

Consumer Track

The Individual Conundrum— Chapter 7, 11 or 13?

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**THE INDIVIDUAL CONUNDRUM CHAPTER 7, 11, or 13?
ALTERNATIVES FOR INDIVIDUALS**

**Prepared for the American Bankruptcy Institute
31st Annual Spring Meeting
April 18-21, 2013**

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Issues and Topic Outline

1. Eligibility

Chapter 7. Any individual can be a debtor under Chapter 7,¹ but the case may be dismissed if he or she has primarily consumer debt and the filing would be an “abuse” of Chapter 7. Individuals whose debts are not primarily consumer debts are not subject to dismissal of their cases for abuse under Section 707(b). However, filings by individuals whose debts are primarily consumer debts may constitute “abuse” if they cannot pass the “Means Test” set forth in Section 707(b)(2)² or if they are found to have filed the petition in bad faith or if the totality of the circumstances of the individual’s financial situation demonstrates abuse.³ Even when an individual is eligible to be a Chapter 7 debtor, she may not be entitled to all of the relief offered by the Chapter, such as full application of the automatic stay or the discharge, as explained later in these materials.

Chapter 11. Any individual can be a debtor under Chapter 11 except stockbrokers or commodity brokers.⁴ While some circuits once denied individuals access to Chapter 11 if they were not in business on an ongoing basis, that requirement has been abolished.⁵

Chapter 13. Only individuals with regular income can be debtors under Chapter 13.⁶ That income can come not only from employment but also from alimony, spousal support, welfare, social security, pensions, or investments. The income may be regular even if it is earned as infrequently as yearly, as may be the case with a farmer. However, an individual’s income will not make him eligible for Chapter 13 if it is too low to support payments under a plan.

In addition to regular income, an individual (or the individual and his or her spouse if filing jointly) must have noncontingent, liquidated, unsecured debts of less than \$360,475

¹ 11 U.S.C. § 109(b).

² 11 U.S.C. § 707(b)(2).

³ 11 U.S.C. § 707(b)(3).

⁴ 11 U.S.C. § 109(d).

⁵ Toibb v. Radloff, 501 U.S. 157 (1991).

⁶ 11 U.S.C. § 109(e).

and noncontingent, liquidated, secured debts of less than \$1,080,400.⁷ [rif on non-con & liquidated?]

As with Chapter 11, stockbrokers and commodity brokers cannot be debtors under Chapter 13.⁸

2. Credit Counseling and Financial Management.

All individual debtors must undergo credit counseling within 180 days of the filing date,⁹ except in the rare instances where they qualify for one of the three exceptions: the U.S. Trustee or bankruptcy administrator has determined that the credit counseling agencies in the district are not reasonably able to provide adequate services;¹⁰ there are exigent circumstances, the debtor requested credit counseling services and was unable to obtain services, and the court approves;¹¹ or the debtor is unable to complete credit counseling due to incapacity, disability, or active military duty in a military combat zone.¹²

Individual debtors in Chapter 7 and 13 are required to take a financial management course before receiving a discharge.¹³ An individual in Chapter 11 is not required to take a financial management course.¹⁴

3. Income Tax Issues

Chapter 7. Upon the filing of a Chapter 7 case, a separate taxable entity arises for the bankruptcy estate.¹⁵ The debtor continues to report postpetition income on Form 1040 and the chapter 7 trustee reports any income received by the estate on Form 1041.

⁷ These debt limits are updated every three years; the limits provided here are no longer accurate after April 1, 2013.

⁸ 11 U.S.C. § 109(e).

⁹ 11 U.S.C. § 109(h)(1). Debtors are further required to submit proof that they completed such courses and a copy of the debt repayment plan, if any, that was developed in the credit counseling course. 11 U.S.C. § 521(b).

¹⁰ 11 U.S.C. § 109(h)(2).

¹¹ 11 U.S.C. § 109(h)(3).

¹² 11 U.S.C. § 109(h)(4).

¹³ 11 U.S.C. §§ 727(a)(11) and 1328(g)(1).

¹⁴ It is sometimes incorrectly asserted that 11 U.S.C. § 1141(d)(3) requires individual debtors to take a financial management course in the limited circumstances where the plan provides for liquidation of all or substantially all of the property of the estate; the debtor does not engage in business after consummation of the plan; and the debtor would be denied a discharge under 727(a) if the case were a chapter 7 case. Section 1141(d)(3) does not address general applicability of the discharge, only whether the confirmation of the plan discharges the debtor. Section 1141(d)(5) addresses the discharge of the individual Chapter 11 debtor and provides that the court can separately order the confirmation of the plan to discharge debt. Section 1141(d)(5) does not require “an instructional course concerning personal financial management described in section 111,” as explicitly set forth in sections 727(a)(11) and 1328 (g)(1).

The debtor's prepetition tax attributes – net operating losses, general business credit carryovers, minimum tax credits, capital losses, property basis, passive activity loss and credit carryovers, and foreign tax credit – pass into the estate on the filing date and pass out of the estate with the transfer of property associated with a tax attribute or at the termination of the estate. Debtors should be aware that the Chapter 7 discharge will not create a discharge-of-indebtedness tax liability, but it will reduce the tax attributes that are in the estate.¹⁶ A mere transfer of property from the debtor to the estate and a transfer from the estate to the debtor at the termination of the estate are not taxable,¹⁷ and tax attributes that move with property (including basis and some kinds of losses) will transfer between the debtor and estate unaffected. Sales and exchanges between the Debtor and the estate are taxable.¹⁸

Chapter 7 debtors have the option under Internal Revenue Code section 1398(d) to split the normal 12-month reporting period into two short tax years, the first ending on the day before the filing date and the second running from the filing date to the last day of the regular reporting period, unless the estate has no assets.¹⁹ By making the election, the debtor's tax liability for the short year becomes an allowable prepetition priority claim against the assets of the estate, as opposed to a postpetition claim that the debtor is wholly responsible to pay. The debtor may use tax attributes such as net operating losses existing as of the first day of the reporting period during the short year prior to the bankruptcy filing. But debtors must be careful that they do not inadvertently miss the opportunity to elect the short tax year by missing the special tax filing deadline: the short-year election is made by filing the debtor's form 1040 before the 15th day of the fourth full month after the bankruptcy filing date.

Chapter 7 debtors and trustees must pay attention to property that will, upon disposition, result in a taxable gain but generate insufficient cash proceeds to pay that gain. An example is real estate owned by the debtor for a long period of time that is subject to a recent mortgage. In that case, the tax basis for the property may be quite low and the mortgage loan

¹⁵ 26 U.S.C. § 1398(e)(1).

¹⁶ 26 U.S.C. § 108(a).

¹⁷ 26 U.S.C. § 1398(f).

¹⁸ Id.

¹⁹ 26 U.S.C. § 1398(d)(2).

may exceed the value of the property. A foreclosure by the lender will generate no cash but will trigger a taxable gain equal to the difference between the fair market value and the basis. If the trustee allows the redemption period to run while the real estate is property of the estate, a priority tax claim will arise that may wipe out the recovery for general unsecured creditors. On the other hand, if the trustee abandons the property, the debtor may be stuck with the taxable gain without the benefit of tax attributes such as net operating losses that are stuck in the estate until the estate is terminated. Thus both the debtor and the trustee should be vigilant and seek out tax counsel if a debtor files for Chapter 7 with: property subject to foreclosure whose fair market value exceeds its tax basis; net operating losses; passive, capital, and at-risk losses; or ownership through regarded, disregarded, and pass-through entities.

Chapter 11. As with Chapter 7, the filing of an individual Chapter 11 case creates a separate taxable entity for the estate.²⁰ All the Chapter 7 tax considerations – including transfer of property, short year elections, and the management of tax liabilities and attributes – apply equally in individual Chapter 11 cases.

Chapter 11 cases are even more burdensome on the debtor. Because the debtor in possession also acts as the trustee,²¹ it is the debtor's responsibility to obtain the estate's EIN and complete and file Form 1041 on behalf of the estate. The debtor and the estate must file a "Notice 2006-83 Statement" in the year the bankruptcy case commences, allocating the debtor's compensation to the debtor for the period prior to the petition date and to the estate for the period after the filing date.

The Chapter 11 debtor should also be aware that taxes may be higher during the case. The estate must use tax rates for a married individual filing separately, which can lead to higher taxes for married debtors.²² The debtor must notify filers of information returns, such as 1099s, that the reportable payments should be provided to the bankruptcy estate. However, employers continue to report income and withholding on W-2 forms under the debtor's social security number. In both cases, the income is deemed to go to the estate, which in turn pays the debtor for his or her services. The estate should be able to deduct the

²⁰ 26 U.S.C. § 1398(e)(1).

²¹ 11 U.S.C. § 1107(a).

²² 26 U.S.C. § 1398(c)(2).

debtor's salary as an administrative expense,²³ but tax law does not clarify whether such administrative expenses must be approved by the court or whether court approval of an expense can make an otherwise non-deductible expense deductible. The debtor should also be able to deduct tax withholdings required of both the estate and the debtor, but there is still double-taxation risk for debtors who are employees since the employer is paying the debtor's social security tax before payment is made to the estate, and the estate is required to pay social security tax again as the deemed employer of the debtor.²⁴ Furthermore, the creation of the Chapter 11 estate does not relieve the self-employed debtor of the obligation to report and pay self-employment taxes.

Finally, when considering the tax treatment of properties whose disposition will lead to taxable gains without corresponding cash proceeds, such as in some foreclosures, in addition to the considerations relating to tax attributes faced by the Chapter 7 debtor and trustee the individual Chapter 11 debtor should consider whether a discharge for cause before the end of plan payments²⁵ will reduce tax attributes that could have otherwise offset the taxable gain.

Chapter 13. The filing of a Chapter 13 case does not create a separate taxable estate.²⁶ As in Chapters 7 and 11, if the debtor has any tax attributes they will be reduced upon the debtor's discharge.

4. Domestic Support Obligations.

All Chapters. Most of the treatment regarding domestic support obligations ("DSOs") is common among all chapters of title 11. DSOs are defined in section 101(14A) and are generally debts owed to a spouse, former spouse, child, or applicable government agency in the nature of alimony, maintenance or support established by a separation agreement, divorce decree, property settlement agreement, court order, or determination of a governmental unit.²⁷ In a Chapter 7, 11, or 13 case, the trustee is charged with providing written notice to

²³ 28 U.S.C. § 1398(h)(1).

²⁴ These and other tax issues are explored in Jack F. Williams & Jacob L. Todres, *Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11*, 13 AM. BANKR. INST. L. REV. 701 (2005).

²⁵ See 11 U.S.C. § 1141(d)(5)(A).

²⁶ 26 U.S.C. § 1399.

²⁷ 11 U.S.C. § 101(14A).

holders of DSO claims and state child support agency of, among other things, the filing of the bankruptcy case, the discharge, and contact information of the debtor.²⁸

The automatic stay does not stop the commencement or continuation of a civil action or proceeding to: establish paternity; establish or modify an order for DSOs; address child custody or visitation; dissolve a marriage, except with respect to division of property of the estate; or address domestic violence.²⁹ Similarly, the automatic stay does not stop the collection of a DSO from property that is not property of the estate or the withholding of income that is property of the estate for payment of a DSO.³⁰

Prepetition payments on account of DSOs are not avoidable as preferences.³¹

Prepetition DSOs are accorded the highest priority of payment, subject only to the costs a trustee incurs in administering the assets that are the source of payment for such DSO claims.³² Under all three chapters, DSO claims incurred after the filing of the case are also accorded administrative expense claim status.³³ DSO claims cannot be discharged.³⁴ Furthermore, debts that do not meet the definition of a DSO but are nevertheless owed to a “spouse, former spouse, or child in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court” or a determination by a governmental unit are also non-dischargeable.³⁵

Although DSOs are accorded the same special treatment in each of Chapters 7, 11, and 13, there are some differences in their treatment under Chapters 11 and 13.

Chapter 11. Failure to pay DSOs that arise postpetition is cause to convert or dismiss a Chapter 11 case.³⁶ It follows that to confirm a Chapter 11 plan the individual debtor must be current on all postpetition DSO payments.³⁷ With respect to its treatment of prepetition

²⁸ 11 U.S.C. §§ 704(c), 1106(c), and 1302(d).

²⁹ 11 U.S.C. § 362(b)(2)(A).

³⁰ 11 U.S.C. § 362(b)(2)(B) and (C).

³¹ 11 U.S.C. § 547(c)(7).

³² 11 U.S.C. § 507(a)(1).

³³ 11 U.S.C. § 503(b)(1)(A)(ii).

³⁴ 11 U.S.C. § 523(a)(5).

³⁵ 11 U.S.C. § 523(a)(15).

³⁶ 11 U.S.C. § 1112(b)(4)(P).

³⁷ 11 U.S.C. § 1129(a)(14).

DSOs, a Chapter 11 plan must either (a) pay DSOs in full over time if such treatment is accepted by the holder of the DSO claims or (b) pay DSOs in full as of the effective date if the plan is rejected by the holders of DSO claims.³⁸

Chapter 13. Failure to pay DSOs that arise postpetition is also cause to convert or dismiss a Chapter 13 case.³⁹ To confirm a Chapter 13 plan the debtor must be current on all postpetition DSO payments.⁴⁰ Unlike the individual Chapter 11 debtor, the Chapter 13 debtor has the absolute right to pay prepetition DSOs over time through the plan.⁴¹ DSOs owed directly to a spouse, former spouse, child, or other party described in 11 U.S.C. § 101(14A)(A) must be paid in full.⁴² However, DSOs owed directly to a government unit (and not just assigned for collection purposes) may be paid less than the full amount of the claim if the debtor is proposing a 5-year plan that provides that all of the debtor's projected disposable income is applied to payments under the plan.⁴³ Unlike under Chapters 7 or 11, in order to obtain a discharge in Chapter 13 the Debtor must certify that all postpetition DSOs and all prepetition DSOs provided for under the plan have been paid.⁴⁴

5. Conversion and Dismissal of Cases

Chapter 7. The debtor may convert a Chapter 7 case to a case under Chapter 11, 12, or 13, provided that the case was not already converted from Chapter 11, 12, or 13 to Chapter 7 and the debtor is eligible to be a debtor under such chapter.⁴⁵ The debtor's absolute right to convert a case from chapter 7 to 13 was the subject of Marrama v. Citizens Bank,⁴⁶ where the Supreme Court held that conversion could be denied if the debtor committed acts that would result in the immediate dismissal of the case under section 1307(c). However, as the dissent noted, whether the debtor is denied the right to convert the case to Chapter 13 or is allowed

³⁸ 11 U.S.C. § 1129(a)(9)(B).

³⁹ 11 U.S.C. § 1307(a)(11).

⁴⁰ 11 U.S.C. § 1325(a)(8).

⁴¹ 11 U.S.C. § 1322(a)(2).

⁴² Id.

⁴³ 11 U.S.C. § 1322(a)(4).

⁴⁴ 11 U.S.C. § 1328(a).

⁴⁵ 11 U.S.C. § 706(a) and (d).

⁴⁶ 549 U.S. 365 (2007).

to convert and the case is immediately converted back to a case under Chapter 7 has the same effect on the debtor's ability to succeed in Chapter 13.

A party in interest, after notice and a hearing, may convert a Chapter 7 case to a case under Chapter 11, but a case cannot be converted to Chapters 12 or 13 without the debtor's consent.⁴⁷ Again, for such conversions to occur the debtor must be eligible to be a debtor under the target Chapter.⁴⁸

While section 707 provides grounds for the dismissal of a Chapter 7 case, such as abuse, failing the means test, and a bad faith filing, there is no right for a Chapter 7 debtor to dismiss the case without court approval.⁴⁹

Chapter 11. The debtor may convert a Chapter 11 case to Chapter 7 unless (a) the debtor is no longer the debtor in possession, (b) the case was originally commenced as an involuntary case, or (c) the case was converted to a Chapter 11 case other than on the debtor's request.⁵⁰ Note that an individual debtor can file a Chapter 7 case, convert it to Chapter 11 pursuant to section 707(a), and convert back to Chapter 7.

Conversions or dismissals initiated by parties in interest may only be for cause.⁵¹ Even where cause is established the court cannot convert a case to Chapter 7 if the individual debtor is a farmer unless the debtor requests such conversion.⁵² Furthermore, the court may only convert to Chapter 12 or 13 if (a) the debtor requests the conversion, (b) the debtor did not get a chapter 11 discharge, and (c) if the debtor requests conversion to Chapter 12, such conversion is equitable.⁵³ As with any conversion, the debtor must be eligible to be a debtor under the target Chapter.⁵⁴

⁴⁷ 11 U.S.C. § 706 (b) and (c). Arguably, the failure to require an individual debtor's consent (as opposed to an entity debtor's consent) to conversion to a case under Chapter 11 is an oversight of BAPCPA since the 2005 amendments to section 1115 (Property of the Estate) raise the same issues that originally led Congress to give Chapter 13 debtors the unconditional escape clause to Chapter 7 under section 1307(a).

⁴⁸ 11 U.S.C. § 706(d).

⁴⁹ 11 U.S.C. § 707.

⁵⁰ 11 U.S.C. § 1112(a).

⁵¹ 11 U.S.C. § 1112(b).

⁵² 11 U.S.C. § 1112(c).

⁵³ 11 U.S.C. § 1112(d).

⁵⁴ 11 U.S.C. § 1112(f).

Chapter 13. A debtor has an absolute right to convert a Chapter 13 case to a case under Chapter 11 at any time, and that right cannot be waived.⁵⁵ An interesting question has arisen since the BAPCPA amendments in 2005: does a debtor who converts from Chapter 13 to Chapter 7 have to pass the Means Test? At issue is the language of section 707(b)(2) that “the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts” if allowing the case to proceed would be an abuse of Chapter 7, including if the debtor fails the Means Test.⁵⁶

The controversy surrounds the phrase “filed by an individual debtor under this chapter.” Some courts have reasoned that the word “filed” modifies “under this chapter” and therefore the Means Test only applies to cases that were commenced under Chapter 7.⁵⁷ Other courts have held that “filed” only modifies “by an individual debtor” and therefore applies to a case converted from any chapter under which an individual originally filed.⁵⁸ Still other courts have held that the word “filed” is expansive enough in its own right to describe the conversion of a case into Chapter 7 as well as the filing of a petition.⁵⁹

As of the writing of these materials, six reported opinions have held that debtors with primarily consumer debts converting from Chapter 13 to Chapter 7 have to pass the Means Test,⁶⁰ and six opinions have held that they do not.⁶¹ Because eleven of the reported opinions are at the bankruptcy court level and only one is at the district court level, unless the case is

⁵⁵ 11 U.S.C. § 1307(a).

⁵⁶ 11 U.S.C. § 707(b)(1) (emphasis added).

⁵⁷ See, e.g., In re Chapman, 431 B.R. 216 (Bankr. D. Minn. 2010).

⁵⁸ See, e.g., In re Willis, 408 B.R. 803 (Bankr W.D. Mo. 2009).

⁵⁹ See, e.g., In re Lassiter, Case No. 08-31578, 2011 WL 2039363 (Bankr. E.D. Va., May 24, 2011).

⁶⁰ Cases holding that the Means Test applies to Chapter 13 conversions: In re Lassiter, Case No. 08-31578, 2011 WL 2039363 (Bankr. E.D. Va., May 24, 2011); In re Kraft, Case No. 09-21052, 2010 Bankr. LEXIS 5121 (Bankr. D. Wy., August 13, 2010); In re Willis, 408 B.R. 803 (Bankr W.D. Mo. 2009); In re Kellett, 379 B.R. 332 (Bankr. D. Ore., 2007); In re Kerr and In re Kallberg, Case No. 06-12302, 2007 Bankr. LEXIS 2474, (Bankr. W.D. Wash., July 18, 2007); In re Perfetto, 361 B.R. 27 (Bankr. R.I. 2007).

⁶¹ Cases holding that the Means Test does not apply to Chapter 13 conversions: In re Layton, Case No. 10-02014, 2012 WL 5193242 (Bankr. M.D. Fla., Oct. 19, 2012); In re Chapman, Case No. 431 B.R. 216 (Bankr. D. Minn. 2010); In re Guarin, Case No. 09-42294, 2009 Bankr. LEXIS 3871 (Bankr. D. Mass., December 3, 2009); In re Dudley, 405 B.R. 790 (Bankr. W.D. Va. 2009); In re Ryder, Case No. 07-40192, 2008 Bankr. LEXIS 2220 (Bankr. N.D. Cal., August 18, 2008); In re Fox, 370 B.R. 639 (D. N.J. 2007).

in front of one of these eleven judges or in the District of New Jersey, there is currently no definitive guidance on whether the Means Test will apply to any particular debtor.

6. The Automatic Stay

All Chapters. The Bankruptcy Code limits the automatic stay to protect creditors from serial filers and debtors who do not state their intentions with respect to leased property and collateral. The automatic stay does not apply to a creditor's acts to enforce liens or security interests in real property where (a) the debtor had a bankruptcy case pending in the 180 days prior to the filing date and (i) the case was dismissed by the court for failure to abide by orders or properly prosecute the case or (ii) the debtor dismissed the case following a creditor's request for relief from the stay; or (b) the current case was filed in violation of a bankruptcy court order prohibiting the debtor from filing further cases.⁶² The automatic stay only applies for 30 days after filing in a Chapter 7, 11, or 13 case where the debtor had a case pending in the year prior to the filing date and that case was dismissed.⁶³ That 30-day stay can be extended upon notice and hearing if the movant can show that the filing of the later case is in good faith as to the creditors to be stayed.⁶⁴ In the event two or more cases involving the debtor were pending within the year prior to the filing date, there is no automatic stay unless a party in interest brings a motion requesting the stay.⁶⁵

Furthermore, if an individual debtor fails to timely file a statement of intention indicating whether the debtor will surrender or retain property that (a) secures a claim in whole or in part or (b) is subject to an unexpired lease, the automatic stay is terminated as to such property and such property is no longer property of the estate.⁶⁶

Chapter 13. Unlike any other chapter of title 11, Chapter 13 provides a stay of actions against codebtors, whether such codebtors have filed for bankruptcy relief.⁶⁷ This codebtor stay relates only to individuals who are liable with the debtor on consumer debt, and prevents creditors from acting or commencing or continuing any civil action to collect on any part of

⁶² 11 U.S.C. §§ 362(b)(21), 109(g).

⁶³ 11 U.S.C. § 362(c)(3).

⁶⁴ 11 U.S.C. § 362(c)(3)(B) and (C).

⁶⁵ 11 U.S.C. § 362(c)(4).

⁶⁶ 11 U.S.C. § 362(h)(1).

⁶⁷ 11 U.S.C. § 1301.

the debt.⁶⁸ The court may grant a creditor relief from the codebtor stay on one of three bases: the codebtor received the consideration for the creditor's claim; the debtor's plan proposes not to pay the claim; or the creditor's interest would be irreparably harmed if the stay continues.⁶⁹

7. **Property of the Estate**

- A. §541 is generally applicable to Chapter 7, 11 and 13. Each differs, however, in the inclusion of property and these differences can be significant.
- B. **Chapter 7** - §541 applies to Chapter 7. All property interests which exist on the date of the filing of the Petition in Chapter 7 are property of the estate. Certain exceptions bringing inheritances, life insurance proceeds and property settlements which the debtor becomes entitled to within 180 days of the Petition date, also included additional post-petition property as property of the estate. (Note also that proceeds, profits, rents and monetary benefits emanating from property of the estate is also included in property of the estate. This means the Chapter 7 Trustee is entitled to such proceeds, profits and rents until such time as the property or interest is abandoned by the Trustee, which may create problems for an individual debtor.)
- C. **Chapter 11** - Generally, §541 applies to Chapter 11 cases, however, if the Chapter 11 debtor is an individual, new §1115 adds all of the property in §541 acquired during the pendency of the case until the case is closed, dismissed or converted, as well as earnings from services performed by the debtor after the commencement of the case, but before the case is closed, dismissed or converted. - this is a drastic change from pre-BAPCPA treatment where an individual debtor in Chapter 11 kept and could use post-petition income for personal use, subject to committing enough of it to the Plan to pass the good faith requirement for confirmation.

⁶⁸ 11 U.S.C. § 1301(a).

⁶⁹ 11 U.S.C. § 1301(c).

- (1) This raises issues for the debtor's use of post-petition income for other than actual and necessary costs of preserving the estate. §363(c) i.e. living expenses. While Chapter 13 has a Disposable income@ formula in §707(a)(2), which contemplates using post-petition earnings of the debtor, it is not applicable to Chapter 11 and, therefore, it is not explicitly permitted that an individual debtor can utilize estate property other than as a fiduciary for his or her creditors as a debtor in possession. This raises issues as to an individual debtor being able to pay an attorney to represent him or her for issues outside the debtor in possession role. i.e. divorce proceedings, dischargeability issues, exemption litigation, criminal defense, which are all things that are personal to the debtor and not in furtherance of a fiduciary duty to the estate.
 - (2) §327 would allow the debtor to employ an attorney, but §330 only allows compensation for services that benefit the estate. Literally, services performed for the debtor personally may not be considered to have benefitted the estate, where the debtor wears the hat of the debtor in possession. No provision was inserted into §330(a)(4)(B) by BAPCPA to authorize compensation for representing the debtor=s interest. (There is for Chapter 13 and Chapter 12).
- D. **Chapter 13** - Property of the estate includes all that noted in §541 plus post-petition earnings, but there is specific authorization for both payment of counsel for work aiding the debtor's personal issues as opposed to the debtor in possession issues, as well as living expenses (Means Test allowances specific to expenses). Note: Under the Chapter 13 Means Test, debtors will be generally limited in their proposed expenses to the Internal Revenue Collection Standard Allowances for expenses which standards are draconian in nature. The Means Test, as it relates to expenses, is not applicable to Chapter 11 individual debtors and presumably only a good faith standard in light of the circumstances of the case would be applicable in allowing actual Schedule J expenses.

8. Attorneys Fees/Costs of Proceedings

A. Chapter 7 - Typically, a flat fee for actual proceedings and usually paid up front-compensation for post-petition services may be made from post-petition income, which is free of creditors' claims, but subject to Court approval. (§541 does not generally include debtors' post-petition acquired property or post-petition income).

- (1) Generally inexpensive, with the exception of dischargeability litigation
- (2) No indentured servitude / fresh start
- (3) Fees generally not subject to affirmative approval by the Court - paid pre-petition

B. Chapter 11 - §1115 includes all post-petition personal service as income as well as all pre-petition property / rents / profits from property.

- (1) Creates estate and fiduciary duties (the debtor in possession concept)
- (2) Use of property of the estate to pay for personal attorneys fees for such things as divorce, exemption litigation, dischargeability - issues which are personal to debtors may be literally precluded by lack of §330 exception for payment of fees for services rendered to individual debtors in Chapter 11 (see §330(a)(4)(B)).
- (3) Pre-petition retainers are generally property of the estate subject to approval before being earned by counsel, even when held as security retainers in trust.
- (4) Very expensive proceeding compared to either Chapter 13 or Chapter 7 due to the complexity and requirements of pre-confirmation disclosure, solicitation of affirmative ballots, and the general pervading concept that Chapter 11 is a complicated and, thus, an expensive proceeding.
- (5) Quarterly fees based on distributions made by the estate during the length of the Plan are required to be paid to the United States Trustee (query

whether Plan duration is determined by the period during which payments are made under the Plan.) §1129(a)(15)(B).

- (6) No standing trustee percentage fee
 - (7) Fees for counsel and other professionals sought upon application and order per §330.
- C. **Chapter 13** - Presumed reasonable fees usually set by custom or Local Rule and not subject to the formality of application and order for compensation.
- (1) Relatively inexpensive as compared to Chapter 11 as disclosures are limited, confirmation battles with creditors are the exception, but the issues as to confirmation are fairly limited.
 - (2) Post-Petition, Post-Confirmation fees must be sought on application with an order of the Court under §330.
 - (3) Trustee fee only on payments which are made through the Trustee - no quarterly fees on all disbursements by the debtor on trustee fees on debtor direct payments.

9. Plan Confirmation Issues

- A. **Chapter 7** - Since there is no Plan in a Chapter 7, there are no Plan confirmation issues. This is the great benefit of Chapter 7 if the case can be conformed to the strictures of Chapter 7. Generally speaking, Chapter 7 may be appropriate where the following, facts by way of illustration, not limitation, are found.
- (1) Non-consumer debtor
 - (2) Cooperative secured creditors willing to work with the debtor post-petition (may require a formal reaffirmation)
 - (3) Usually a situation with insurmountable unsecured / under-secured debt that needs to be washed away in the cleansing waters of the bankruptcy

discharge where the debtor has a significant ability to go forward and repay primary and important secured creditors.

B. **Chapter 11** - Post-Petition income for an individual Chapter 11 debtor is included in the estate under §1115 and the Plan must provide for payment to creditors from such income and earnings (' 1123(a)(8)) as are necessary to fund the Plan.

- (1) If an unsecured creditor objects to the Plan, there is a requirement that the individual debtor commit five years worth of projected disposable income, as defined in §1325(b)(2), to be distributed under the Plan. This is probably not a temporal requirement, but the language of the statute is tortured. §1129(a)(15)(B).
- (2) The Absolute Priority Rule - has it been abolished in Chapter 11?
 - (i) Maybe - see §1129(b)(2)(B)(ii)
 - (ii) Courts are still trying to determine this issue. The narrow view cases hold that the Absolute Priority Rule has not been abolished. See, generally, Gbadebo, 431 B.R. 229, and its progeny, which reject the abrogation of the Absolute Priority Rule. See also In Re: Stephens, 2013 W.L. 151193 (C.A. 10)(Okl.)(January 15, 2013). The broad view cases held that the Absolute Priority Rule has been abrogated. See In Re: Shat, 424 B.R. 865, In Re: Friedman, 466 B.R. 471, (B.A.P. 9th Cir. 2012). If the Absolute Priority Rule is determined not to be applicable, the debtor can force the confirmation of the Plan over the objection of creditors that the debtor is retaining any property when creditors are not being paid in full. If the Absolute Priority Rule stands, the debtor cannot retain any property - not even post-petition earnings - over the objection of a creditor or creditors.
- (3) Property may or may not be vested in an individual debtor on confirmation. Discharge, however, would be delayed until completion of

payments (§1141(d)(5)(A)), but there is a provision for early discharge if the Abest interests@ test is met and modification is not practicable. §1141(d)(5)(B). (Note that hardship need not be shown as in Chapter 13.)

- (4) The debtor exclusively has the right to file a Plan and this period may be extended for cause (except there is a limitation of 300 days in small business cases). There is no end date specified by which a Plan must be filed, even if exclusivity is eliminated.
 - (5) An individual debtor must comply with §1129(b), which requires an impaired class to accept the Plan in order for the Plan to be confirmed over the objection of a creditor.
 - (6) A Disclosure Statement is required in an individual case, but the standard may be loosened.
 - (7) All priority taxes must be paid 60 months from the date of the Order of Relief (§1129(a)(9)), which may create problems if payments are commenced only upon confirmation, which may be substantially beyond the date of the Order for Relief in a case where priority tax claims are significant.
 - (8) In an individual Chapter 11, the value of property to be distributed under the Plan must be equal to the debtor's projected disposable income, but need not necessarily be applied to make payments to unsecured creditors under the Plan as in Chapter 13. Contrast §1129(a)(15) to §1325(b)(1).
- C. Chapter 13 - Chapter 13 is a simple Plan, generally on proscribed forms, with a fill in the blanks mentality. Higher-end individual debtors who are not generally wage earners may file Plans which vary from these form Plans, but they are generally the nightmare of all Chapter 13 trustees.
- (1) Chapter 13 has no Absolute Priority Rule issues

- (2) In Chapter 13 Plans where creditors' claims are being crammed down / paid less than 100%, draconian expense allowances contained in §707 Means Test formulas are imposed on the debtor
- (3) No Disclosure Statement is required, but Plan must be filed within days of the Petition date.
- (4) Expedited process / generally inexpensive Plan confirmation issues.
- (5) Priority taxes must be paid over a maximum of five years from the commencement of Plan payments. §1322(a)(4).

10. Modification of Secured Claims / Mortgage Issues

A. Chapter 7 - Not possible

B. Chapter 11

- (1) No modification of mortgages secured only by the debtor's homestead, §1123(b)(5), but modifications acceptable for all other aspects of secured claims without regard to actual length of Plan.
- (2) Ride through or leaving unaltered the claims of secured creditors is acceptable, but such claim treatment must be specified in the Plan. §1141(c).
- (3) Strip down acceptable. §506(a)(2) is not applicable to Chapter 11, which requires replacement value to be used as valuation in Chapter 13.
- (4) Requires Disclosure Statement under §1125, but BAPCPA relaxed the standard in individual cases by adding language regarding the complexity of the case, cost / benefit analysis when determining whether a Disclosure Statement is adequate.
- (5) Requires the consent of an impaired class affirmatively voting for the Plan in order to cram down treatment on any particular class of impaired claims. §1129(a)(10).

- (6) Can be used as a liquidating mechanism where the debtor is in control.

C. **Chapter 13** -

- (1) No modification of mortgage secured only by the debtor's homestead. §1122(b)(2).
- (2) A very circumscribed treatment of secured claims requiring full payment under the Plan (§1325(a)(5)(B)(I)), in equal monthly payments (iii) - payment in full is no longer than five years.
- (3) No requirement for affirmative voting by creditors and, therefore, no consenting impaired class necessary to modify secured claims or cram down classes
- (4) No Absolute Priority Rule
- (5) Ride Through possible without specifying terms in the Plan by continuing to pay a secured creditor pursuant to terms
- (6) Cram down in Chapter 13 context requires the value of secured claims to be paid over the life of the Plan. §1322(d)
 - (i) Sub-valuation of collateral is at retail §506(a)(2)
 - (ii) Purchase Money Security Interest of a certain duration may not be bifurcated into secured and under-secured claims. §1325(a)
- (7) Can be a liquidating Plan

11. Payment of priority tax claims

Chapter 7. In a chapter 7 case, the trustee will pay priority claims in the order of their priority assuming the trustee has the funds to pay the claims. In a no asset case, there is no money to pay the priority tax claim. Once the debtor obtains a discharge, the government may proceed to collect the tax from the debtor. Since the tax is usually a priority claim it will generally not be subject to discharge. §§523(a)(1), 507(a)(8). Counsel should always check

to make sure of whether the tax claim is priority or not. Taxes that are greater than 3 years old and were timely filed may be subject to discharge. The taxpayer/debtor will get some benefit from the automatic stay but ultimately collection activity will be recommenced with respect to priority tax claims. If the trustee does have sufficient funds collected in order to make distributions to creditors, the taxes will be paid in their order of priority. While the taxes are an eighth level priority, there may not be many claims between the administrative expense claims and the taxes and some payment can be made on the tax claims. If the claims can be satisfied the debtor will emerge from the chapter 7 case without a tax problem.

Chapter 11. In a chapter 11 case, the priority tax claims must be paid pursuant to the plan of reorganization. While payment of the claims may be deferred and paid over time, the Code contains limitations on the extent to which repayment can be accomplished. §1129(a)(9)(C and D). The taxes must be paid with interest accrued at the rate determined under nonbankruptcy law. 11 U.S.C. §511. The term for repayment cannot exceed five years from the debtor's petition date. While the taxes may be amortized over the remaining term for repayment, they do not have to be amortized and could be paid from asset sales or otherwise.

Chapter 13. Chapter 13 requires that the debtor, if required to file tax returns, have filed all returns due within the 4 years prior to the petition date and the returns are due to be filed on or before the day before the date of the creditors meeting. §1308(a). The priority tax claims are generally paid in full with interest on an amortized basis over the term of the chapter 13 plan.

12. Discharge, when obtained

Chapter 7. In a chapter 7 case, the discharge may be obtained after 60 days following the creditors meeting and after the debtor has filed their certificate of debtor education. The 60 day time period may be extended for cause. Bankruptcy Rule 4004(a and b). Typically, the time period may be extended to enable a creditor to do discovery using Bankruptcy Rule 2004. Nonetheless, the creditor must be diligent in pursuing discovery or the court may not allow the extension. Note also that the debtor must file the certificate showing they have completed a debtor education class before a discharge can be granted.

Chapter 11. An individual in a chapter 11 case will not get a discharge until they have completed payments to creditors under their chapter 11 plan. If the plan is a five year plan, a discharge will not enter until the end of the repayment term. §1141. Some courts require the debtor to file a certificate that they have completed the financial management course.

Chapter 13. The chapter 13 discharge is obtained after all payments are completed under the chapter 13 plan. An earlier discharge may be allowed in case of a hardship.

13. Discharge – challenges and opportunities

Chapter 7. In a chapter 7 case, creditors and the chapter 7 trustee have a defined period of time to object to the debtor's discharge. The time period, unless extended, is for sixty days following the first date set for the creditors meeting. Once the time period passes, creditors can not object to the discharge. A motion to extend the sixty day period may be filed prior to expiration of the sixty day period. Generally, reasonable extensions are allowed so a creditor or the trustee can conduct reasonable discovery. Creditors should beware that allowing time to pass without actively doing the discovery may result in denial of a requested extension. This is especially true when a prior extension has already been granted. Denial of discharge is governed by §727. This section contains all of the grounds on which the debtor's discharge may be denied. The grounds for denial of discharge generally consist of actions taken by the debtor that are contrary to taking an honest approach to addressing creditor issues in bankruptcy. They consist in part of:

a) the debtor with intent to hinder, delay, or defraud a creditor or officer of the estate charged with custody of property under title 11 has transferred, removed, destroyed, mutilated, or concealed property of the debtor within one year before the petition date or property of the estate after the petition date;

b) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

c) the debtor knowingly and fraudulently in or in connection with the case made a false oath or account, presented or used a false claim, gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or

advantage, for acting or forbearing to act, or withheld from an officer of the estate books and records relating to the debtor's property or financial affairs;

d) the debtor failed to explain satisfactorily, before determination of denial of discharge any loss of assets or deficiency of assets to meet the debtor's liabilities;

e) the debtor has refused to obey an order of the court; and

f) the debtor was granted a discharge in a bankruptcy case in the prior 8 years.

Chapter 11. In a chapter 11 case, the debtor may be denied a discharge for any of the grounds specified under §727(a). §1141(d)(3). The main difference from chapter 7 is that the discharge may not be granted until the debtor has completed all payments under the chapter 11 plan. §1141(d)(5). The court may grant the debtor an early discharge before all payments have been made if the payments made exceed what creditors would have received in a chapter 7 case, modification of the plan is not practicable, and §522(q)(1) is not applicable. §1141(d)(5)(B). In advising the debtor as to the cost and benefit between the chapter 7 and 11 alternatives, the timing of the discharge is a major issue. If the consumer debtor files the case because they are ineligible for chapter 7 and have too much debt for chapter 13, they may have to wait 5 years before obtaining a discharge. The 5 years is somewhat flexible in chapter 11 in that the debtor may have to pay out at least the level of net income that would have been received over a 5 year period, there is no requirement that the debtor wait out the 5 year term. It is advisable to include early payout provisions in the chapter 11 plan.

Chapter 13. The chapter 13 debtor is eligible for a discharge once all of their payments have been made under their chapter 13 plan and after the debtor certifies that all domestic support obligations that became due prior to making the certification have been paid. §1328(a). In order to obtain a chapter 13 discharge, the debtor must not have received a prior discharge under chapter 11 or 7 within 4 years prior to the chapter 13 case or 2 years before in the case of a prior chapter 13 case. §1328(f). Under chapter 13 the debtor has a much shorter waiting period between cases. A hardship discharge is allowed on an early basis in chapter 13 if the specific circumstances are met. §1328(b).

It should be noted that in all cases, a discharge cannot enter until after the debtor has completed a financial management course and filed the certificate with the court.

13. Dischargeability of debt issues

Chapter 7. §523 provides a list of those debts that are not dischargeable in a chapter 7 case.

Chapter 11. §1141(d)(2) excepts from discharge any debt that is not dischargeable under §523. Treatment is the same in both chapters.

Chapter 13. The “Super Discharge”. While chapter 13 has a slightly broader discharge than chapter 7 or 11, the breadth of the discharge is not as super as it was before the more recent amendments to the Code. Now, all debts that are identified under §523(a) are non-dischargeable in chapter 13 as are debts with a final payment due after the final payment is due under the plan, such as a mortgage. Debts that are covered under the super discharge that are dischargeable under chapter 13 and are not dischargeable under chapter 7 include: a) debts for willful and malicious injury to property; b) debts incurred to pay nondischargeable tax claims; and c) debts from property settlements in a divorce or separation.

14. Plan modification

Chapter 7. Not applicable.

Chapter 11. In a chapter 11 case for an individual, §1127(e) allows the confirmed plan to be amended at any time. Note that this differs from a chapter 11 plan for a business entity that may not be amended after there is substantial consummation of the plan. While amendments are to be allowed for individuals, it is rare to see them filed once the plan is confirmed. Interestingly enough, creditors are allowed to amend the debtor’s plan as well as the debtor.

Chapter 13. § 1329(a) provides plan modification rules for chapter 13 plans that are similar to chapter 11 plan modification provisions for individuals.

15. Timing of case

Chapter 7. One of the many benefits of a chapter 7 case for an individual is the speed at which the case progresses. Once the case is filed, the creditors meeting occurs within approximately six weeks, and a discharge can be entered just over sixty days following the creditors meeting. While these dates can be extended if dates and times are delayed, the typical case moves fairly rapidly and unless an objection to discharge is filed, the debtor is

typically discharged within approximately 4-5 months. Debtors should bear in mind that while their discharge may enter, the trustee may keep the case open for an extended period of time to liquidate assets, avoid transfers, and administer the estate.

Chapter 11. The chapter 11 case moves substantially slower than a chapter 7 case. While a case can be done as quickly as less than 90 days, typically the case takes 6 months or longer to complete. The chapter 11 process is inherently time consuming. The creditors meeting will occur within approximately 6 weeks. The debtor's exclusive time for filing a plan lasts for 120 days and may be extended for cause. Assuming the plan is filed at the end of that timeframe, the approval of the disclosure statement to accompany the plan can take approximately 60 days. Once the disclosure statement is approved, the voting period with respect to the plan will take at least another month. This time period is approximately 7 months. While the chapter 11 case is more time consuming, the problems faced by the debtor in chapter 11 are generally more complicated and involve larger sums of money. The time required to get through the process is useful to provide time to settle controversies and work out the terms of a plan.

Chapter 13. A chapter 13 case will take somewhat longer than a chapter 7 case but not as long as a chapter 11 case to get to plan confirmation. Chapter 13 cases are very rule oriented and most of the bankruptcy courts have very particular rules and forms that must be followed in order to get a plan confirmed. While creditors can object to plan confirmation, the plan is usually filed along with the Statement of Affairs and Schedules or shortly thereafter. Voting does not occur with respect to a chapter 13 plan and there is no disclosure statement to have approved. Depending upon the level of income the debtor has and whether they will otherwise qualify for a chapter 7 case, the chapter 13 plan will typically last anywhere from 3 to 5 years. A discharge is entered when payments are completed.

16. Closing the estate

Chapter 7. A chapter 7 case is generally closed when the trustee has either concluded that it is a no asset case and files a no asset report or after all of the assets are liquidated, claims are filed, and distributions completed.

Chapter 11. Quarterly fees are due and payable by the chapter 11 debtor from the time the case is opened until the case is closed. Once a plan is confirmed for an individual, the

case could remain open until all payments are completed under the plan. This can be a costly situation for a debtor. Many courts are allowing the debtor to close the case once the plan is confirmed subject to reopening the case after payments are concluded in order to allow the discharge to enter. This process will save the debtor substantial funds in the form of UST fees during the term of plan repayment.

Completion of plan- Once plan payments are completed, the case can be closed. If the case has remained open during the term of the plan, the discharge can be entered and the case closed. This will discontinue the quarterly fees. If the case was closed prior to the completion of payments, the case will need to be reopened in order for the discharge to enter.

Chapter 13. Completion of the plan is typical before the chapter 13 case is closed. The case will stay open as long as the plan remains pending and payments are being made under the plan. This period is generally 3-5 years. In a chapter 13 case there are no UST fees to pay and an early closing is not the issue it is in a chapter 11 case.