dependents. But for an above-median debtor, the only expense deductions are those allowed under the means test, which are generally IRS allowances rather than the amount the debtor actually spends. (For a below-median debtor, the court does not use the means test and has substantial discretion to determine what amounts are "reasonably necessary" for the support of the debtor or the debtor's dependents.[125]) Whatever is left after deducting expenses is "disposable income," the entirety of which the debtor must devote to repaying creditors under the plan (unless the plan provides for 100% repayment).[126] An above-median debtor also must have an "applicable commitment period" — the time over which the debtor must pay disposable income — of not less than five years.[127]

Evaluating the Means Test. The 2005 amendments have been the subject of several academic papers studying the amendments' effects. Professors Christopher Cornell and Bing Xu found the means test shifted the percentage of chapter 13 cases by three percentage points in states most sensitive to the means test — that is, states with a larger fraction of the population just above the state median income.[128] In a working paper, Professors Stefania Albanesi and Jaromir Nosal found that BAPCPA led to a 50% drop

121 *Id.* § 707(b)(2)(B)(i).

122 *See id.* § 707(b)(2)(B)(ii).

123 Cases holding that special circumstances are the exclusive means to rebut the presumption of abuse and that a court must dismiss if special circumstances are not present include Robbins v. Alther (*In re* Brown), 537 B.R. 262 (Bankr. W.D. Va. 2015); *In re* Maura, 491 B.R. 493 (Bankr. E.D. Mich. 2013); and *In re* Woodruff, 416 B.R. 369 (Bankr. D. Mass. 2009). Courts holding that use of the word "may" gives discretion not to dismiss even when special circumstances are not present to rebut the presumption of abuse include *In re* Jenkins, 2012 WL 2564901 (Bankr. W.D.N.C. 2012); *In re* Mravik, 399 B.R. 202 (Bankr. E.D. Wis. 2008); and *In re* Skvorecz, 369 B.R. 638 (Bankr. D. Colo. 2007).

124 *See* 11 U.S.C. § 1325(b)(2) (stating "the term 'disposable income' means current monthly income" less specified expense deductions).

125 The Commission explains these different approaches to expenses in its recommendation on reserve funds in chapter 13 plans. *See* § 4.03 Reserve Fund in Chapter 13 Cases.

126 *See* 11 U.S.C. § 1325(b)(1) (stating that, if there is an objection to confirmation, the plan cannot be confirmed unless it provides for full payment of claims or for all of the debtor's disposable income during the applicable commitment period to be applied to repayments to unsecured creditors under the plan).

127 *See id.* § 1325(b)(4)(ii).

128 *See* Christopher Cornell & Bing Xu, *Effects of the BAPCPA on the Chapter Composition of Consumer Bankruptcies*, 124 Econ. Letters 439 (2014).

in chapter 7 filings but a 25% increase in insolvency generally (where "insolvency" is defined as having at least one loan that is 120+ days overdue and no loans overdue for shorter periods). Their evidence showed that the decrease in filings came from debtors not being able to afford the higher filing costs after the 2005 changes.[129] "Taken together, these findings suggest the main effect of the 2005 bankruptcy reform was to shift financially stressed individuals from Chapter 7 bankruptcy to insolvency."[130]

These findings are echoed in earlier studies closer to the time of BAPCPA's enactment. Using data from 2007, a group of researchers concluded, "[I]nstead of functioning as a sieve, carefully sorting the high-income abusers from those in true need, the [2005] amendments' means test functioned more like a barricade, blocking out hundreds of thousands of struggling families indiscriminately, regardless of their individual income circumstances."[131] In another study, Professor Michael Simkovic found that the cost of borrowing increased after the 2005 amendments and concluded that the amendments "benefited credit card companies and hurt their customers."[132] Finally, the ABI Consumer Bankruptcy Fee Study found the additional administrative burdens imposed by the 2005 amendments, including the increased documentation requirements from the means test, raised costs to debtors, with a 51% increase for a no-asset chapter 7 and a 24% to 27% increase for a chapter 13.[133]

Although the means test was at the heart of BAPCPA's reforms, it is difficult to separate its effects from the effects of other provisions in the 195-page-long statute. The Commission considered the scholarly evidence about BAPCPA, as well as the diverse experience of the commissioners about how debtors experience the means test on the ground. The Commission weighed all of the options, including repealing the means test. In the end, the Commission decided it could be most effective by recommending specific reforms that would improve the administration of the means test. As with many of the Commission's recommendations, some commissioners preferred more extensive changes, while others might not have gone as far as the recommendations do. But, as discussed in the Foreword, the Commission's means test recommendations represent its "collective professional judgment about the best ways to improve the consumer bankruptcy system for all its stakeholders."

Recommendation — Reducing Documentation Requirements. As discussed above, the means test begins with a calculation of CMI. Procedurally, all individual debtors in chapter 7 and 13 cases must prepare and file a Statement of Current Monthly Income. In chapter 7 cases, the debtor calculates CMI based on the statutory definition and reports the income information on Official Form 122A-1. If the CMI amount is below the applicable state median income, as reflected in Part 2 of the statement, the debtor checks the box on the top of the form stating that "there is no presumption of abuse" and is not required to complete the remaining means test calculations in Official Form 122A-2.

129 *See* Stefania Albanesi & Jaromir Nosal, *Insolvency after the 2005 Bankruptcy Reform*, working paper (2018), available at https://www.nber.org/papers/w24934 (last visited Jan. 21, 2019).

130 *Id.* at 32.

131 *See* Robert M. Lawless, Angela K. Littwin, Katherine M. Porter, John A. E. Pottow, Deborah K. Thorne, and Elizabeth Warren, *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 Am. Bankr. L.J. 349, 353 (2008).

132 Michael Simkovic, *The Effect of BAPCPA on Credit Card Industry Profits and Prices*, 83 Am. Bankr. L.J. 1, 17, 22 (2009).

133 Lois Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 Am. Bankr. Inst. L. Rev. 17, 30 (2012).

A similar process is used in chapter 13 cases. Chapter 13 debtors must calculate CMI based on the statutory definition and report the income information on Official Form 122C-1. Debtors whose incomes are below the applicable state medians do not use the means test to calculate their disposable income and so do not complete the other means test form, Official Form 122C-2.

Consistent with the means test, section 521(a)(1)(B)(iv) requires, unless the court orders otherwise, that every employed debtor file copies of all payment advices or other evidence of payment received from employers within sixty days before the petition was filed. Federal Rule of Bankruptcy Procedure 1007(b)(1)(E) and (c) specify compliance with this requirement. Because section 521(a)(1)(B) applies only if the court does not order otherwise, some courts have used their power to "order otherwise" to adopt local rules or general orders providing that payment advices are to be delivered to the trustee at or before the meeting of creditors rather than filed with the court.

Compliance with these paperwork requirements imposes substantial burdens on debtors and their attorneys and has increased the cost of fling bankruptcy for consumer debtors. To properly calculate CMI, the attorney must collect detailed wage and other income information for the entire prepetition six-month period. In a joint case, this information must be collected for both debtors. Many individual debtors work several jobs or supplement their wage employment with self-employment, which requires additional document collection and makes the CMI calculation more complex. Because the appropriate median family income is determined based on household size, which may include nonrelated individuals living in the household, income information also may need to be collected and analyzed from other household members for the prepetition six-month period.

Debtors rarely provide to their attorneys all needed information at one time. They also often struggle to come up with the funds needed to file, including filing, credit counseling and attorney fees. As a result, an anticipated filing date is often postponed, requiring the attorney to recalculate the CMI and collect additional documentation based on a new filing date. For some debtors, such recalculations may be required multiple times.

The vast majority of consumer debtors have income that is below the state median income. A USTP report to Congress following BAPCPA estimated that approximately only about 8% of chapter 7 debtors and 27% of chapter 13 debtors are above-median.[134] The median CMI for chapter 7 debtors in 2016 was $2,996, and debtors' CMI has changed little over the past decade.[135] As a result, few bankruptcy filings result in the USTP filing a motion to dismiss or convert under section 707(b). In fiscal year 2016, the USTP brought 1,738 actions under the general "for cause" dismissal rules of section 707(a) and 1,417

134 Executive Office of U.S. Trustee, Impact of the Utilization of Internal Revenue Standards for Determining Expenses on Debtors and the Court 3-4 (2007), https://www.justice.gov/sites/default/files/ust/legacy/2011/07/13/Rpt_to_Congress_on_IRS_Standards.pdf (last visited Jan. 21, 2019).

135 Ed Flynn, *The Changing Profile of Chapter 7 Debtors*, Am. Bankr. Inst. J., Sept. 2018, at 30, 75 exh.3.

actions under the means-test dismissal rules of section 707(b) — less than 0.3% of the 482,693 chapter 7 cases filed during that year.[136]

In most cases, the debtor's income is far below CMI. Even where a presumption of abuse arises, very few bankruptcy filings result in the USTP filing a motion to dismiss or convert under section 707. The USTP annual report for fiscal year 2016 states: "In FY 2016, the USTP declined to file a motion to dismiss in about 63 percent of presumed abusive cases. The percentage of declinations has grown from less than 35 percent in FY 2006 to more than 60 percent in recent years. This suggests that the objective criteria of the means test are now well-established and that most debtors' attorneys file presumed abusive cases only if the cases satisfy statutory exceptions."[137]

The Commission recommends statutory changes that would reduce the documentation requirements that have added substantial costs to every individual bankruptcy case, while still requiring sufficient documentation to corroborate the debtor's sworn statement of income in Schedule I. Rather than file sixty days of payment advices, below-median debtors should be permitted to file other forms of documentation, such as a recent pay stub showing the debtor's year-to-date income or a tax return. The current requirements in section 521(a)(1)(B)(iv) would remain unchanged for above-median-income debtors.

In the small number of cases in which the debtor's income has changed significantly, or where the exact amount of the debtor's income is critical to determining whether the case is an abuse — because the CMI or calculations under section 707(b)(2) are close to the amounts that would give rise to a presumption of abuse — the trustee or U.S. Trustee may request additional documentation. Consistent with the Commission's proposal for trustee best practices,[138] such a request should only be made in individual cases that warrant further information.

The safe harbor in section 707(b)(7)(A) should also be amended to delete the requirement for calculating CMI for below-median debtors. If the debtor's monthly income as reported on Schedule I, multiplied by twelve, is equal to or less than the highest median-income figure for the debtor's state, the section 707(b)(7)(A) protections should apply without the need for a CMI calculation. Again, in appropriate cases the trustee or U.S. Trustee could request additional information.

Recommendation — Excluding Public Assistance, Government Retirement, and Disability Benefits. As discussed above, section 101 excludes from CMI "benefits received under the Social Security Act." Reducing CMI means a debtor is more likely to pass the means test in a chapter 7, lowers "disposable income" that must be paid under a chapter 13 plan, and makes it more likely that the applicable commitment period for a chapter 13 plan will be three years rather than five. The exclusion of Social

136 U.S. Dep't of Justice Exec. Office of U.S. Trustees, United States Trustee Program Annual Report of Significant Accomplishments Fiscal Year 2016, at 4-5, available at https://www.justice.gov/ust/file/ar_2016.pdf/download (last visited Jan. 21, 2019).

137 *Id.* at 6.

138 *See* § 3.09 Document-Production Requests by Bankruptcy Trustees.

Security benefits from CMI derives from the statutory prohibition on assignment of Social Security benefits, specifically as to the "operation of any bankruptcy or insolvency law."[139]

Congress traditionally has prevented the assignment of Social Security benefits out of concerns for the elderly and disabled. In discussing a predecessor bill to what became the 2005 amendments, Senator Kennedy offered the amendment to exclude Social Security benefits and described the reasons for doing so:

> The amendment I have offered will protect a debtor's Social Security benefits during bankruptcy. This amendment is very important to older Americans. . . .
>
> My amendment excludes Social Security benefits from the definition of "current monthly income" and ensures that those benefits will never be used to repay credit card debt and other debt.
>
> This amendment is particularly important to seniors. Between 1991 and 1999 the numbers of people over 65 who filed bankruptcy grew by 120 percent. . . .
>
> One can ask, why are we doing this now rather than before? The reason it was not necessary before is because the Social Security effectively was protected with a series of protections that were included in the existing bankruptcy law which have not been included in this legislation. Therefore, without this kind of an amendment, they would be eligible for creditors. We think protecting our senior citizens, those on Social Security, as a matter of both public policy and the fact of the importance of their contributions, obviously, in terms of society, should be protected during their senior years. . . .
>
> The bottom line is that bankruptcy shouldn't be made more difficult for those who are depending on Social Security for their livelihood. Social Security was developed to ensure that seniors can live their golden years in dignity. If we allow Social Security income to be considered while determining whether someone is eligible for bankruptcy, a portion of those benefits could be used in a manner inconsistent with Congress' intent.[140]

The federal and state governments provide numerous public-assistance benefits programs that can supplement or supplant Social Security benefits, whether for retirement or disability, often based on the type of employment. Examples include programs for veterans[141] or railroad workers.[142] Generally speaking, these programs take the place of Social Security benefits, at least for the period during which the worker held the type of employment covered under the program. These programs almost always

139 42 U.S.C. § 407(a).

140 145 Cong. Rec. 29,929 (1999).

141 *See* 38 U.S.C. §§ 1101-1163 (service-connected military disability benefits); *id.* §§ 1501-1543 (nonservice-connected disability benefits).

142 42 U.S.C. §§ 231-231v (Railroad Retirement Act of 1974).

contain protections similar to the Social Security Act, preventing assignment or seizure of these benefits by creditors.[143]

Although the definition of CMI excludes some rare sources of income,[144] the more common sources of public assistance or retirement benefits are not excluded, although they serve a purpose comparable to Social Security benefits, which are excluded. Despite their prohibitions on assignability, most courts have declined to exclude "Social Security-like" benefits in the face of clear and unambiguous language, despite the prohibitions on assignability of these benefits under nonbankruptcy law.[145]

The disparate treatment of similar benefits programs can lead to a situation where the nature of a retired or disabled debtor's previous employment results in dramatically different CMI calculations. A disabled railroad worker's benefits are swept into CMI, making it more likely the worker fails the means test, but an identically disabled person receiving Social Security disability benefits can exclude them.

The disparate treatment of disability benefits is especially pronounced in the case of veterans' disability benefits. The ABI has a Task Force for Veterans and Servicemembers whose mission is to focus attention on financial distress in veterans and servicemembers and "to financially strengthen those that strengthen us with the respect and dignity they deserve."[146] As three of its members observed about the treatment of veterans' disability benefits: "There is no sensible basis for the Bankruptcy Code treating benefits paid to veterans through the Department of Veterans Affairs differently than benefits received by individuals from the Social Security Administration. The disparate treatment results in systematic discrimination against veterans, even if wholly unintentional."[147] Senator Baldwin introduced legislation in 2018 that would have eliminated the disparate treatment of veterans' disability benefits, but the legislation was not passed.[148] The Commission agrees with this legislation but would go further.

Debtors receiving income from public retirement and disability benefit programs outside the Social Security Act should not be disadvantaged relative to those receiving Social Security benefits. At the same time, debtors should not be advantaged merely because they receive public retirement and disability benefits. Therefore, the Commission recommends that public and disability benefits comparable to Social Security — including those for veterans, railroad workers, and state and federal civil servants

143 *See* 5 U.S.C. § 8346 (exempting civil service retirement benefits from legal process); 22 U.S.C. § 4060(c) (exempting foreign service retirement and disability payments from attachment); 33 U.S.C. § 916 (exempting longshoremen's and harbor workers' pensions from assignment and legal process); 38 U.S.C. § 1562 (exempting Congressional Medal of Honor pension from legal process); 38 U.S.C. § 5301(a)(1) (exempting veterans' benefits from assignment and legal process); 45 U.S.C. § 231m (exempting railroad retirement benefits from assignment).

144 Specifically, CMI excludes income for "victims of war crimes or crimes against humanity on account of their status as victims of such crimes, and payments to victims of international terrorism. . . ." 11 U.S.C. §101(10A).

145 *See, e.g.*, *In re* Brah, 562 B.R. 922 (Bankr. E.D. Wis. 2017) (holding veterans' disability benefits are not excluded); *In re* Waters, 384 B.R. 432 (Bankr. N.D. W. Va. 2008) (same).

146 Jay Bender, Elizabeth Gunn & John H. Thompson, *Defending Our Veterans: Excluding Veterans' Benefits from Current Monthly Income*, Am. Bankr. Inst. J., Nov. 12, 2018, at 12, 12.

147 *Id.* at 13.

148 *See* 164 Cong. Rec. S3633 (daily ed. June 11, 2018) (introducing an amendment to the John S. McCain National Defense Authorization Act for Fiscal Year 2019, H.R. 5515, 115th Cong., 2d Sess.).

— should be excluded from CMI, but that the exclusion be capped at the maximum allowed for Social Security benefits, which is currently $2,788.00 a month.[149]

The rationale for excluding from CMI public assistance retirement and disability benefits comparable to Social Security does not apply to privately funded retirement and disability income. Unlike public assistance benefits, privately funded retirement and disability income is generally derived from contributions made or purchased by the debtor (including employer matches and benefits) to supplement the applicable public assistance benefits. Further, unlike public assistance benefits, debtors often have a greater degree of control over any income distributions from those funds, and, by delaying distributions, can retain the funds intact and exempt during bankruptcy.[150]

Recommendation — Best Interpretation of CMI for Unemployment Benefits. The definition of CMI "excludes benefits *received under* the Social Security Act" (emphasis added). In addition to traditional Social Security, Social Security Disability, and Medicare, there are clear public assistance benefits that are "received under" the Social Security Act and thereby excluded from CMI.[151]

Beyond these benefits, the question has arisen of whether unemployment benefits are "received under" the Social Security Act as well as state unemployment benefits funded to differing degrees with federal monies under the Social Security Act. In the case of *In re Kucharz*, Judge Thomas Perkins succinctly outlined the history of the unemployment program and the relationship between the federal Social Security Act and state law:

> Enacted as part of President Roosevelt's New Deal legislation, the Social Security Act of 1935 incentivized the states to adopt conforming laws to pay unemployment insurance benefits to their involuntarily unemployed citizens. The Congress rejected the alternative of a uniform national unemployment insurance system, preferring instead to preserve the autonomy of the states to adopt their own systems. The states were given a wide range of judgment and broad freedom to set up the type of unemployment compensation system they preferred.
>
> The incentive for the states to act was a financial one, provided through the Federal Unemployment Tax Act (FUTA). FUTA imposes an excise tax on wages paid by employers. An employer, however, is allowed a credit of up to 90% of the federal tax for

149 By "maximum," the amount intended is the maximum benefit for any individual, not the maximum benefit to which a specific debtor might have been entitled if all of his or her work had been done for an employer covered under the Social Security Act. Such a determination would not be practical.

150 11 U.S.C § 522(b)(4).

151 *See, e.g.*, Adinolfi v. Meyer (*In re* Adinolfi), 543 B.R. 612 (B.A.P. 9th Cir. 2016) (holding adoption-assistance payments are "benefits received under the Social Security Act").

Other benefits provided under the Social Security Act include Medicaid, 42 U.S.C. § 1396b; programs in Guam, Puerto Rico, and the Virgin Islands providing old age benefits, *id.* §§ 301-306; the Stephanie Tubbs Jones Child Welfare Services Program, *id.* §§ 620-628; programs for family support, family preservation, family reunification, and adoption-support services, *id.* §§ 629-629i; foster care and adoption assistance, *id.* §§ 670-679c; and aid to the blind in Puerto Rico, Guam, and the Virgin Islands, *id.* §§ 1201-1206.

> contributions the employer pays to a state fund established under a federally approved state unemployment compensation law. All 50 states have unemployment insurance laws implementing the federal mandatory minimum standards of coverage. The conditions attached to allowance of the credit are designed to assure that each state's program contains basic standard provisions.
>
> In order to protect the employer contributions against loss, the states are required to invest the funds with the U.S. Treasury. The states' funds are deposited and held in an "Unemployment Trust Fund." Although the funds are aggregated for investment purposes, the U.S. Treasury maintains separate accounts for the deposits made by each state and the earnings on the deposits. The U.S. Treasury remits the funds back to the states upon request on an as-needed basis.
>
> In order for a state to retain its program certification, it must use the trust funds solely for the payment of unemployment compensation benefits, exclusive of expenses of administration. . . .
>
> The Unemployment Trust Fund includes an extended unemployment compensation account to provide funding for payment of extended benefits during times of high unemployment. . . . From time to time, Congress legislates additional weeks of extended benefits on top of the 26 weeks provided by most states. . . .
>
> Unemployment insurance claims are submitted to, evaluated and paid or denied by state officials implementing state law. Appeals are heard by state officials. Illinois, for example, has enacted a comprehensive code of intricate unemployment insurance laws. The Illinois Department of Employment Security was created to administer those laws and to adopt regulations to effect such administration. Benefits are payable as determined under state law and the regulations promulgated thereunder, independent of the SSA and FUTA.[152]

A majority of courts join *Kucharz* in holding that, despite the intertwining of federal and state laws, unemployment benefits are not received "under" the Social Security Act within the meaning of section 101 of the Bankruptcy Code and therefore are not excluded from CMI.[153]

As *Kucharz* notes, the language is reasonably admissible of either interpretation,[154] and the best interpretation is not just a matter of counting cases. The Commission agrees with the courts that have found that unemployment benefits are received "under" the Social Security Act and therefore are

152 *In re* Kucharz, 418 B.R. 635, 637-39 (Bankr. C.D. Ill. 2009) (citations omitted).

153 *See In re* Washington, 438 B.R. 348 (Bankr. M.D. Ala. 2010); *In re* Baden, 396 B.R. 617 (Bankr. M.D. Pa. 2008); *In re* Overby, 2010 WL 3834647 (Bankr. W.D. Mo. 2010); *In re* Winkles, 2010 WL 2680895 (Bankr. S.D. Ill. 2010); *In re* Nance, 2010 WL 2079653 (Bankr. S.D. Ind. 2010); *In re* Rose, 2010 WL 2600591 (Bankr. N.D. Ga. 2010).

154 *Kucharz*, 418 B.R. at 640; *see also Baden*, 396 B.R. at 622 (the provision is open to "varying interpretations").

excluded from CMI.[155] As one of these courts noted, this interpretation advances the purpose of the Social Security Act as identified by the Supreme Court:

> The purpose of the [Social Security] Act was to give prompt if only partial replacement of wages to the unemployed, to enable workers "to tide themselves over, until they get back to their old work or find other employment, without having to resort to relief." Unemployment benefits provide cash to a newly unemployed worker "at a time when otherwise he would have nothing to spend," serving to maintain the recipient at subsistence levels without the necessity of his turning to welfare or private charity.[156]

Given the ambiguity in the statute, the Commission agrees it is best interpreted to further the policies of the Social Security Act and the Bankruptcy Code in a way that is consistent with the usual rules in the Bankruptcy Code and across federal and state law that protect public assistance benefits from being used for repayment of private debts. Although the Commission believes this result is the best interpretation of the existing statute, it would welcome a clarifying amendment to the same effect from Congress.

Recommendation — Interpreting "Special Circumstances." As explained above, if the amount remaining after deductions is above certain thresholds, a presumption of abuse arises that allows the court to dismiss a chapter 7 case. Debtors have sought to avoid the presumption of abuse in some cases by arguing that certain expenses not covered by the means test may still reduce current monthly income as a "special circumstance."

Section 707(b)(2)(B) defines these "special circumstances" only generally. The circumstances must "justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative." As examples of acceptable "special circumstances," section 707(b)(2)(B) mentions obligations that result from "a serious medical condition or a call or order to active duty in the Armed Forces."

Several courts have said that an obligation to pay a nondischargeable student loan can be a "special circumstance" similar to a serious medical condition or a call to military service.[157] For example, in *In re Delbecq*, the means test left the debtor with $304 in disposable monthly income, and she faced a motion to dismiss by the U.S. Trustee asserting the presumption of abuse. In response, the debtor argued that her monthly student loan payment of $350 was a "special circumstance" that rebutted the presumption.[158]

---

155 *See In re* Munger, 370 B.R. 21 (Bankr D. Mass. 2007); *In re* Sorrell, 359 B.R. 167 (Bankr. S.D. Ohio 2007).

156 *Sorrell*, 359 B.R. at 182 (quoting California Dept. of Human Resources Development v. Java, 402 U.S. 121, 131—32 (1971)).

157 *See In re* Howell, 477 B.R. 314, 316-17 (Bankr. W.D.N.Y. 2012) (debtor rebutted presumption of abuse when magnitude of student loan debt would allow only nominal payments to other unsecured creditors); *In re* Edwards, 2012 WL 3042233 (Bankr. N.D. Ala. 2012) (agreeing that in some cases student loan payments may constitute special circumstances, but not in this case because debtors incurred other high unnecessary expenses); *In re* Sanders, 454 B.R. 855 (Bankr. M.D. Ala. 2011) (debtors who "either directly or on guarantor basis" were responsible for their son's student loan could claim the expense as a "special circumstance" under section 707(b)(2)(B)); *In re* Martin, 371 B.R. 347 (Bankr. C.D. Ill. 2007); *In re* Delbecq, 368 B.R. 754 (Bankr. S.D. Ind. 2007); *In re* Haman, 366 B.R. 307 (Bankr. D. Del. 2007) (debtor's obligation to pay as co-signor on son's student loan is "special circumstance"); *In re* Templeton, 365 B.R 213 (Bankr. W.D. Okla. 2007); *see also* Anthony P. Cali, Note, *The "Special Circumstance" of Student Loan Debt Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 52 Ariz. L. Rev. 473 (2010) (reviewing decisions and policies related to issue and generally supporting treatment of student loans payments as "special circumstance").

158 *Delbecq*, 368 B.R. at 755.

In agreeing with the debtor, the court in *Delbecq* looked to the legislative history of the means test. The court referred to a Senate Judiciary Committee Report issued in 1999 in connection with the proposed legislation that first introduced "special circumstances" as a part of the means test. The Senate Report noted that the purpose of the provision was to "protect debtors from rigid and arbitrary application of a means-test," and that the "Committee adopted the 'special circumstances' standard, rather than the 'extraordinary circumstances' standard included in the Conference Report. . . ."[159] The *Delbecq* court also noted that the legislative history does not indicate that the specific examples provided in § 707(b)(2)(B) were intended to "define, qualify or otherwise limit the meaning of 'special circumstances.'"[160]

Delbecq concluded that the debtor did not have a meaningful ability to pay her debts. If her case had been dismissed, the debtor would likely have been forced to defer repayment of her student loans to pay her other unsecured debt and thereby incur additional indebtedness. The court did not find this to be a reasonable alternative. On the other hand, forcing the debtor into chapter 13 would do nothing to advance the goal of the means test. Because separate classification of student loan debts was permitted in the district,[161] the non-student loan creditors would receive nothing under any plan the debtor was likely to propose. Thus, the debtor did not have any meaningful ability to repay her debts either inside or outside of bankruptcy.[162]

A similar analysis was applied in a chapter 13 case. Finding that monthly payments of $450 toward a nondischargeable student loan were "special circumstances," the court in *In re Knight* held that a downward adjustment of the debtor's projected disposable income in the amount of his scheduled student loan payments was appropriate.[163] The court found that the debtor had no reasonable alternative to payment of his student loans, and that it would be unfair to the debtor if completion of a chapter 13 plan left him in default on his student loans and subject to garnishment or tax offsets.[164]

Some courts have rejected debtors' arguments that student loan payments can be "special circumstances" because they do not involve an involuntary hardship.[165] According to these courts, student loans are a routine obligation that individuals take on voluntarily, and "they are not unforeseeable, unavoidable, or beyond a debtor's control."[166] Under this view, payments toward a nondischargeable student loan would never be a special circumstance.

159 S. Rep. No. 106-49, at 2 (1999).

160 *Delbecq*, 368 B.R. at 758.

161 The Commission has recommended that the best interpretation of chapter 13 is to allow separate classification of student loans in the plan and that Congress should pass a clarifying amendment to this effect. *See* § 1.01 Student Loans.

162 *Delbecq*, 368 B.R. at 761-62.

163 370 B.R. 429 (Bankr. N.D. Ga. 2007).

164 *Id.* at 437; *see also In re* Howell, 477 B.R. 314, 317 (Bankr. W.D.N.Y. 2012) (discussing the negative impact of chapter 13 on debtor's student loan debt as factor under section 707(b)(2)(B)(i) rebutting claim of abuse of chapter 7).

165 *See In re* Zahringer, 2008 WL 2245864 (Bankr. E.D. Wis. 2008); *In re* Pageau, 383 B.R. 221 (Bankr. D.N.H. 2008).

166 *In re* Brown, 500 B.R. 255, 261 (Bankr. S.D. Ga. 2013).

The decisions that give substantial weight to the reasons why the debtor incurred a particular debt, such as a student loan, ignore the relevant statutory language. By its terms, the statute requires only that the debtor demonstrate that certain circumstances are "special" to the extent that they require additional expenditures from current monthly income and there is no reasonable alternative to payment of these expenditures. There is nothing in the statutory language suggesting that the past circumstances that created the obligation should control the determination of a special circumstance. The relevant factor is whether there is presently a reasonable alternative to the necessary expenditure.[167] The standard should be met when there is nothing within the debtor's power to avoid paying the debt or otherwise avoid an additional expense. The means-testing system was intended to direct debtors with truly discretionary income or an extravagant lifestyle into some form of debt repayment. The lack of alternatives for repayment of student loan debt or other obligations should focus on the debtors' resources, expenses, and economic circumstances and not on whether student loans are a common or "voluntary" form of debt.[168]

For all of these reasons, the Commission recommends that, under the best interpretation of current law, the presence of "special circumstances" should depend on the circumstances at the time of the administration of the means test and not on whether the obligation at issue was incurred involuntarily. The Commission also would support a clarifying amendment from Congress to reach the same result.

Recommendation — Calculating Deductions from CMI. Both for purposes of the chapter 7 means test and determining a chapter 13 debtor's disposable income, an above-median debtor first calculates CMI and then deducts expenses, with two of the main categories of expenses being the amounts allowed under the IRS's National Standards and the Local Standards. The National Standards serve as an allowance on expenses for food, clothing, and other expenses, such as a 5% additional allowance for food and clothing.[169] As recognized by the USTP, the allowances under the National Standards are granted "without questioning the amount actually spent."[170] The debtor takes the specified National Standard deductions whether the debtor actually spends more or less than the amount on the item in question.

In *Ransom v. FIA Card Services, Inc.*, the Supreme Court ruled that an above-median debtor can only take a transportation ownership deduction under the Local Standards to the extent the debtor actually makes loan or lease payments on a motor vehicle.[171] The court expressly reserved ruling on the question of whether the debtor was entitled to take deductions under the Local Standards beyond the amount actually spent.[172] The U.S. Trustee and some courts, however, have interpreted the Local Standard deductions for transportation and housing expenses (other than the payments of secured

167 *See In re* Haman, 366 B.R. 307, 313-14 (Bankr. D. Del. 2007) (rejecting view that circumstances must result from events outside debtor's control).

168 *See In re* Sanders, 454 B.R. 855 (Bankr. M.D. Ala. 2011) (student loan repayment is "special circumstance" rebutting presumption of abuse; allowing indebtedness to increase under long-term payment program not a reasonable alternative).

169 *See* § 707(b)(2)(A)(ii)(I).

170 U.S. Dep't of Justice, Means Testing, https://www.justice.gov/ust/means-testing/20181101 (last visited Jan. 21, 2019).

171 562 U.S. 61 (2011).

172 *Id.* at 75 n.8.

debt) as limited to the "amounts actually spent" by the debtor, not to exceed the allowance.[173] Other courts have disagreed.[174]

The differing treatment of the National Standards and the Local Standards has a practical justification. National standards cover a broad spectrum of living expenses. Local standards, however, are focused. For example, the Local Standard for transportation divides into two categories: an allowance for operating a motor vehicle and an amount for the "ownership allowance" of an automobile. The intent was to segregate the expenses involved with a motor vehicle to the cost of maintenance, repair, and fuel from the costs of acquiring or leasing a motor vehicle. Given the statutory ambiguity, the Commission again believes that the best interpretation is the one that furthers the policy behind the statute and recommends that courts interpret the National Standards as allowing a deduction regardless of actual expense and the Local Standards as a cap, allowing a deduction in the amount actually spent for the category of expense up to the amount specified in the Local Standards. Again, the Commission supports a clarifying amendment to this effect.

An above-median debtor also may deduct secured-debt payments that are contractually due in the five-year period after the bankruptcy filing, which can prevent a presumption of abuse under the means test in chapter 7 or lower the "disposable income" that the debtor must pay to creditors in chapter 13.[175] In contrast, a below-median chapter 13 debtor may only deduct such payments to the extent they are reasonably necessary for the support of the debtor or the debtor's dependents.[176] So a question arises as to whether there is any restriction on an above-median debtor's deduction of secured-debt payments, even payments that go beyond those reasonably necessary for support. Without any restriction, an above-median debtor could deduct secured-debt payments on a luxury home or car where the "reasonably necessary" test would bar the below-median chapter 13 debtor from doing the same. For example, the Ninth Circuit found that Congress had removed the "reasonably necessary" component from the secured-debt payments as applied to above-median debtors in the means test. The result was that the debtor could deduct from CMI the mortgage payments on a $400,000 luxury home.[177]

Although the Commission recognizes that section 707(b) does not expressly have a "reasonably necessary" standard, not having such a standard for the debt repayments of above-median secured creditors leads to the absurd result of above-median-income debtors with huge secured debts for luxury items being able to deduct the full payment on those debts. Prior to the 2005 amendments, a wealthy debtor who sought to keep luxury items would be met in a chapter 7 with a claim of substantial abuse and in a chapter 13 with the "reasonably necessary" requirement. In adopting the means test to channel

173 *See, e.g., In re* Cooper, 2015 WL 1545282, at 9 (Bankr. E.D.N.C. 2015); *In re* Harris, 522 B.R. 804 (Bankr. E.D.N.C. 2014).

The USTP position is shown on the webpage with the means-testing information: U.S. Dep't of Justice, Means Testing, https://www.justice.gov/ust/means-testing/20181101 (last visited Jan. 21, 2019).

174 *See, e.g.*, *In re* O'Neill Miranda, 449 B.R. 182 (Bankr. D.P.R. 2011); *In re* Young, 392 B.R. 6 (Bankr. D. Mass. 2008).

175 *See* § 1325(b)(3) (incorporating § 707(b)(2)(b)(2)(A)(iii)(I) into chapter 13 in determining the disposable income of above-median debtors).

176 *See* 11 U.S.C. § 1325(b)(2).

177 *See* Drummond v. Welsh (*In re* Drummond), 711 F.3d 1120 (9th Cir. 2013).

"can pay" debtors into chapter 13, Congress could not have intended to create a loophole for higher-income debtors.

Therefore, the Commission believes the better interpretation of the means test is that an above-median debtor can deduct payments on secured debt only if the payments are reasonably necessary for the support of the debtor or the debtor's dependents.[178] For an above-median debtor, this interpretation should apply both under the chapter 7 means test and in the calculation of disposable income for a chapter 13 debtor. The Commission believes this interpretation is best under the existing statute, but, as with its other recommendations for "best interpretations," supports a clarifying statutory amendment implementing this result.

§ 3.08 Application of Means Test in Converted Cases

The means test should apply in cases converted from chapter 13 to chapter 7. Furthermore, courts should apply the means test as of the date of the original filing. If the debtor would have been eligible for chapter 7 on the date of the original filing, the debtor passes the means test for purposes of conversion. These results are not only the best interpretation of existing law but also sound policy that Congress should clarify as part of any statutory amendment.

Background. Elsewhere, the Commission has made recommendations regarding changes to the computations for the means test, which serves as a regulatory gatekeeper for chapter 7.[179] As part of those recommendations, the Commission has explained the origin and operation of the means test in detail. Generally speaking, the means test requires a chapter 7 debtor to calculate currently monthly income (CMI) using a statutory formula and then deduct specified expenses. If the remaining amount falls above certain thresholds, a presumption of abuse arises, and unless the debtor shows "special circumstances," the court can dismiss the chapter 7 (or convert it to chapter 13 with the debtor's permission).[180]

The issue arises whether the means test applies when a chapter 13 debtor converts the case to a chapter 7.[181] Section 707(b) applies the means test to "a case filed by an individual debtor under this chapter whose debts are primarily consumer debts." The interpretive question is whether the phrase "filed . . . under this chapter" describes a case originally filed under chapter 13.

178 *Cf. In re* Kramp, 2011 WL 4002614 (Bankr. N.D. W. Va. 2011) (holding it was not good faith to propose a chapter 13 plan paying creditors less than 100% while making secured-debt payments on a Harley Davidson motorcycle); *In re* Allwas, 2008 WL 6069662 (Bankr. D.S.C. 2008) (same, including a plan that also involved a Harley Davidson motorcycle); *In re* LaSota, 351 B.R. 56, 59 (Bankr. W.D.N.Y. 2006) (in dicta, suggesting a chapter 13 plan cannot propose to keep an expensive Harley Davidson if creditors are not paid in full).

179 *See* § 3.07 Means Test Revisions & Interpretations.

180 *See* 11 U.S.C. § 707(b). The subsection also allows conversion to chapter 11, but this is not a practical option for most consumer debtors.

181 *See id.* § 1307(a) ("The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time.").

Consumer Corner

By Pernell W. McGuire and Aubrey L. Thomas

401(k) Contributions under Post-BAPCPA Case Law

Pernell W. McGuire
Davis Miles McGuire Gardner PLLC
Flagstaff, Ariz.

Aubrey L. Thomas
Davis Miles McGuire Gardner PLLC
Flagstaff, Ariz.

Pernell McGuire is a partner at Davis Miles McGuire Gardner PLLC in Flagstaff, Ariz., and is a certified bankruptcy specialist. He is also a lecturer of business law at Northern Arizona University. Aubrey Thomas is an associate in the same office.

Allowing a chapter 13 debtor to continue making reasonable contributions to a qualified retirement plan—such as a 401(k)—has, for many years, been taken as a "given." It has been properly understood to be an integral part of the debtor's "fresh start." With the amendments to the Bankruptcy Code through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the protection of retirement plans became explicit under 11 U.S.C. § 541(b)(7), but the ability of a debtor to continue making 401(k) contributions throughout the life of a chapter 13 plan has recently come under fire. This article addresses the statutes that govern whether 401(k) contributions are allowable during the course of a chapter 13 case, the case law that has developed to interpret those statutes, and an argument to allow 401(k) contributions that debtors' attorneys could make in response to recent decisions denying such contributions.

The Statutory Context

Before examining how the courts have addressed this issue, it is helpful to set out the relevant statutory provisions. Section 1325(b)(1) provides, in part, that "if the trustee or the holder of an allowed unsecured claim objects," then the court may not confirm a plan unless "all of the debtor's projected disposable income [is] received in the applicable commitment period." There is no definition of "projected disposable income," but the U.S. Supreme Court has held that in applying a "forward-looking approach," projected disposable income is first calculated by determining a debtor's disposable income on the date of filing and then taking into account "other known or virtually certain information about the debtor's future income or expenses" to modify the amount that the debtor must pay on a monthly basis.[1]

A debtor's disposable income is determined under 11 U.S.C. § 1325(b)(2). Essentially, disposable income is a debtor's current monthly income less "amounts reasonably necessary" for "maintenance and support of the debtor or a dependent of the debtor," charitable contributions and certain business expenses. Subsection (3), however, clarifies that for debtors with above-median income, "amounts reasonably necessary" under subsection (2) "shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2)."

Considering § 1325 as a whole, two initial observations are important. First, a court may confirm a chapter 13 plan that includes a debtor's deduction for a 401(k) contribution. Scrutiny regarding such an expense only arises when the trustee or an unsecured creditor objects on that basis. Therefore, if a debtor wishes to maintain a 401(k) contribution, there is no harm in continuing it with the debtor's express understanding that, if challenged, the court may not allow the contribution to continue if objected to by the trustee or an unsecured creditor. Knowledge of the trustee's position in your particular area is helpful when advising the debtor on that proposed strategy.

Second, and more importantly, there is a difference between above- and below-median-income debtors. For below-median-income debtors, the inquiry is simply whether the court believes that the 401(k) contribution is a "reasonably necessary" expense.[2] For above-median-income debtors, the analysis of whether the debtor's expenses are "reasonably necessary" is strictly governed by § 707(b)(2)(A)-(B), also known as the "means test." Thus, it appears that it will be easier for a below-median-income debtor to continue a 401(k) contribution than an above-median-income debtor.

Unfortunately for above-median-income debtors, under the means test, "reasonably necessary" expenses are restricted to those allowable expenses provided under the Internal Revenue Service (IRS) guidelines set out in the *Internal Revenue Manual,* 5.15.1.7-.10 (rev. ed. 2012). As several courts have noted, contributions to a 401(k) plan are not included in the IRS's list of allowable, necessary expenses.[3] Still, one remaining statutory wrinkle, which was created as part of the BAPCPA amendments to the Bankruptcy Code, comes into the analysis for above-median debtors who wish to continue modest contributions to their 401(k) plans.

In defining property of the estate in a chapter 13 case, § 1306 incorporates all "property of the estate" as defined by § 541. In turn, § 541(b)(7)(A) provides, in part, that "any amount" that is "withheld by an employer from the wages of employees for payment as contributions" to a tax-qualified plan

1 *Hamilton v. Lanning*, 130 S.Ct. 2464, 2475 (2010).

2 *In re McCullers*, 451 B.R. 498, 501 n.6 (Bankr. N.D. Cal. 2011). *See also In re Hebbring*, 463 F.3d 902, 907 (9th Cir. 2006).

3 *In re Egebjerg*, 574 F.3d 1045, 1052 (9th Cir. 2009); *In re Prigge*, 441 B.R. 667, 676 (Bankr. D. Mont. 2010); *IRM* 5.15.1.27.

(*i.e.*, a 401(k) plan) is not property of the estate. The statute continues with what some courts have labeled the "hanging paragraph":[4] "except that such amount under this subparagraph shall not constitute disposable income as defined by section 1325(b)(2)."

The problem with the hanging paragraph is that, on first read, it does not make grammatical sense. The words "except that," which begin the hanging paragraph, would normally indicate an exception to that particular rule, but instead, the statute continues to address a wholly unrelated topic: "disposable income" in a chapter 13 case. In a sense, in drafting § 541(b)(7)(A), Congress jumped from point A to point C, conflating distinct and arguably unrelated concepts (*i.e.*, property of the estate and disposable income) without explaining the logical connection between the two. As one court aptly said, "the hanging paragraph reflects its ambiguity," and attempts to divine its intended meaning to have "split the courts nationwide."[5] The question then becomes whether the hanging paragraph functions to allow 401(k) contributions by above-median-income debtors in spite of the omission of 401(k) contributions from the list of necessary expenses under the means test.

Divergent Approaches

In answering that question, courts have developed three distinct lines of interpretation of the hanging paragraph in § 541(b)(7)(A). In the first line of cases, which seems to have been the majority interpretation immediately following the enactment of BAPCPA, courts have held that debtors "may fund 401(k) plans in good faith, so long as their contributions do not exceed the limits legally permitted by their 401(k) plans."[6] Under that interpretation, a debtor may contribute up to the full allowable contribution amount, even if the debtor did not make 401(k) contributions prior to filing for bankruptcy. The cases that embrace this interpretation overwhelmingly focus solely on the phrase "shall not constitute disposable income" in the hanging paragraph of § 541(b)(7)(A) and essentially ignore the remaining statutory context.

The first real attempt at explaining the significance of the hanging paragraph in the greater statutory context—and also the case cited most frequently as clearly setting out the second interpretation of that paragraph—is *In re Seafort*.[7] In *Seafort*, the court addressed whether a debtor, who had not made 401(k) contributions prior to filing for bankruptcy, could begin doing so after filing and thereby decrease the amount of disposable income available to the debtor's creditors. The court first acknowledged that continuing 401(k) contributions by a chapter 13 debtor was clearly allowable, citing *Nowlin* and *Johnson*.[8] In explaining why it was allowable to continue such contributions but not to increase or begin in the first instance to make those contributions, the court noted that § 541 defines "property of the estate" *at the commencement of the case* and, therefore, "only 401(k) contributions [that] are being made at the commencement of the case are excluded from property of the estate under § 541(b)(7)."[9]

The court then explained that because property of the estate in a chapter 13 case includes "earnings from services performed by the debtor after the commencement of the case," without a similar exclusion like that in § 541(b)(7) of income contributed to a 401(k) plan, a debtor was not allowed to divert income from creditors by beginning to make 401(k) contributions. Inherent in the court's reasoning—although not explicitly stated—is that by making prepetition 401(k) contributions, § 541(b)(7) allows a debtor to, in essence, grandfather in all future 401(k) contributions throughout the chapter 13 plan, even though § 1306, as acknowledged by the court, does not provide for an exclusion of those contributions from "property of the estate." The court described the policy underpinnings of that allowance, stating that "Congress clearly intended to strike a balance between protecting debtors' ability to save for their retirement and requiring that debtors pay their creditors the maximum amount they can afford to pay."[10]

> **The interpretive method that will have any staying power must address the grammatically perplexing beginning to the hanging paragraph: "except that."**

The final interpretation of the "hanging paragraph"—one that appears to be gaining significant traction in at least two circuits—is that first set out in *In re Prigge*.[11] Under this line of cases, courts have held that § 541(b)(7) is inapplicable, and therefore, contributions to a 401(k) plan for an above-median-income debtor must cease and those funds must be used to pay creditors through the debtor's chapter 13 plan.

Surprisingly, *Prigge* addressed § 541(b)(7) in only a brief footnote that is arguably *dictum*.[12] Instead, the court's analysis focused on the incorporation of the IRS standards into § 1325, which specifically prohibit 401(k) contributions being treated as a necessary expense.[13] The court also noted that, as part of the BAPCPA amendments, Congress included a specific exclusion from "disposable income" under § 1322(f): 401(k) loan repayments. Section 1322(f) provides that "[a] plan may not materially alter the terms of a loan described in section 362(b)(19) and any amount required to repay such loan shall not constitute 'disposable income' under section 1325." By not including a similar exclusion for actual contributions to 401(k) plans, the court reasoned, Congress exhibited an intent to not shelter that income from the equation of disposable income.[14]

Cases that have followed *Prigge* directly address the issue of how to interpret the hanging paragraph of § 541(b)(7), and

4 Not to be confused with the "hanging paragraph" found in 11 U.S.C. § 1325(a)(5).
5 *In re Parks*, 475 B.R. 703, 707 (B.A.P. 9th Cir. 2012).
6 *In re Johnson*, 346 B.R. 256, 263 (Bankr. S.D. Ga. 2006). *See also In re Leahy*, 370 B.R. 620, 623 (Bankr. D. Vt. 2007) ("These cases speak with one voice in concluding that, pursuant to § 541(b)(7), 401(k) or ERISA-qualified savings plan funds are not property of the bankruptcy estate."); *In re Nowlin*, 366 B.R. 670, 676 (Bankr. S.D. Tex. 2007) (same).
7 437 B.R. 204 (B.A.P. 6th Cir. 2010), *aff'd on other grounds*, 669 F.3d 662 (6th Cir. 2012).
8 *In re Seafort*, 437 B.R. 204, 207 (B.A.P. 6th Cir. 2010), *aff'd on other grounds*, 669 F.3d 662 (6th Cir. 2012).
9 *Id.* at 209.
10 *Id.* at 210.
11 441 B.R. 667 (Bankr. D. Mont. 2010). *See also In re Parks*, 475 B.R. at 707 (adopting *Prigge* reasoning); *In re Seafort*, 669 F.3d 662, 674 n.7 (6th Cir. 2012) (in *dictum*, adopting reasoning of *Prigge*); *In re McCullers*, 451 B.R. 498 (Bankr. N.D. Cal. 2011).
12 *In re Prigge*, 441 B.R. at 677 n.5.
13 *Id.* at 676.
14 *Id.* at 677.

continued on page 81

Consumer Corner: 401(k) Contributions under Post-BAPCPA Case Law

from page 19

in one of the cases, *McCullers*, the court made two important conclusions. First, the court held that under § 541(b)(7), the only funds that are exempt from property of the estate are funds that the debtor earned pre-petition and that were withheld for contribution to the debtor's 401(k) plan but were still currently in the possession of the debtor's employer.[15] That is so, the court explained, because § 541 describes property of the estate "as of the commencement of the case," and pre-petition wages earned but not yet paid are otherwise treated as property of the estate under § 541(a). Second, the court posited that the purpose of the transitional phrase "except that" was "merely to counteract any suggestion that the exclusion of such [401(k)] contributions from property of the estate constitutes post-petition income to the debtor."[16] Courts that follow the third interpretive approach find the exclusion of 401(k) contributions from the list of necessary expenses in the *IRS Manual* to be conclusive and limit § 541(b)(7) to the most narrow meaning possible.

Thoughts on Moving Forward

None of these three approaches provides a particularly satisfying analytical pathway to its conclusion. The first interpretive method, as typified by the *Johnson* case, fails to address the thorny statutory issues the other two methods have taken up. The second interpretive method, set out in *Seafort*, provides a somewhat more satisfactory answer, particularly because the result appears to be in harmony with the public policy behind bankruptcy: the allowance of a fresh start while still providing for the fair treatment of creditors. Still, the *Seafort* court's analysis breezes by the actual text of § 541. The interpretive method that will have any staying power must address the grammatically perplexing beginning to the hanging paragraph: "except that." That is why the third interpretation is gaining some traction.

The problem with the narrow interpretation of "except that" embraced by the third approach is that it renders the "hanging paragraph" ineffective. Specifically, *McCullers* provides that the words "except that" imply that the only purpose of the "hanging paragraph" is to counteract any suggestion that funds withheld from a debtor's paycheck by an employer to be contributed to a 401(k) plan *but that are still in the employer's possession on the date of filing* are not "post-petition income." Whether certain funds are "post-petition income," however, is irrelevant—the Code focuses on "projected disposable income" and "disposable income." There is no legal significance to treating those funds as "post-petition income," and therefore, the exclusion that *McCullers* asserts that the hanging paragraph creates is really a meaningless one.

Furthermore, § 541(b)(7)(A) itself refers to those funds not being treated as "disposable income." Thus, the statute requires that in some way, the exclusion must factor into the disposable-income analysis of § 1325(b)(2). Most courts have focused on whether 401(k) contributions are considered a reasonably necessary expense, but that focus is misplaced. In fact, as courts have aptly noted, because 401(k) contributions are not an allowable IRS expense, it seems contradictory to allow the "hanging paragraph" to override that specific exclusion.

Instead, the focus should be on whether amounts contributed to a 401(k) plan are even "current monthly income" at all. Examining the statute in that context, there is a strong argument that the answer is "no." Again, the "hanging paragraph" states that "such amount *under this subparagraph*" is not disposable income. The amount described "under this subparagraph" is "any amount" that is "withheld by an employer from the wages of employees for payment as contributions" to a qualified plan. There is no limitation *in that subparagraph* to amounts held on the date of the petition. That limitation is under § 541(a) and is irrelevant to the "hanging paragraph" itself; indeed, the creation of property of the estate is irrelevant to the "disposable-income" analysis, and courts should be wary to conflate the two concepts. Thus, when calculating current monthly income as the first step in determining "disposable income," amounts contributed to a 401(k) plan should be excluded.

This approach seems attractive for several reasons. First, it results in below-median and above-median-income debtors being treated the same, as opposed to allowing a 401(k) contribution as a "reasonable expense" for below-median-income debtors but not for above-median-income debtors. Second, it is consistent with the policy throughout the Bankruptcy Code of protecting the retirement contributions of debtors. Last, it actually gives effect to the "hanging paragraph" instead of rendering it meaningless, as the interpretation of *Prigge* does. It is important for practitioners to be aware of these various approaches and, in jurisdictions that do not allow such contributions, to argue for an interpretation that makes the most sense out of the perplexing "hanging paragraph." abi

15 *McCullers*, 451 B.R. at 503.
16 *Id.* at 504.

22. Emergency Savings Fund.

A. Line 21 of Schedule J (the Debtor(s)' expense budget) includes a provision for an emergency savings fund by the Debtor(s). Deposits into the Emergency Savings Fund will be made to the Trustee. Withdrawals from the Emergency Savings Fund may be made by application to the Court, utilizing the form application from the Court's website. Withdrawals should be requested only in an emergency. The form application need only be served electronically, and only to persons subscribing to the Court's CM/ECF electronic noticing system. An application will be deemed granted on the 15th day after filing unless (i) an objection has been filed; or (ii) the Court has set a hearing on the application. The Debtor(s) may request emergency consideration of any application filed under this Paragraph. The balance, if any, in the Emergency Savings Fund will be paid to the Debtor(s) following (i) the completion of all payments under this Plan; (ii) the dismissal of this case; or (iii) the conversion of this case to a case under chapter 7, except under those circumstances set forth in 11 U.S.C. § 348(f)(2).

B. The deposits into the Emergency Savings Fund will be:

Month of First Deposit of this Amount	Month of Last Deposit of this Amount	Amount	Total
		TOTAL	

C. Funds paid to the Trustee will not be credited to the Emergency Savings Fund unless, at the time of receipt by the Trustee, the Debtor(s) are current on payments provided for in the Plan that are to be distributed to creditors or that are to be reserved under Paragraph 23. After funds have been credited to the Emergency Savings Fund, they may only be withdrawn in accordance with this Paragraph.

D. The Debtor(s) may file a Notice reflecting any change into the Emergency Savings Fund deposits. Unless a party-in-interest objects within 14 days of the filing of the Notice, the Trustee must file a Notice of Plan Payment Adjustment to reflect the change.

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE SOUTHERN DISTRICT OF TEXAS
_____ DIVISION

In re:	§	
John and Mary Doe,	§	**Case No 14-xxxxx**
Debtors	§	

NOTICE AND APPLICATION FOR
WITHDRAWAL FROM SAVINGS FUND

THIS NOTICE AND APPLICATION SEEKS RELIEF THAT MAY ADVERSELY AFFECT YOU. IF YOU OPPOSE THE APPLICATION, YOU SHOULD IMMEDIATELY CONTACT THE MOVING PARTY TO RESOLVE THE DISPUTE.

IF YOU AND THE MOVING PARTY CANNOT AGREE, YOU MUST FILE A RESPONSE AND SEND A COPY TO THE MOVING PARTY. YOU MUST FILE AND SERVE YOUR RESPONSE WITHIN **14** DAYS OF THE DATE THIS APPLICATION WAS FILED. YOUR RESPONSE MUST STATE WHY THE APPLICATION SHOULD NOT BE GRANTED. IF NO PARTY FILES AN OBJECTION, THE RELIEF IS DEEMED GRANTED ON THE 15TH DAY UNLESS AN ORAL HEARING HAS BEEN SET BY THE COURT. IF EMERGENCY RELIEF IS REQUESTED BELOW, THE COURT MAY CONSIDER THE RELIEF AT AN EARLIER DATE.

REPRESENTED PARTIES SHOULD ACT THROUGH THEIR ATTORNEY.

Name of Debtor(s) filing this Application: _____.

Total amount on deposit in Savings Fund as of the date of the application.	$
Amount of requested withdrawal.	$
Date on which withdrawal is required.	
Total of all other savings held by Debtors.	$
If the funds are withdrawn, for what will the funds be used?	
Describe, in detail, why it is necessary to spend the funds. Attach additional pages if required.	
Describe any other information that should be considered by the Court in determining whether to allow the withdrawal. Attach relevant invoices and other documents.	
Lists dates and amounts of any previous withdrawals.	

[SIGNATURE BLOCK BY ATTORNEY OR PRO SE DEBTOR]

CERTIFICATE OF SERVICE

Service of this application was made only by electronic means through the Court's CM/ECF system. Copies of the application will not be mailed.

Date: _____ _____