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Consumer Corner

The Means Test: Seeing Clearly the CMI

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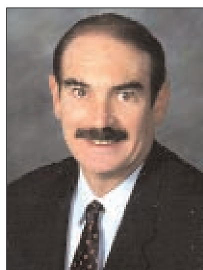
By now, anyone who has had to cope with the means test has come to know that "CMI" is an acronym for the term "current monthly income," which is defined in the Bankruptcy Code.[1] However, the exceedingly broad definition of current monthly income does not actually encompass "current" income at all; instead, the definition imposes a six-month look-back period. CMI is the cornerstone of the means test because it alone determines whether a debtor can stop at line 15 (for chapter 7) or line 17 (for chapter 13) of the means test form, or whether a debtor is forced to navigate his or her way through the morass of local and national deductions, eventually leading to a determination of whether a presumption of abuse arises.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The following discussion briefly summarizes decisions since the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on this important new concept.

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Schedule I—Still Relevant?

This six-month look-back period for CMI creates several dis-tinct, new issues when determining whether a presumption of abuse arises and in deter-mining whether a deb-tor has projected dis-posable income. This definition "creates an opportunity for savvy debtors to artificially reduce CMI by intentionally avoiding pre-petition income: 'The debtor might take an unpaid leave of absence, quit a job or refuse overtime they formerly welcomed.'"[2] As a result, the U.S. Trustee (UST) has begun to urge the court to look at a debtor's Schedule I income in addition to the CMI as reported on the means test form.

It is important to note that the income reported as CMI and the income reported on Schedule I are two very different calculations (although one judge has reasoned that, with regard to requiring a non-consumer debtor to file a means test form and a Schedule I, "it would be absurd, however, to require a debtor to file essentially the same information twice at the same time."[3]) So how are they different? CMI income and income as reported on Schedule I "differ because Form B22C requires the debtor to list the *average* monthly income for the six months prior to the petition, while the Schedule I instructions direct the debtor to give the 'estimate of monthly income as of the filing of the petition.'"[4]

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So, if CMI and schedule I income are decidedly different, is a court permitted to examine a debtor's Schedule I as a measure of the debtor's income? This issue has arisen in the factual context of a chapter 13 debtor who obtains a lucrative job shortly before filing. His means test form would not reflect the new income, but his Schedule I would, and the UST has argued that his Schedule I income, not his means test CMI, should be used to determine disposable income.[5] Some courts have agreed with the UST and held that, for the purposes of determining projected disposable income, a court is permitted to consider both the debtor's CMI as reported on the means test and the debtor's Schedule I income.[6] However, other courts strictly construe the provisions of BAP-CPA and determine that "§1325(b)(3) dic-tates that in above-median income cases, bankruptcy courts are no longer permitted to review the debtor's Schedule J to deter-mine what expenses are

1 In 11 U.S.C. §101(10A), CMI is very broadly defined as follows: the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income...and includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent), but excludes benefits received under the Social Security Act, payments to 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 (as defined in §2331 of title 18) or domestic terrorism (as defined in §2331 of title 18) on account of their status as victims of such terrorism.

2 *In re Johnson,* 346 B.R. 256, 264 (Bankr. S.D. Ga. 2006), *citing* Culhane and White, "Catching Can-Pay Debtors: Is the Means Test the Only Way?," 13 Am. Bankr. L. Rev. 665, 689 (2005).

3 *In re Moates,* 338 B.R. 716, 718 (Bankr. N.D. Tex. Jan. 27, 2006). It is actually absurd, because 11 U.S.C. §707(b)(1) authorizes dismissal of presumptively abusive cases filed only by individuals whose debts are primarily consumer debts.

4 *In re Guzman,* 345 B.R. 640, 642 (Bankr. E.D. Wis. July 19, 2006).

5 *See generally In re Pak,* 343 B.R. 239 (Bankr. N.D. Cal. May 18, 2006).

6 *See In re Pak, supra. See, also, In re Grady,* 343 B.R. 747 (Bankr. N.D. Ga. June 21, 2006); *In re Bossie,* 2006 WL 3703203, *2 (Bankr. D. Alaska Dec. 12, 2006), the court held that "the debtors' plan can be based on their anticipated, or projected, income during the term of the plan. The figure stated on Line 58 of Form 22C is not the sole factor to be utilized in determining their projected disposable income."

reasonably necessary for the debtor's support, or to require that excess Schedule I income over Schedule J expenses must be dedicated to the plan."[7] At this point, it seems that in a battle between use of the means test and the use of Schedules I and J in chapter 13 cases, there is a split of authority as to which controls.

What About Income Tax Refunds?

At first glance, it seems like the answer should be quite simple: If a debtor receives an income tax refund within the six months prior to filing, under the definition of CMI the income tax refund should be included.[8] However, the two courts that addressed this particular issue to date have differed. In *Baxter v. Johnson (In re Johnson),*[9] the issue before the court was whether a debtor who received income tax refunds prior to six months before filing was required to include these refunds for purposes of their chapter 13 plan. The court stated that "[w]ere the previous year's tax refunds included in as gross income, then 'disposable income' would be inaccurately skewed. That is because gross income is itself taxed and refunded. Including both would create a double accounting problem that would persist for the plans' duration."[10] The court held that the debtors bore the burden of establishing that the amount withheld was actual, necessary and reasonable, and ruled that if the debtors could establish this fact, the income tax refunds would not be included in their CMI. The court held this way despite the UST's argument that the "effect of over-withholding is to shelter assets from creditors...these debtors are withholding more than their actual annual tax obligations, and will continue these patterns of over-withholding throughout the terms of their plans."[11]

However, the court in *In re Risher* heard arguments similar to those made in *Johnson,* but reached a different decision.[12] The court in this chapter 13 case was asked to determine whether tax refunds of the debtor were still considered disposable income post-BAPCPA.[13] The court held that "disposable income is interpreted broadly and includes tax refunds...a debtor who receives substantial tax refunds during the life of a chapter 13 plan is likely over-withholding. Thus, such funds should be considered as future income and must be dedicated to the plan."[14] The court was not persuaded by the debtor's argument that taxes are already captured in disposable income calculations.[15]

Both cases thus deal with the same issue—whether income tax refunds received by the debtor should be included as income in a chapter 13—but each court came to a different conclusion. The basis for the difference was their analysis of whether or not the proper amount of taxes was withheld, thereby potentially shielding an asset of the estate from the creditors.

What About a Non-filing Spouse's Income?

As discussed above, CMI "includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent)."[16] Immediately after the effective date of BAPCPA, the issue of whether a non-filing spouse's income is included in CMI was predicted to be controversial. Practitioners and trustees alike anticipated that this issue was going to be hotly contested. Instead, the collection of cases that have addressed the issue are fairly uniform with regard to their holdings: a non-filing spouse's income should be included to the extent that he or she contributes to the household expenses. However, the definition of "household expenses" and to what extent a non-filing spouse's income can be included for the purposes of a motion to dismiss for abuse are emerging as the hot-button issues.

The court in *In re Travis*[17] indicated that a non-filing spouse's income is includable in the means test to the extent that he or she contributes to household expenses, but further expanded what is meant by "household expenses." This chapter 7 case dealt primarily with the interpretation of line 17 Form B22A, which allows a non-filing spouse to deduct income that is not contributed to household expenses.[18] The court astutely stated that "the calculation of current monthly income when there is a non-filing spouse is complicated. The requirements which the Code imposes on a non-filing spouse in reference to the non-filing spouse's income are not clearly defined and are subject to interpretation."[19]

The UST objected to the debtor deducting $2,616 for amounts that the non-filing spouse did not contribute to the household expenses. The UST argued that allowing the debtor to use the median income for a family of five, which included the non-filing spouse, and to deduct for income not contributed to household expenses would amount to double dipping. The debtor argued that his non-filing spouse had several extraordinary expenses that were akin to contributions to the household expenses. Such expenses primarily included expenses of the non-filing spouse for caring for her mother, grown daughter and granddaughter.

The court ultimately held that income of the non-filing spouse spent on utilities and food were clearly household expenses.[20] However, the court held that expenses for the non-filing spouse's clothing and personal items may be deducted as part of the marital adjustment, even if some of the personal items are used for the dependents, to the extent that they are reasonable.[21] The court also held that allowing the debtor to use the median income for a family of five, which included the non-filing spouse, and to deduct for income not contributed to the household expenses did not amount to double dipping.[22]

In *In re Quarterman,*[23] the court held that income of the non-filing spouse of the debtor should be considered for purposes of calculating CMI to the extent that it is paid on a regular basis for the household expenses of the debtor or his dependents. The court held that if a non-filing spouse's income is not expended regularly for household expense or the income is not used for household expenses, then the non-filing spouse's income cannot be included in the debtor's CMI.[24] The court also pointed out that for the purposes of determining household expenses, there still remains an issue when a debtor's funds are co-mingled with a non-filing spouse's in a joint checking account.[25]

Yet another court has struggled with how to treat a non-filing spouse's income for the purposes of the means test. This court,

7 *See, also, In re Guzman,* 345 B.R. 640, 646 (Bankr. E.D. Wis. July 19, 2006); *see, also, In re Pak,* 2006 WL 3690181, *3 (Bankr. N.D. Cal. Dec. 14, 2006), where the court held that "[i]n determining whether a plan provides all of the debtor's 'projected disposable income,' a court should attempt to predict what the debtor's disposable income during the term of the plan will be, using the definition of 'current monthly income' set forth in 11 U.S.C. §101(10A);" *In re Casey,* 2006 WL 3071401, *5 (Bankr. E.D. Wash. Oct. 27, 2006), where the debtor was not permitted to "mix and match" the calculations on B22C and his schedules. The court held that "[t]he expense under Form B22C are related to the income reflected on Form B22C, not some other amount of income reflected on a difference form which is defined differently than the income of Form B22C."

8 11 U.S.C. §101(10A).

9 346 B.R. 256, 269 (Bankr. S.D. Ga. July 21, 2006).

10 *Id.*

11 *Id.* at 268.

12 344 B.R. 833 (Bankr. W.D. Ky. July 12, 2006).

13 *Id.* at 835.

14 *Id.* at 837.

15 *Id.*

16 *See* n. 7, *supra.*

17 *In re Travis,* 2006 WL 3169074 (Bankr. E.D. Mich. Nov. 6, 2006).

18 *Id.* at *2.

19 *Id.* at *3.

20 *Id.* at *5.

21 *Id.*

22 *Id.*

23 342 B.R. 647 (Bankr. M.D. Fla. March 28, 2006).

24 *Id.* at 651.

25 *Id.* at fn 6.

rather than just determining the extent that a non-filing spouse contributes to household expenses, indicated that a non-filing spouse's income can be included when the debtor and non-filing spouse's finances are *intertwined.*[26] In this case, the non-filing spouse of the debtor had substantial income. The debtor listed her husband's income on the means test form, but indicated that he contributed no income to the household expenses. The debtor later admitted that they have a joint checking account and that her husband did, in fact, contribute to many of the household expenses. The court held that "it can still consider the debtor's husband's income to see if the case constitutes an abuse of the provisions of chapter 7."[27] Despite the fact that the court could have dismissed the case based on abuse for the debtor's failure to include the non-filing spouse's income that is contributed to the household expenses, the court dismissed the case based on bad faith because the court held that the debtor and the husband "operate as a single financial unit."[28]

The court in *Travis* also addressed the extent that a non-filing spouse's income should be considered for the purposes of a motion to dismiss for abuse. The court held that "a non-filing spouse's income should be considered only if it is substantial enough to significantly raise the debtor's standard of living and general total household income."[29] The court ultimately declined to dismiss the case for abuse. Instead it gave a very detailed review of the fact-centered analysis that should be considered when attempting to determine the marital adjustment for a non-filing spouse.[30]

Conclusion

Despite the expansive definition of CMI, under BAPCPA there still remain outstanding questions about its application that have not reached the court's docket. The case law to date has not addressed the issue of whether a debtor is required to provide his or her calculations of CMI.[31] There also seems to be little argument about whether a debtor is required to provide six months of payment advices to the case trustee or the UST upon request, even though there is no Code provision specifically requiring it.[32] Also absent from the current law is the answer to the question: Is unemployment compensation includable as CMI?[33] Finally, despite cases addressing a non-filing spouse's income, absent from these cases is the discussion of whether a trustee is entitled to a non-filing spouse's payment advices, income tax returns, and other evidence of income and expenses.

For now, the case law interpreting CMI gives little firm guidance. There are no appellate decisions, only contradicting bankruptcy decisions. The question of whether the schedules or the means test form controls still remains unresolved. The issue of whether an income tax refund is includable in CMI also remains up in the air. While the issue of whether a non-filing spouse's income should be included in CMI seems to be largely resolved, the issue of what is meant by "household expenses" is likely one that will continue to be litigated for years to come, especially because each case will present unique fact situations for the court's interpretation. Equally unresolved is to what extent a non-filing spouse's income can be considered when determining abuse. Finally, the underlying issue of whether a six-month look-back period makes sense at all when analyzing the projected disposable income needed to fund a chapter 13 plan remains in doubt, despite Congress's all-encompassing definition of CMI.[34] ■

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26 *In re Haney,* 2006 WL 3020961 (Bankr. W.D. Ky. Oct. 19, 2006).

27 *Id.* at *2.

28 *Id.*

29 *Id.* at *8.

30 *Id.*

31 11 U.S.C. §521(a)(1)(B)(v): The debtor shall file "a statement of the amount of *monthly net income, itemized to show how the amount is calculated.*" (emphasis added). 11 U.S.C. §707(b)(2)(C): "As part of the schedule of current income and expenditures required under §5/21, the debtor shall include a *statement* of the debtor's current monthly income, *and the calculations* that determine whether a presumption arises *under subparagraph (A)(i),* that show how each such amount is calculated." (emphasis added). The means test forms may require "calculations" of CMI not specifically authorized by the Code.

32 11 U.S.C. §521(a)(1)(B)(iv) requires that the debtor provide "copies of all payment advices or other evidence of payment received *within 60 days* before the date of the filing of the petition, by the debtor from any employer of the debtor." (emphasis added).

33 The definition of CMI excludes payments made under the Social Security Act. The UST has taken the position that unemployment compensation is includable in CMI because the definition is expansive and includes income "from all sources." However, there is an argument to the contrary. Unemployment compensation is arguably a payment made under the Social Security Act because the Social Security Administration oversees unemployment compensation and makes distributions to the states.

34 Although the "false positive" presumption of abuse that may be created by the look-back period may be rebutted by demonstrating special circumstances pursuant to 11 U.S.C. §707(b)(2)(B)(i).

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The Means Test, Part II: Deductions

More Ambiguity in the New Era of Means Testing

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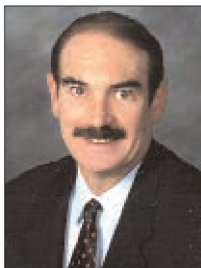
Consumer Corner

Let's imagine you are a debtor's attorney, and your client has come in to your office to inquire as to whether he will qualify for a chapter 7 bankruptcy or be required to file a chapter 13 petition. You collect his information and commence preparation of the means test. You start by inputting his current monthly income information into the 22A form, and your client's median income falls above the median income for his household size and state. You begrudgingly realize that, lo and behold, you are now going to be filling out the "long form" means test, navigating your way through a series of deductions in the hopes that your client will "pass" the means test. As a result of this "long form" means test, debtor's attorneys, U.S. Trustees (USTs) and occasionally case trustees are litigating unanswered questions related to the means test deductions contained in 11 U.S.C §707(b)(2). To date, there has been a wide spectrum of decisions on various deduction issues including double dipping, mortgage expenses, vehicle ownership expenses and 401(k) loan repayments.


David W. Allard

Does the Means Test Prohibit Double Dipping on Expenses?

The answer has been a resounding "yes" from courts across the country, but practitioners should be aware that finding the duplicate deductions can be a tricky endeavor. In *In re Lara*, the debtors attempted to take a deduction for their cell phone, Internet access and basic phone service under the "other necessary expenses" section of the means test.[1] The Northern District of Texas held that the debtors claim for basic phone service did not fall within "other necessary expenses" because basic phone service was included in the Local Standard housing and utility allowance, and the debtors would not be permitted to double dip.[2]

As for a Code section that prohibits double dipping, the Northern District of Texas stated that even if the Code does not specifically disallow double dipping, the prohibition on double deductions is implicit.[3] Specifically, §707(b)(2)(A) (ii)(I) explains, "[t]he debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and *the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses...*" (emphasis added). However, §707(b)(2)(A)(ii)(I) also states "*[n]otwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts*" (emphasis added). In *Hardacre*, the debtor attempted to double dip by taking the standard mortgage expense deduction and her actual mortgage payment amount. She also attempted to take the standard car ownership expense as well as the average monthly payment on her car. The debtor argued that "by using the conjunction 'and' in §707(b)(2)(A)(i) [sic],[4] Congress clearly intended for debtors to deduct expenses under each of these clauses, even if some categories of expenses (in this case mortgage and car

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1 *In re Lara*, 347 B.R. 198 (Bankr. N.D. Tex. June 28, 2006).

2 *Id.* at 203. Interestingly, in this case the debtors also attempted to deduct recreational expenses and additional transportation expenses as "other necessary expenses." The court stated the necessary expenses test: "Debtors bear the initial burden of proving that a requested expense is (i) their actual monthly expense, (ii) within one of the categories identified as an Other Necessary Expense by the IRS and (iii) necessary for their health and welfare or for the production of income. Once the debtors satisfy this burden, the burden of going forward with the evidence shifts to the trustee." *Id.* at fn 6. The court held that the debtors were only entitled to deduct the actual monthly expenses for the categories specified by the IRS and would not allow these additional deductions. *Id.*

3 *In re Hardacre*, 338 B.R. 718, 727-28 (Bankr. N.D. Tex. March 6, 2006).

4 The court also addressed Congress' improper use of the word "and" in *In re TCR of Denver LLC*, 338 B.R. 494, 498 (Bankr. D. Colo. Feb. 17, 2006). The court addressed the drafting problems with §1112(b), which, as amended, provides that a motion to dismiss shall be granted if 16 separate factors, all connected with the word "and," were met. The judge recognized that the proper conjunction should have been "or" because all of these factors could never co-exist within a corporate debtor, and that if the plain meaning of the statute would have been applied, it would have produced absurd results.

ownership expenses) overlap each other."[5] The court recognized that the interpretation of this sentence is unclear and looked to the legislative intent and the statutory con-struction to conclude that the debtor is only allowed to deduct either the standard deductions or the actual deductions, but not both.[6]

The Eastern District of Missouri has also indicated an unwillingness to allow double dipping for housing expenses and further interpreted the confusing line 21 of the form 22A (line 26 of form 22C). In *In re Skaggs,* a chapter 7 case, the UST filed a motion to dismiss for abuse.[7] On line 20B of the means test, the debtors took the $418 IRS Housing and Utilities Standard deduction. However, they did not deduct their $236.70 per month mobile home payment as required. The debtors then attempted to take an additional $182 above the IRS Housing and Utilities Standard on line 21 for rent they were paying on an apartment. The court stated that the instructions for line 21 unambiguously state that "the process set out in Lines 20A and 20B does not accurately compute the allowance to which you are entitled under the IRS Housing and Utility Standards...."[8] Since the debtors did not contend that the allowance was not accurately computed, the court held that the debtors were not entitled to take an amount over and above the standard deduction of $418.

Can a Debtor Deduct a Mortgage Expense Where There's No Actual Payment?

Although limited, case law has also examined the issue of whether a debtor who does not pay a mortgage expense can deduct the IRS Housing and Utility Standard. In *In re Farrar-Johnson,* the debtors in this chapter 13 attempted to take the IRS Housing and Utility Standard, even though they lived in military housing and did not actually pay housing or utility payments.[9] The court looked to the language in §707(b)(2)(A)(ii)(I), which permits a debtor to claim "the applicable monthly expense amount" for housing and utilities. The trustee argued that the word "applicable" meant that the debtors were not entitled to this deduction because they did not actually incur this expense. The court held that the deduction was "applicable" to the debtors because they lived in a certain state and county and had a household of a particular size, so the deduction applied to them. The court held that "[t]he debtors are entitled to claim that expense, whether they had it or not."[10]

Can a Debtor Deduct a Vehicle Ownership Expense for a Car Owned Free and Clear?

Perhaps the most highly litigated issue with regard to a debtor's means test deductions is whether a debtor may deduct the ownership expense on line 23 (Form 22A) or line 28 (22C Form) for a vehicle on which he does not make payments. In fact, the decisions regarding this issue seem to be equally split. The initial decisions seemed to indicate that a debtor was not permitted to take the ownership deduction for a vehicle that he owned free and clear of liens.[11] The rationale for these decisions comes from the language in §707(b)(2)(A)(ii)(I), which states that "[t]he debtor's monthly expenses shall be the debtor's *applicable* monthly expense amount." (emphasis added). In other words, the courts have held that the expense is "applicable" if the debtor was actually incurring the expense.[12] The court in *In re McGuire* looked at the *IRS Financial Analysis Handbook,* which instructs that "[i]f a taxpayer has no car payment, only the operating-cost portion of the transportation standard is used to figure the allowable transportation expense."[13]

In *Hardacre*, the court also looked at the issue of whether a debtor can take a deduction for an asset that is owned free and clear.[14] The debtor owned a second car free and clear of any liens and was not making a monthly car payment. The court held that "[b]ecause the Local Standards only provide for a deduction for automobiles that are subject to lease or purchase, they do not permit a debtor to claim an ownership deduction for a vehicle owned free and clear by the debtor."[15]

However, even more recently, several district courts have determined that a debtor is entitled to the ownership deduction for a vehicle even if he or she does not make a car payment.[16] The court's rationale seems to focus on the latter part of 11 U.S.C. §707(b)(2)(A)(ii)(I), which states that "the debtor's applicable monthly expense amounts [are] *specified under the...Local Standards*" (emphasis added). The court in *In re Hartwick* emphasized that this amount "is the higher of the Standard amount or actual expense. This does not change when the actual amount is 0."[17] The court emphasized that "[t]he means test presents a backward-looking litmus test performed using mathematical computations of arbitrary numbers, often having little to do with a particular debtor's actual circumstances and ability to pay a portion of debt."[18]

The other predominant argument supporting the position that a debtor who owns a vehicle free and clear should be entitled to the ownership deduction was set forth in *In re Grunert*, where the court adopted the rationale set forth in *In re Farrar-Johnson* (quoted above) and opined that "applicable" as used in §707(b)(2)(A)(ii)(I) means "the region where the debtor lives or the number of vehicles owned by the debtor."[19]

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5 *Hardacre, supra* at 725.

6 *Hardacre, supra* at 726.

7 *In re Skaggs*, 349 B.R. 594 (Bankr. E.D. Mo. Aug. 16, 2006). Line 21 states: "Local Standards: housing and utilities; adjustment. If you contend that the process set out in lines 20A and 20B does not accurately compute the allowance to which you are entitled under the IRS Housing and Utility Standards, enter an additional amount to which you contend you are entitled, and state the basis for your contention in the space below."

8 *Id.* at 597.

9 *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. Sept. 15, 2006). *See also, generally, In re Hartwick*, 352 B.R. 867 (Bankr. D. Minn. Oct. 23, 2006).

10 *Farrar-Johnson, supra* at 230.

11 *In re Oliver*, 350 B.R. 294 (Bankr. W.D. Tex. Aug. 8, 2006), where the court held that, "[i]f a debtor does not owe a debt upon a vehicle or a lease of one, the ownership expense is not allowed as to that debtor and the debtor cannot claim a vehicle ownership expense under the IRS Standards. Thus, because this debtor does not currently have a vehicle ownership expense, he cannot claim it on his MTF." *Id.* at 301; *In re Barraza*, 346 B.R. 724 (Bankr. N.D. Tex. Aug. 1, 2006), where the debtor was not permitted to take the ownership allowance for a truck that was neither financed nor leased; *In re McGuire*, 342 B.R. 608 (Bankr. W.D. Mo. June 1, 2006), where the trustee objected to the debtors' plan because the debtors attempted to take an ownership deduction for a vehicle that they owned free and clear of liens; *In re Carlin*, 348 B.R. 795 (Bankr. D. Ore. Aug. 18, 2006), where the court denied the ownership expense when the debtor owned his vehicle free and clear; *In re Wiggs*, 2006 WL 2246432, *3 (Bankr. N.D. Ill. Aug. 4, 2006), where debtors were not permitted to take a deduction for transportation ownership when they did not have a payment on the vehicle; *In re Johns*, 342 B.R. 626, 629 (Bankr. E.D. Okla. May 26, 2006), where the debtors were not permitted to take a deduction for vehicles for which they had no car payments; *In re Lara, supra* at 202-03, where debtors were not permitted to take a vehicle ownership expense when there is no debt or lease payment on that vehicle. It is interesting to note that in *In re Lara*, the court also held that the language in §707(b)(2)(A)(ii)(I) "does not permit each debtor in a joint case to take a one-vehicle expense allowance. Rather, the debtor and the spouse of the debtor in a joint case are considered a unit for means test purposes, and they are entitled to take the vehicle expenses allowance applicable to their household...." *Id.* at 202; *See, also, In re Haley*, 2006 WL 2987947 (Bankr. D. N.H. Oct. 18, 2006); *In re Devilliers*, 2007 WL 92504 (Bankr. E.D. La. Jan. 9, 2007).

12 *In re McGuire*, 342 B.R. 608, 612 (Bankr. W.D. Mo. June 1, 2006).

13 *Id.* The court further noted that "the IRS uses its Standards as a cap, not an absolute number: The *Internal Revenue Manual* provides that, when considering allowances for housing and transportation, the taxpayer is allowed the amount provided by the Local Standards, or 'the amount actually spent.'" *Id.* at fn. 16.

14 *Hardacre, supra* at 708.

15 *Id.*

16 *In re Fowler*, 349 B.R. 414 (Bankr. D. Del. Sept. 11, 2006); *In re Demonica*, 345 B.R. 895 (Bankr. N.D. Ill. July 31, 2006); *In re Hartwick*, 352 B.R. 867 (Bankr. D. Minn. Oct. 13, 2006); *In re Grunert*, 353 B.R. 591 (Bankr. E.D. Wis. Nov. 20, 2006); *In re Prince*, 2006 WL 3501281 (Bankr. M.D.N.C. Nov. 20, 2006); *In re Wilson*, 2006 WL 3591266 (Bankr. D. Del. Dec. 11, 2006); *In re Zak*, 2007 WL 143065 (Bankr. N.D. Ohio Jan. 12, 2007).

17 *In re Hartwick*, 352 B.R. at 869.

18 *Id.* at 870.

19 *In re Grunert*, 353 B.R. at 592.

May a Debtor Deduct a Vehicle Expense for a Vehicle He Intends to Surrender?

The Eastern District of Missouri has treated surrendered vehicles in the same manner as vehicles owned free and clear of liens. In *In re Skaggs*, the court held that a debtor who intends to surrender a vehicle is not entitled to take an ownership deduction for that vehicle.[20]

However, the court in *In re Singeltary* held that the mere act of declaring an intent to surrender collateral on a statement of intention does not extinguish a debtor's right to deduct those payments.[21] The court said that since the debtors' vehicle had actually been surrendered at the time the U.S. Trustee's motion to dismiss had been filed, the debtor was not entitled to a deduction. However, just because the debtors had indicated on their statement of intention to surrender their house, did not mean that the debtor was not entitled to that deduction.[22] Obviously, these cases present another area of future debate among the courts.

Is a Debtor Entitled to Deduct Payments Made on a 401k Loan?

This issue arises when a debtor begins borrowing from his 401(k) account, but is required to pay back the loan. These issues are litigated when the UST brings a motion to dismiss, arguing that a presumption of abuse would arise if the debtor had not taken a deduction for the 401(k) repayment. In *In re Lenton,* the court held that since the debtor's retirement contributions were discretionary and not a requirement of his job, the debtor could not deduct these payments on line 26 of form 22A, which reads "Other Necessary Expenses: mandatory payroll deductions."[23]

Using a slightly different approach, the court in *In re Thompson* first looked at whether a debtor's 401(k) loan repayment could be deducted as a payment on account of secured debt.[24] The court looked to the common meaning of "secured debt," which is defined as "a debt backed by collateral."[25] The court held that 401(k) funds, although not property of the estate, were a secured debt and could be deducted as payments on account of a secured debt for purposes of the means test.

The court went on to hold that repayment of the 401(k) loan did not constitute "Other Necessary Expenses" within the meaning of 11 U.S.C. §707(b)(2)(A)(ii)(I) because the loan repayments were payments on a debt.[26] The court, however, did find that the 401(k) loan repayment constituted "special circumstances" within the provision of §707(b)(2)(B)(i) based on the debtor's particular fact situation, and the debtor could use the loan repayments to rebut the presumption of abuse.[27]

Conclusion

The interpretation of what can be a deductible expense on the means test will be an issue that will continue to evolve. How the court defines "applicable" for the purposes of deducting a vehicle under §707(b)(2)(A)(ii)(I) is an issue currently splitting the circuits. The volume of published and unpublished opinions that are in direct contradiction to each other is staggering, and a resolution does not seem to be imminent. The issue of deductions for a vehicle intended to be surrendered seems equally murky.

Additionally, although the courts have decided to take a firm stance on forbidding double dipping with regard to deductions, the issue of whether a debtor who does not make a house payment shall be permitted to take a deduction for the Housing and Utility Standard will arise more frequently as our troops return from overseas.

With a technical amendments bill in the works, there is a possibility that Congress will choose to address some of these deduction issues, but the resolution of most issues will more likely come from the courts. ■

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20 *In re Skaggs, supra* at 598. *See, also, In re Love*, 350 B.R. 611 (Bankr. M.D. Ala. Aug. 30, 2006); *In re Harris*, 353 B.R. 304 (Bankr. E.D. Okla. Oct. 13, 2006); *In re Nockerts*, 2006 WL 3689465 (Bankr. E.D. Wis. Dec. 14, 2006).

21 *In re Singeltary*, 2006 WL 2987945 (Bankr. S.D. Tex. Oct. 19, 2006). *See, also, In re Walker*, 2006 WL 1314125 (Bankr. N.D. Ga. May 1, 2006).

22 *See, also, In re Randle*, 2006 WL 3734351 (Bankr. N.D. Ill Dec. 19, 2006), discussing the issue of whether a debtor who intends to surrender collateral is allowed to deduct the debt.

23 *In re Lenton*, 2006 WL 3850011 (Bankr. E.D. Pa. Dec. 15, 2006). It should be noted that when the debtor argued that his loan repayments were nevertheless a necessary expense, the court adopted the language of the *Internal Revenue Manual* §5.15.1.23 and determined that "[i]f future voluntary contributions to the 401(k) plan are not necessary expenses, it is hard to argue that the replenishment of past voluntary contributions to the 401k account by repaying loans is a necessary expense." *Id.* at *5; *See, also, In re Barraza*, 346 B.R. 724 (Bankr. N.D. Tex. Aug. 1, 2006).

24 *In re Thompson*, 350 B.R. 770 (Bankr. N.D. Ohio Sept. 26, 2006).

25 *Id.* at 775, *citing Black's Law Dictionary*, 331 (7th ed. (abridged) 2000).

26 *Id.* at 776-77.

27 *Id.* at 777.

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The Means Test: Part III

Keeping Up with Dismissals under BAPCPA

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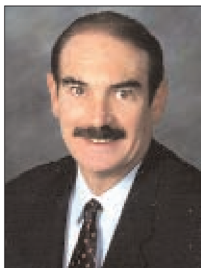
Debtors' bankruptcy cases are being dismissed more frequently for various violations of the Code, as decisions regarding dismissal under BAPCPA are being rendered at an earth-shattering pace. The opinions range from strictly adhering to the plain language of the Code (if there is such a thing) to creating new tests and interpretations of it. The number of new decisions make it difficult for practitioners to keep up. Failing to file payment advices, abuse based on totality of the circumstances, abuse based on bad faith, and failure to rebut the presumption of abuse by showing special circumstances are some of the more frequently used justifications for dismissal of a debtor's case. As debtor's attorneys, U.S. Trustees (USTs) and judges become more familiar with §§521 and 707(b)(3), a consensus of decisions interpreting these laws and presenting new ways of construing these provisions is developing.


David W. Allard

Can a Debtor's Petition Be Dismissed for Failing to Provide Payment Advices?

Absolutely. Some-times. Code §521(i) (1) and (2) allows for an automatic dismissal of the debtor's bankruptcy petition if payment advices, or a request for extension of time to file payment advices, is not filed within 45 days of the petition.[1]

About the Author

David Allard is a founding shareholder of Allard & Fish, P.C., a bankruptcy and insolvency firm in Detroit. He is a chapter 7 bankruptcy trustee and an author and lecturer for many national and local organizations on numerous bankruptcy issues including means testing. Katherine Catanese is an associate attorney at Allard & Fish, P.C. and is the lead attorney representing Mr. Allard in many chapter 7 bankruptcy cases. She practices in the areas of bankruptcy, insolvency and litigation.

Feature

In *In re Fawson,* a consolidated case, Debtor Webster's attorney claimed that he had delivered payment advices to the U.S. Trustee and chapter 7 trustee, but he was not aware that he had to file them with the court because of his inexperience with the new law.[2]

Debtor Fawson's attorney was experiencing computer problems the week prior to the §341 meeting.[3] The attorney filed payment advices, but these payment advices were filed after the 45 days had lapsed and did not cover the 60-day period prior to filing for bankruptcy. Both Webster and Fawson argued that the court had discretion not to enter dismissal orders in circumstances such as these.[4] But the court held that by operation of statute, both cases were automatically dismissed on the 46th day when payment advices or a motion to extend time had not been filed. The court stated that Code §521(i)(2) is clear regarding the court's duties and it "relieves the [c]ourt of discretion in the matter and makes entry of the dismissal order under §521(i)(2) ministerial."[5]

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More recently, judges have begun finding loopholes in the language of §521. Where debtors filed payment advices but were missing a few, the judge determined that "[t]he pay stubs submitted to the trustee, *along with the year-to-date totals found on these pay stubs,* constitute 'other evidence of payment' sufficient to satisfy the requirements."[6] Another court interpreted the language of §521(a)(1)(B), which states that payment advices should be filed "unless the court orders otherwise," to mean that the court could excuse the filing requirements in a case at any time, before or after the 45-day period, under appropriate circumstances.[7] The court has also held that if a debtor fails to file payment advices because his income stemmed from Social Security and Worker's Compensation payments, his case is not subject to dismissal because he had no employer and no payment advices.[8]

1 *In re Fawson,* 338 B.R. 505 (Bankr. D. Utah Feb. 21, 2006).
2 *Id.* at 509.
3 *Id.*
4 *Id.* at 510.
5 *Id.* at 511. *See, also, In re Wilkinson,* 346 B.R. 539 (Bankr. D. Utah May 30, 2006), and *In re Ott,* 343 B.R. 264, 268 (Bankr. D. Colo. April 12, 2006), where the court stated "BAPCPA is a complex and extensive statute that is, at times, unforgiving to debtors and to their counsel. Snares and traps are present throughout BAPCPA for unwary debtors. By the design of Congress, the [c]ourt is not in a position to extricate counsel and the debtors from these perils."
6 *In re Luders,* 2006 WL 3487980, *1 (Bankr. W.D. Va. Dec. 5, 2006).
7 *In re Parker,* 351 B.R. 790, 800 (Bankr. N.D. Ga. Sept. 13, 2006). *See, also, In re Spencer,* 2006 WL 3820702, *2 (Bankr. D. Colo. Dec. 22, 2006).
8 *In re LaPlante,* 354 B.R. 648 (Bankr. W.D.N.Y. Oct. 3, 2006).

Judges are also challenged by the "automatic dismissal" language of §521(i)(2). In a rather unique and Dr. Seuss-like fashion, one judge, who may have been inspired by the debtors' name, commented in *In re Riddle* regarding automatic dismissal: "What is the clue on the 46th day? Is the case still here, or gone away... Was there a case, or wasn't there one? How do you undo what's been done?"[9] Since there is no controlling precedent (as is the case with most contested issues under BAPCPA) and no clear consensus has formed, perhaps courts should consider adopting local rules addressing automatic dismissal under §521. Without further guidance, it is nearly impossible to determine whose job it is to police cases where the debtor has failed to comply with the provisions regarding payment advices in §521.

What about Dismissal for Abuse under §707(b)(3)?

Gone are the days of "substantial abuse." Dismissal is now predicated on a finding of simple "abuse." In determining whether dismissal is warranted based on abuse, the court shall consider "(A) whether the debtor filed the petition in bad faith; or (B) [whether] the totality of the circumstances...of the debtor's financial situation demonstrates abuse."[10] So what factors are the courts looking at when determining "totality of the circumstances?"[11] Not surprisingly, the factors the courts are considering under BAPCPA are similar to those under the former "substantial abuse" standard.

When determining what test to apply to determine totality of the circumstances pre-BAPCPA, three approaches arose in the case law: "(1) the *per se* rule of the Eighth and Ninth Circuits under which the debtor's ability to pay his debts, standing alone, justified dismissal; (2) the totality of the circumstances test of the Fourth Circuit which required a showing of more than an ability to pay; and (3) the hybrid approach of the Sixth Circuit which permitted the dismissal based on ability to pay alone, but also allowed the debtor to demonstrate mitigating circumstances."[12]

1. Ability to pay alone is enough to justify dismissal for abuse when considering the totality of the circumstances. Despite the change from "substantial abuse" to "abuse," the Ninth circuit has adopted the traditional ability-to-pay test in *Price v. United States Trustee (In re Price)*[13] when determining the totality of the circumstances in substantial abuse cases. The court adopted this test in *In re Mitchell,* stating, "it appears that the *Price* test (which was formulated for the more rigorous "substantial abuse" standard) is still relevant in making determinations of 'abuse' under the current version of §707(b)(3)."[14]

2. Totality of the circumstance constitutes more than just ability to pay. The court in *In re Nockerts* adopted the Fourth Circuit's test for totality of the circumstances to determine abuse, stating "[t]he Fourth Circuit's 'totality of the circumstances' test was adopted by name in BAPCPA §707(b)(3)(B), suggesting that something other than an ability to pay is required to succeed on a Motion to Dismiss."[15]

The court examined the factors contained within the Fourth Circuit's totality of the circumstances test: "(1) [w]hether the bankruptcy petition was filed because of sudden illness, calamity, disability or unemployment; (2) [w]hether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay; (3) [w]hether the debtor's proposed family budget is excessive or unreasonable; (4) [w]hether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect the true financial condition; and (5) [w]hether the petition was filed in good faith."[16] The court determined that, "while ability to pay is a factor in the totality of circumstances test, and may even be the primary factor to be considered, if it is the only indicia of abuse, the case should not be dismissed under that test."[17]

In *In re Richie,* the court did not outwardly state which test it was applying when determining totality of the circumstances, but the court seemed to apply the same reasoning as applied in the Fourth Circuit.[18] The court stated that it must look first to the debtor's ability to pay at the time of the hearing on the motion to dismiss. Then, if the court determines that the debtor does not have the ability to pay her creditors, the court must "delve further and find out why the debtor does not have the ability to pay. Finally, the [c]ourt concludes that if the debtor's inability to pay creditors is self-imposed, it may consider this fact both in terms of the totality of the debtor's financial circumstances and the debtor's good or bad faith."[19]

In that case, the debtor had obtained a master's degree in outdoor therapeutic recreation administration. She had applied for jobs in her field, but the positions were all out of state, and even if she had been offered the positions, she was unwilling to relocate. The court concluded that "a debtor who lacks the ability to pay because she has not engaged in a broad employment search, does not wish to work outside her chosen field, does not wish to work within her chosen field outside of southeastern Wisconsin, and takes this position at the expense of her creditors abuses the provisions of chapter 7 by seeking an immediate discharge." The court granted the UST's motion to dismiss.[20]

3. Dismissal can be based on the ability to pay alone, but the debtor is permitted to demonstrate mitigating circumstances. The Sixth Circuit looks to the debtor's ability to pay and also the factors set forth in *In re Krohn,* a pre-BAPCPA case, to determining if abuse exists based on the totality of the circumstances.[21] In *In re Mestemaker,* the UST brought a motion to dismiss the debtors' chapter 7 petition for abuse under §707(b)(3) because the debtors' schedules showed excess income over expenses that could be used to pay a portion of their unsecured debt.[22] The court concluded that "a court must consider a debtor's actual debt-paying ability in ruling on a motion to dismiss based on abuse where the presumption does not arise or is rebutted."[23]

However, the court went on and adopted the factors in *In re Krohn* to determine if the debtor has demonstrated mitigating circumstances. Specifically, the court relied on the following factors when looking at the totality of the circumstances: whether a

9 344 B.R. 702 (Bankr. S.D. Fla. July 17, 2006). *See, also, In re Jackson,* 348 B.R. 487 (Bankr. S.D. Iowa Aug. 28, 2006).

10 11 U.S.C. §707(b)(3) (West 2006).

11 It should be noted that the case law holds that even if a debtor "passes" the means test, the court can still dismiss his or her case if the totality of the circumstances or bad faith are present.

12 *In re Nockerts,* 2006 WL 3689465 (Bankr. E.D. Wis. Dec. 14, 2006).

13 353 F.3d 1135 (9th Cir. 2004).

14 2006 WL 3586263, *8 (Bankr. C.D. Cal. Dec. 5, 2006). *See, also, In re Pak,* 343 B.R. 239 (Bankr. N.D. Cal. May 18, 2006).

15 *In re Nockerts,* 2006 WL at *7.

16 *Id.* at * 8, *citing In re Green (Green v. Staples),* 934 F.2d 568 (4th Cir. 1991).

17 *Id.* at *9. The court recognized a distinction between the facts in *Nockerts* and the decisions rendered in *Pak, Parrot* and *Pennington.* In those cases, the debtors were below the median income and had not completed the deductions sections of the means test. However, the debtors in *Nockerts* were above the median and had completed the entire means test.

18 353 B.R. 569, 575 (Bankr. E.D. Wis. Oct. 3, 2006).

19 *Id.*

20 *Id.* at 581.

21 886 F.2d 123, 126 (6th Cir. 1989).

22 2007 WL 79306 (Bankr. N.D. Ohio 2007).

23 *Id.* at *4, *citing U.S. v. Boucha,* 236 F.3d 768, 774 (6th Cir. 2001).

debtor is "needy" and worthy of discharge, whether his disposable income permits liquidation of his consumer debts with ease, whether the debtor enjoys a stable source of future income; whether he is eligible for a chapter 13, whether there are state remedies with potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.[24]

When applying these factors to the debtors, the court determined that the debtors had regular income, did not face a loss of employment or decrease in income within the next year, were eligible for relief under chapter 13, and had excess income over expenses as set forth in their schedules and the court dismissed their petition.[25]

4. Bad-faith filing. As enumerated in §707(b)(3), a court can dismiss a debtor's petition if it was filed in bad faith. Several BAPCPA cases have arisen developing what constitutes a "bad faith" filing under the new law. In at least one case, the court has listed five factors to be considered when determining bad faith: "(1) the debtor's history of filings and dismissals; (2) whether a debtor misrepresented facts in his or her petition, unfairly manipulated the Bankruptcy Code, or otherwise filed the petition in an inequitable manner; (3) whether the debtor is actually in need of bankruptcy protection; (4) whether the debtor intended to invoke the automatic stay for improper purposes, such as for the sole objective of defeating state court litigation; and (5) whether egregious behavior is present."[26]

The court in *In re Mitchell* looked at these factors and determined that the debtor's unemployment, extravagant spending on the eve of bankruptcy absent mitigating circumstances, additional income that was not reported on the debtor's schedules, and the creation of a false sense of financial solvency because the debtor lied to at least one creditor to obtain additional credit amounted to a bad-faith filing. The court determined that "[t]he debtor is seeking more than a 'fresh start.' She is seeking a 'head start' at the expense of her creditors."[27]

Additionally, courts have held that a petition was filed in bad faith when the debtor did not attend the §341 meeting, did not attend pre-petition credit counseling, failed to pay the filing fee, and filed for no legitimate purpose other than to thwart the efforts of a mortgage company.[28] Additionally, a debtor's petition has been dismissed because of bad faith when the debtor received a $20,000 employment bonus pre-petition and used this bonus to purchase items such as a $600 dog kennel, a $235 rifle, a $200 bowling ball and bag, $180 hunting boots, a $150 dog shock collar, a $535 snow blower, a $60 wheelbarrow, a $60 shop vac, $600 washer and dryer, Christmas gifts for his family, and an $800 trip to watch the Chicago Bears play football.[29]

What Does a Debtor Need to Do to Rebut Abuse by Showing "Special Circumstances"?

The debtor can rebut the presumption of abuse by "demonstrating special circumstances, such as a serious medical condition or a call to active duty in the Armed Forces to the extent that such special circumstances that [sic] justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative."[30] There have been very few decisions where a debtor has successfully rebutted a showing of abuse by demonstrating special circumstances. Generally, debtors attempting to utilize special circumstances to justify additional expenses do not meet their burden because they fail to provide supporting documentation or a detailed explanation of the additional expenses as required under §707(b)(2)(B)(ii).[31]

Repayment of a 401(k) loan is generally not a special circumstance, although the court in this case indicated that a fact-specific inquiry was necessary for each case.[32] Additionally, inability to make payments in the past as part of a debt consolidation program is not a special circumstance.[33]

However, debtors who established that they were forced to commute a great distance, and they were in so many accidents caused by deer that littered their route that their insurance company threatened to cancel their insurance policy, justified special circumstances.[34]

Conclusion

The law in the area of dismissals under §521 and §707(b) continues to evolve and develop, with new decisions arriving so fast it is challenging to keep up. It will continue to be interesting to see how courts find additional loopholes in the plain language of §521, allowing a debtor who has not fully complied with §521 to avoid automatic dismissal. There also seems to be surfacing general agreement on three distinct tests defining "totality of the circumstances" under BAPCPA, similar to the tests formerly applied when examining "substantial abuse." Factors used to determine bad faith will likely develop further as the courts flesh out the definition of bad faith under BAPCPA. Finally, it is clear that debtors will have to get the message that to establish that a special circumstance exists, they must provide supporting documentation or a detailed explanation as to why they are entitled to such an expense to successfully argue entitlement to claim that a special circumstance exists. We know all bankruptcy practitioners out there will be waiting for resolution of these issues with bated breath. ■

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24 *Id.*

25 *See, also, In re McIvor,* 2006 WL 3949172 (Bankr. E.D. Mich. Nov. 15, 2006), utilizing the factors in *In re Krohn; In re Sorrell,* 2007 WL 211276 (Bankr. S.D. Ohio Jan. 26, 2007), adopting the test used in *In re Mestemaker.*

26 *In re Mitchell,* 2006 WL at *9 (citations omitted).

27 *Id.* at *12. (citations omitted); *See, also, In re Hare,* 2007 WL 201249 (Bankr. E.D. Cal. Jan. 24, 2007).

28 *In re Delone,* 2006 WL 3898390, *3 (Bankr. E.D. Pa. May 31, 2006).

29 *In re James,* 345 B.R. 664 (Bankr. N.D. Iowa June 30, 2006). The court concluded that the debtor's purchases were "recklessly wasteful, at the expense of his creditors." *Id.* at 668.

30 11 U.S.C. §707(b)(2)(B) (West 2006).

31 *See In re Johns,* 342 B.R. 626, 628 (Bankr. E.D. Okla. May 26, 2006); *In re Renicker,* 342 B.R. 304 (Bankr. W.D. Mo. May 11, 2006); *In re Singletary,* 354 B.R. 455, 473-74 (Bankr. S.D. Tex. Oct. 19, 2006); *In re Harris,* 353 B.R. 304 (Bankr. E.D. Okla. Oct. 13, 2006); *In re Skaggs,* 349 B.R. 594 (Bankr. E.D. Mo. Aug. 16, 2006); *In re Oliver,* 350 B.R. 294 (Bankr. W.D. Tex. Aug. 8, 2006); *In re Barazza,* 346 B.R. 724 (Bankr. N.D. Tex. Aug. 1, 2006); *In re Tuss,* 2007 WL 442051 (Bankr. D. Mont. Jan. 5, 2007).

32 *In re Lenton,* 2006 WL 3850011, *7 (Bankr. E.D. Pa. Dec. 15, 2006). *See, also, In re Thompson,* 350 B.R. 770 (Bankr. N.D. Ohio Sept. 16, 2006).

33 *In re Oliver,* 350 B.R. 294, 297 (Bankr. W.D. Tex. Aug. 8, 2006).

34 *In re Batzkiel,* 349 B.R. 581, 586 (Bankr. N.D. Ohio Aug. 7, 2006).

AMERICAN BANKRUPTCY INSTITUTE
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Consumer Corner

CHAP 13 CHAP 7

Means Testing, Dismissal and Conversion Under the New Law

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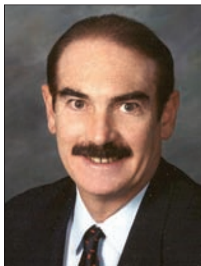
Means testing is the heart of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). It provides a very detailed formula for determining when abuse arises in the case of an individual debtor with primarily consumer debts.


David W. Allard

The amendments to §707(b) of the Code substantially modify the pro-visions of the current law with respect to cases filed on or after its effective date, Oct. 17, 2005. The old presumption that the debtor is entitled to relief under chapter 7 except upon a showing of "substantial abuse" will be discarded and replaced by a presumption of abuse through means testing. In addition to the introduction of means testing, the new law will allow a debtor to convert his or her case to chapter 11 or 13 as an alternative to having the case dismissed. Generally, U.S. Trustees (USTs), trustees, bankruptcy administrators (if any) and any party in interest may file a motion to dismiss a consumer debtor's case under §707(b).[1]

Current Monthly Income Defined

Means testing begins with the definition of "current monthly income" found in amended §101(10A). "Current monthly income" (hereinafter sometimes referred to as "CMI"[2]) is defined as the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) in the six-month period ending on the last day of the calendar month prior to the commencement of the case.[3] Section 101(10A)(A) specifically includes income without regard to whether such income is taxable income. Section 101(10A)(B) provides that CMI also includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse) on a regular basis for the household expenses of the debtor or the debtor's dependents. Social Security benefits and certain other payments will not be included to determine the debtor's CMI.[4] Note that the definition of CMI is different from the definition of "disposable income" under §1325(b)(2), which excludes child support payments, foster care payments or disability payments for a dependent child.[5] Note also that thisnew definition will not always be a sure indicator of the debtor's actual month-ly income due to job losses, promotions, increased overtime and other factors.[6]

Median Family Income Defined

When a debtor seeks to file under chapter 7 of the revised Code, counsel will also need to determine under §707(b)(6) how the current monthly income[7] of the debtor and the debtor's spouse combined[8] multiplied by 12 (the "ACMI" or "annualized CMI") compares to the median family income for a family of the debtor's size residing in the applicable state. "Median family income" is defined in new §101(39A) as the median family income both calculated and reported by the Bureau of the Census in the then most recent year adjusted as necessary by the CPI. Pursuant to §707(b)(7), no judge or interested party may file a motion under paragraph (2) if the ACMI is equal to or less than the applicable median family income. Therefore, for debtors who are under the median income, the means-test analysis may end at this early stage in the process.

Chicago Bankruptcy Judge **Eugene R. Wedoff** reports the detailed methodology for determining median family income (a.k.a. "median income") through a custom search of the Census web site in an excellent article on BAPCPA.[9] However, he also states that "it can be expected that the Executive Office for U.S. Trustees will publish median income tables."[10] Moreover, median income tables have already been published by others.[11] Section 101(39A)(B) requires that if the median family income is not both calculated and reported in the then-current year, it must be adjusted annually after such most recent year until the next year in which it is both calculated and reported by the Bureau of Census.[12]

U.S. Trustee Role

USTs[13] have always played an integral role in the filing of §707(b) motions to dismiss. While the amendments to §707(b) expand standing to file such motions, USTs will play an even greater role under the new

1 *See, also,* §707(b)(6), which further provides that only a judge, UST or bankruptcy administrator (if any) may file a motion under §707(b) if the current monthly income when multiplied by 12 is equal to or less than the median family income for a family of the debtor's size in the applicable state.

2 This article will use acronyms (most of which are coined by the author for ease of presentation) including "CMI," "net CMI" and "ACMI."

3 Or in the six-month period ending on the date that current income is determined by the court if the debtor does not file the required schedule of current income.

4 Section 101(10A)(B) also excludes payments to victims of war crimes, crimes against humanity and certain payments to victims of terrorism.

5 Thus, it appears that a debtor may flunk the means test based on the receipt of child support payments and the like, convert to chapter 13 and not be required to use these funds to pay creditors in a chapter 13 plan.

6 Actual monthly income may become relevant in the analysis of bad-faith filings or abuse by the totality of the circumstances.

7 Note that the "current monthly income" referred to in §§707(b)(6) and (7) is the CMI before deductions and not the "net CMI" arrived at after deducting the allowances and actual expenses authorized by §702(b)(2)(A)(ii),(iii) and (iv).

8 Section 707(b)(7)(B) provides that the CMI of the debtor's spouse will not be considered if the debtor and the debtor's spouse are separated and an affidavit is filed substantiating the same and specifying the aggregate amount of money received from the debtor's spouse attributed to the debtor's CMI in both joint and non-joint cases.

9 Wedoff, Hon. Eugene R., "Major Effects on the Consumer Provisions of the 2005 Bankruptcy Reform Legislation (2005)," available on ABI World at www.abiworld.org/pdfs/s256/mainpointa11.pdf.

10 *Id.* at 17.

11 Brown, Hon. William Houston and Ahern, Lawrence R. III, *Appendix to 2005 Bankruptcy Reform Legislation with Analysis,* 390-391 (2005). The tables take into account the requirement specified in the statute that in the case of a debtor in a household exceeding four individuals, $525 per month (increased or decreased in accordance with the cost-of-living adjustment made at three-year intervals pursuant to §104) should be added for each individual in excess of four.

12 Since the last year the Bureau of Census both calculated and reported the median family income was in 2000 (based on 1999 numbers), a CPI adjustment for the year s 2001 through 2004 will be necessary for cases filed in 2005 after the effective date of BAPCPA.

13 And bankruptcy administrators in the states in which the EOUST does not supervise the administration of cases (six judicial districts in North Carolina and Alabama). For purposes of this article, future references to USTs will be assumed to include bankruptcy administrators for those states.

statute. However, since the enactment of the amendments to the Code, the Executive Office of the U.S. Trustees (EOUST) has not, as of the date of this writing, addressed the many issues that arise with respect to the amendments to §707(b) and other provisions of the BAPCPA,[14] most likely so that UST personnel can complete their review of BAPCPA and speak with one voice. Until the EOUST is ready to provide further guidance, information exchanged during consultation with various representatives of the EOUST in 2001 during the preparation of an earlier version of this article may prove instructive,[15] with the understanding that current events, changes in statistical information and developments in EOUST policy may dictate different impressions, statistics or policies.

Commencing with the cases filed after the effective date of Oct. 17, 2005, it is expected that local offices of the UST will quickly review the ACMI stated by all individual debtors and divide the cases into two groups—those debtors who have an ACMI in excess of each state's applicable median income and those who do not. Those debtors who exceed the median income are initially expected to be approximately 15 percent of all filers.

The remaining 85 percent of the cases will be provided to trustees prior to the first meeting of creditors so that they can carefully review the ACMI to confirm that it is below the applicable median income. Section 521(a)(1)(B)(iv) will require that trustees be provided evidence of payments received from any employer of the debtor within 60 days before the date of filing, and §521(e)(2)(A) will require the debtor to provide a copy of the debtor's last year's federal income tax return no later than seven days before the date first set for the §341 meeting. The UST will be required by §704(b)(1)(A) to review all materials filed by the debtor and, no later than 10 days after the §341 meeting, file a statement with the court as to whether the debtor's case would be presumed to be an abuse under §707(b). The court shall provide a copy of the statement to all creditors no later than five days after receiving the statement pursuant to §704(b)(1)(B). New forms and schedules will be required for debtors, trustees and USTs, but it appears that it will be unnecessary to review expense forms (if they are required to be filed) in approximately 85 percent of all chapter 7 cases.

14 This may change prior to the date of publication of this article.

15 The contents of this article are merely this writer's impressions of the generality of the discussions held and should not be quoted as definitive facts nor should this article be cited as representing the positions of the UST, the EOUST or the Department of Justice.

Bad Faith and Totality of the Circumstances

Passing the means test will not always insure that a chapter 7 case will survive a motion to dismiss. Section 707(b)(3) provides that in a case where the presumption of abuse does not arise or is rebutted, the court shall consider (A) whether the debtor filed the petition in bad faith or (B) whether the totality of the circumstances of the debtor's financial situation demonstrates abuse. Only the court may dismiss, and the UST may move to dismiss a case on these grounds in cases in which the presumption does not arise or is rebutted. The court may dismiss and all parties in interest may move to dismiss if the presumption of abuse arises and is not rebutted. However, it remains to be seen what "bad faith" and abuse by the "totality of the circumstances" will mean in these contexts.

"Bad faith" and "totality of the circumstances" are standards that have been significantly developed in the case law with regard to other provisions of the Code. Analogies can and will be drawn to help determine what these terms will mean with respect to the new §707(b). Although amendments to BAPCPA now refer to a "presumption of abuse" as opposed to "substantial abuse," the analysis of "bad faith" and "totality of the circumstances" under the old law will be similar to future analyses to be made. While each appellate court has a slightly different interpretation of "bad faith" or "totality of the circumstances," it appears that an overall theme has been followed with respect to the determination of "substantial abuse" on these grounds.

Sixth Circuit case law provides an excellent illustration of "bad faith" and "totality of the circumstances." In *In re Krohn,* 886 F.2d 123 (6th Cir. 1989), the Sixth Circuit articulated a test meant to deny chapter 7 relief to the dishonest or non-needy debtor." *Id.* at 126, (*quoting In re Walton,* 866 F.2d 981, 983 (8th Cir. 1989)). The court went on to state that "a court should ascertain from the totality of the circumstances whether [the debtor] is merely seeking an advantage over his creditors, or instead is 'honest' in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is 'needy' in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets." *Id.* at 126, (*citing* 4 *Collier, supra,* 707.07, at 707-20).

The court listed some factors that bear on the debtor's honesty. "Counted among them, however, would surely be the debtor's good faith and candor in filing schedules and other documents, whether he has engaged in 'eve of bankruptcy purchases,' and whether he was forced into chapter 7 by unforeseen or catastrophic events." *Id.* at 126.

As for whether a debtor is needy, the court stated that "among the factors to be considered in deciding whether a debtor is needy is his ability to repay his debts out of future earnings." *Id.* at 126, (*citing Walton* at 984-985). The court thought that this factor alone could be sufficient to warrant dismissal. *Id.* at 126. "For example, a court would not be justified in concluding that a debtor is needy and worthy of discharge where his disposable income permits liquidation of his consumer debt with relative ease." *Id.* at 126. The court also listed other factors that would be relevant to determine a debtor's need, including "whether the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities." *Id.* at 126-127.

The bankruptcy judge in *Krohn* placed his focus upon Mr. Krohn's honesty and found sufficient evidence of bad faith to warrant a substantial abuse dismissal. *Id.* at 127. The court offered the following examples of bad faith by the debtor in this case:

> There appear to be no 'eve of bankruptcy purchases' but rather a consistent pattern of living on credit or beyond the debtor's means. At no point in the debtor's history, either before or after filing for chapter 7 relief, has the debtor shown a sincere resolve to repay his obligations and/or to reduce his monthly expenses. The debtor admits to making only minimum monthly payments so as to keep the accounts current... As further evidence of his bad faith, the debtor seeks a discharge only of those unsecured debts held in his name alone and not a discharge of any credit cards held jointly with his wife... The debtor treats his creditors in a callous manner and indulges in a lifestyle in excess of a reasonable standard of living.

Id. at 127. The court also found that although the goals of bankruptcy are intended to give an honest debtor a fresh start, the debtor in this case had not dealt with his creditors equitably and appeared to be seeking a "head start." The court further suggested that the debtor resort to "good, old-fashioned belt tightening." *Id.* at 128.[16]

Other Litigation Issues

The EOUST believed in 2001 that §707(b)(3) would be where the real §707(b) action would occur. At least one commentator believes this to be true, but also believes that other amendments to §707(b) will leave "plenty of room for legal disputes."[17] Referring to §707(b)(2) (B)(i), which states that the presumption of abuse may only be rebutted by demonstrating special circumstances, she says as follows:

> Making this aspect of the legislation interesting is the fact that the seemingly rigid and formulaic means test is littered with language that leaves plenty of room for legal disputes. An obvious example is the provision that allows a debtor to rebut the presumption of abuse "by demonstrating special circumstances that justify" deviation from the means test calculations if there is no "reasonable alternative." [FN77] It will be up to the courts to set the parameters of both "special circumstances" and "reasonable alternative," and it is fair to say this will be done on a case-by-case basis.
>
> Section 102 of the legislation is replete with other language that invites litigation. Many allowable expenses are qualified by "actual," "reasonable" and/or "necessary." [FN78] Current monthly income is measured from a mysterious "date of determination" [FN79] and includes amounts paid by some other entity on a "regular" basis to the "household expenses" of the debtor or his dependents. [FN80] Where the presumption of abuse under the means test either does not arise or has been rebutted, the court may still find abuse if the petition was filed "in bad faith," or where "the totality of the circumstances...of the debtor's financial situation demonstrate abuse." [FN81] Case law interpreting similar language elsewhere in the Code will provide some guidance, [FN82] but not certainty. There is no way of knowing how the courts will treat these and other unclear terms within the specific context of the means test. As the case law develops in this area, some guidelines will emerge. In the meantime, it is fair to conclude that whether an argument is warranted by existing law will depend largely on the reasonableness of counsel's interpretation of the legislation's language.[18]

Abuse Through Means Testing: The Seven-step Method

1. Determine CMI and ACMI. The debtor's CMI should be calculated in accordance with the statute as set forth herein in the section entitled Current Monthly Income. Thereafter, CMI should be multiplied by 12 to yield the ACMI (annualized CMI).

2. Select the Applicable Median Income and Compare with the ACMI. The ap-plicable median income should be deter-mined by reliance upon EOUST tables to be published (or other tables), adjusted annually if necessary and compared to the ACMI. If the ACMI is equal to or less than the applicable median income, the means-test analysis will end here. Since it has been estimated that 85 percent of chapter 7 cases will be in this group, the large majority of chapter 7 debtors will be able to stop their analysis at this point.

3. Reduce CMI by IRS National and Local Standards—Allowances. For the remaining 15 percent of chapter 7 cases, the debtor may reduce his or her CMI by applicable monthly expense amounts specified under the National Standards and Local Standards issued by the IRS (allowances).[19] These national and local standards are the collection financial standards used by the IRS to help determine a taxpayer's ability to pay a delinquent tax liability. The standards are commonly used in the negotiation of offers in compromise and can be found on the IRS web site.[20] According to the IRS:

> Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent.[21]
>
> Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.[22]

While the National Standards for food, housekeeping supplies, apparel and services, personal care products and services and miscellaneous categories are the same for everyone except residents of Alaska and Hawaii, the Local Standards[23] vary not only by state but also by county. Note that the Local Standards are further subdivided into two categories: (1) Housing and Utilities allowances for which the IRS publishes information by size of family and by individual county; and (2) Transportation allowances for which the IRS publishes both a National Standard for Ownership Costs and a Local Standard for which the IRS publishes information by Census Region and Metropolitan Statistical Area (MSA). Michigan is in the Midwest Census Region, and the MSA for Wayne, Macomb and Oakland counties (as well as seven other nearby counties) is listed under "Detroit." Moreover, the statute explicitly states that monthly expenses (including allowances) shall not include any payments for debts.[24] A common example of the effect of the provision would be monthly car payment, which must be deducted from the aforementioned transportation allowance. (However, it appears that the car payments will be added back under payments on account of secured debts pursuant to §707(b)(2)(A)(iii).)

4. Reduce CMI by Actual Monthly Expenses. Certain actual monthly expenses[25] may be used to further reduce monthly income and are specified for the categories listed as "Other Necessary Expenses" issued by the IRS for the area in which the debtor resides.[26] After the amendments to §707(b) were drafted, the IRS issued more detailed expense information in *Internal Revenue Manual - 5.15.1 Financial Analysis Handbook*

16 An excellent additional source for further analyses of what constitutes "bad faith" and "totality of the circumstances" as developed by the case law can be found in the *American Law Report*. Harrison, David B. J.D., Annotation, "Bankruptcy: When Does Filing of Chapter 7 Petition Constitute 'Substantial Abuse' Authorizing Dismissal of Petition Under 11 U.S.C. §707 (B)?," 122 A.L.R. Fed. 141 (2005).

17 Vance, Catherine E., "Attorneys and the Bankruptcy Reform Act of 2001: Understanding the Imposition of Sanctions Against Debtors' Counsel," *Commercial Law Journal* at 262 (footnotes omitted) (Fall 2001).

18 *Id.* at 262-264.

19 §707(b)(2)(A)(ii)(I).

20 www.irs.gov /individuals /article/0,,id=96543,00.html.

21 *See* National Standards for Allowable Living Expenses, available at www.irs.gov/businesses/small/article/0,,id=104627,00.html.

22 Internal Revenue Service, *Collection Financial Standards,* available at www.irs.gov/individuals/article/0,,id=96543,00.html. Tax practitioners advise that the IRS will frequently not permit a full allowance unless it can be demonstrated that actual expenses meet or exceed the allowance. USTs may take the same position.

23 The IRS Local Standards cited in this article are for Detroit, Wayne County, Michigan, which is the author's place of business. The Collection Financial Standards for any place in the country can be determined by a review of the IRS web site.

24 §707(b)(2)(A)(ii)(I).

25 §707(b)(2)(A)(i)(I).

26 *See* IRS Other Necessary Expenses (from the IRS Manual 1.3.2).

HYPOTHETICAL I

I. A. Determine Current Monthly Income (CMI)[1]

- Filing Date - Oct. 18, 2005
- Family Size - 4 persons including 3 minor dependents
- Individual or Joint Case - Individual (debtor is single)
- Residence - Wayne County, Mich.
- Debtor's Annual Income—
  - Occupation - machine operator
  - Wages $23,296
  - Unemployment compensation $538[2]
  - Prior year's tax refunds $5,024[3]
  - Social Security benefits $18,144[4]
  - *Total Annual Income* *$47,002*
- Debtor's CMI—
  - Wages, 4/1/05 - 9/30/05 $11,648
  - Total annual income includable in CMI $11,648
  - CMI (Total divided by 6) $1,941

B. Determine Annualized CMI (ACMI)[5]

- Debtor's ACMI
  - CMI multiplied by 12 $23,292

II. A. Select Applicable Median Income[6]

- State - Michigan
- Family Size - 4
- Year Calculated and Reported - 2000[7]
- Bureau of Census Median Income $62,812
- CPI Percentage, 2001-2004 +8.9%[8]
- CPI Adjustment $5,590
- *Applicable Median Income* *$68,402*

B. Compare ACMI with Median Income

- ACMI $23,292
- Applicable Median Income $68,402

Since Debtor's ACMI Is Equal to or Less than Median Income, Debtor May Stop Analysis[9]

1 Pursuant to §101(10A).
2 Unemployment compensation received in July 2004, during six-month period ending Sept. 30, 2005, therefore it would be included in CMI pursuant to §101(10A)(A)(i) but for the exclusion of benefits received under the Social Security Act under §101(10A)(B). It appears that unemployment compensation is a benefit received under the Social Security Act pursuant to 42 USCA Ch. 7, Subch. IX.
3 Federal tax refund received in February 2005, prior to six-month period ending on Sept. 30, 2005, therefore not included in CMI pursuant to §101(10A)(A)(i).
4 Social Security benefits are excluded from CMI pursuant to §101(10A)(B).
5 Pursuant to §707(b)(6) and (7).
6 Pursuant to §101(39A).
7 Calculated and reported by the Bureau of Census for Census 2000.
8 Calculated pursuant to §101(39A)(B) for purposes of this presentation. It is commonly believed that the EOUST will provide annual median income tables by state commencing with the effective date of the Bankruptcy Abuse Prevention Act, which will eliminate the necessity of calculation.
9 Pursuant to §707(b)(7)(A), assuming there are no issues regarding bad faith or abuse by the totality of the circumstances pursuant to §707(b)(3). Although no motion to dismiss may be filed under §707(b)(2), the trustee referred the case upon which this hypothetical was based for substantial abuse under the prior law primarily because the large tax refund and Social Security benefits were included in income and the debtor could pay $13,167 (100 percent of unsecured claims) to unsecured creditors in a three-year chapter 13 plan.

HYPOTHETICAL II

I. A. Determine Current Monthly Income (CMI)[1]

- Filing Date - Oct. 18, 2005
- Family Size - 2 persons including 1 minor child
- Individual or Joint Case - Individual (debtor is single)
- Residence - Oakland County, Mich.
- Debtor's Annual Income—
  - Occupation - auto worker
  - Wages $83,837
  - Unemployment compensation $0
  - Prior year's tax refunds $3,325[2]
  - Social Security benefits $0
  - *Total Annual Income* *$87,162*
- Debtor's CMI -
  - Wages, 4/1/05 - 9/30/05 $41,919
  - Total annual income includable in CMI $41,919
  - *CMI (Total divided by 6)* *$6,987*

B. Determine Annualized CMI (ACMI)[3]

- Debtor's ACMI
  - CMI multiplied by 12 $83,844

II. A. Select Applicable Median Income[4]

- State - Michigan
- Family Size - 2
- Year Calculated and Reported - 2000[5]
- Bureau of Census Median Income $45,957
- CPI Percentage, 2001-2004 +8.9%[6]
- CPI Adjustment $4,090
- Applicable Median Income $50,047

B. Compare ACMI with Median Income

- ACMI $83,844
- Applicable Median Income $50,047

Since Debtor's ACMI Is Greater than Median Income, Debtor Must Proceed to Steps III through VII[7]

III. Reduce CMI By IRS National and Local Standards - Allowances

- Real Property
  - Owns residence-value $170,000
  - Subject to mortgage $147,763
  - Monthly mortgage payment (excluding taxes and insurance) $1,012
- Personal Property - Automobiles & Other Vehicles
  - Owns 1 automobile(s) (subject to lien)
  - Monthly car payment $238
  - Leases 1 automobile(s)
  - Monthly lease payment $487
  - Other $0
- Other Secured Debts
  - Monthly homeowners association fee $175
- Monthly Tax Payments
  - Real estate $230
  - Federal income $1,325
  - State income $264
- Priority Claims
  - Child support ($867/month) $0

A. IRS National Standards[8]

- Allowable Living Expenses for Food, Housekeeping Supplies, Apparel and Services, Personal Care Products & Services and Miscellaneous[9]
  - Family size - 2 Persons
  - Gross monthly income of $5,834 and over
  - Total allowance $1,280

B. Additional 5 Percent Allowance[10] $48

C. IRS Local Standards[11]

- Michigan - Housing & Utilities Allowable Living Expenses[12]
  - Family Size - 2 or less
  - County - Oakland
  - Net allowance $147[13]
- Allowable Living Expenses for Transportation[14]
  - Number of Cars Owned & Leased - 2
  - Ownership Costs[15]
    - First car $237[16]
    - Second car $338[17]

continued on page 72

Hypotheticals (Consumer Corner)

from page 70

- Operating costs
  & public transportation costs $469

Total Allowances $2,519

IV. Reduce CMI by Actual Monthly Expenses[18]

A. Other Necessary Expenses Issued by IRS[19]

(a) Child care $867[20]
(b) Dependent care:
elderly, invalid or disabled $0
(c) Taxes $1,589[21]
(d) Health care
- Medicare $101
- Other $90
(e) Court-ordered payments $0[22]
(f) Involuntary deductions
- Social Security $433[23]
(g) Secured or legally perfected debts $0[24]
(h) Life insurance $160
(i) Disability insurance
for self-employed individual $0
(j) Union dues $65
(k) Professional association dues $0
(l) Accounting and legal fees[25] $0
(m) Optional telephone service[26] $0
(n) Charitable contributions[27] $20
(o) Other expenses that meet
the Necessary Expense Test $0

Total Other Necessary Expenses $3,325

B. Additional Actual Monthly Expenses Authorized by Statute

(a) Reasonably Necessary Expenses including:[28]
- Health insurance $0
- Disability insurance $0
- Health savings account $0
- Protection from family violence[29] $0

(b) Reasonable & Necessary Expenses including:
- Continuation of actual expenses for the care and support of an elderly, chronically ill or disabled household member or member of the debtor's immediate family[30] $0
- Actual administrative expenses in administering a chapter 13 plan up to 10%[31] $110
- Actual education expenses for each dependent child less than 18 up to $1,500 per year, per child.[32] $0
- Actual monthly expenses for home energy costs in excess of the IRS housing and utilities allowances.[33] $0

Total Additional Actual Monthly Expenses Authorized by Statute $110

V. Reduce CMI by 1/60 of Secured Debts[34]

• Average Monthly Payments on Account of Secured Debts
- Mortgage payment $1,012
- Homeowners association fee $175
- Car payment $238
- Any additional secured payments necessary to maintain possession of primary residence, car or certain other collateral[35] $0

Total Monthly Payments of Secured Debts $1,425

VI. Reduce CMI by 1/60 of Priority Claims[36]

• Average Monthly Payments on Account of Priority Claims $0

Total Monthly Payments of Priority Claims $0

VII. Determine Whether a Presumption of Abuse Arises

• Debtor's CMI $6,987
• Less -
Total allowances ($2,519)
Total other necessary expenses ($3,325)
Total additional actual monthly expenses authorized by statute ($110)
Total Monthly Payments of Secured Debts ($1,425)
Total Monthly Payments of Priority Claims $0
Net CMI ($392)

Since Debtor's Net CMI Is Less than $100,[37] No Abuse Is Presumed. ■

1 Pursuant to §101(10A).
2 Federal tax refund received in February 2005 prior to six-month period ending on Sept. 30, 2005, therefore not included in CMI pursuant to §101(10A)(A)(i).
3 Pursuant to §707(b)(6) and (7).
4 Pursuant to §101(39A).
5 Calculated and reported by the Bureau of Census for Census 2000.
6 Calculated pursuant to §101(39A)(B) for purposes of this presentation. It is commonly believed that the EOUST will provide annual median income tables by state, commencing with the effective date of the Bankruptcy Abuse Prevention Act, which will eliminate the necessity of calculation.
7 Pursuant to §707(b)(7).
8 Pursuant to §707(b)(2)(A)(ii)(I).
9 See National Standards for Allowable Living Expenses.
10 Pursuant to §707(b)(2)(A)(ii)(I), if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance up to 5 percent of the food ($691) and clothing ($276) categories (5% of $967 or $48.35).
11 Pursuant to §707(b)(2)(A)(ii)(I).
12 See Michigan - Housing and Utilities Allowable Living Expenses.
13 EOUST statisticians advised in 2001 that their proposed analysis would require that the mortgage payment (less taxes and insurance) would be allowed as secured debt and debtor would be allowed only the other actual housing costs up to the IRS limit. Therefore, the allowance indicated on the table of $1,334 would be reduced by the mortgage payment of $1,012, leaving a Housing and Utility Allowance of $322. The EOUST proposed analysis is supported by lines 9-11 of §707(b)(2)(A)(ii)(I), which states: "Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payment for debts." The remaining Housing and Utility Allowance of $322 must be further reduced by the monthly homeowners association fee of $175 (another secured debt), leaving a balance of $147.
14 *See* Allowable Living Expenses for Transportation.
15 Lease costs are considered ownership costs by both the IRS and the EOUST.
16 The same proposed analysis as made with the mortgage payment and housing costs would apply to the car payment and transportation costs. Therefore, the ownership costs for the first car indicated on the table of $475 would be reduced by the car payment of $238, leaving a balance of $237.
17 The second car ownership cost would be unaffected as the lease payment is not a secured debt. (Operating costs and public transportation costs are also unaffected.)
18 Most expenses were disclosed on the debtor's Schedule J and not repeated elsewhere in this hypothetical.
19 *See* IRS Other Necessary Expenses (from the IRS Manual 1.3.2).
20 Since the debtor owed no priority child support claims at the time of filing, the entire monthly amount of court-ordered child support can be deducted here or under "court-ordered payments."
21 Real estate taxes of $230 per month are not deducted here because they are already included in the housing allowance (although arguments to the contrary may be made).
22 *See* "child care."
23 Could be deducted here or possibly under "taxes."
24 Deducted elsewhere.
25 For representing a taxpayer before the service and other fees which meet the necessary expense test of health and welfare and/or production of income (the "Necessary Expense Test").
26 If it meets the Necessary Expense Test.
27 To be necessary, charitable contributions must either (1) have to provide for the debtor's or his or her family's health and welfare or be a condition of employment pursuant to IRS Other Necessary Expenses, or (2) be continued contributions to tax-exempt charities up to 15 percent of gross income pursuant to §707(b)(1).
28 Pursuant to §707(b)(2)(A)(ii)(I).
29 These expenses must be kept confidential by the court.
30 Pursuant to §707(b)(2)(A)(ii)(II) provided the expenses have not already been deducted as Other Necessary Expenses.
31 Pursuant to §707(b)(2)(A)(ii)(III) (estimated to be approximately $100 per month on average by the EOUST in 2001 (adjusted for inflation)).
32 Pursuant to §707(b)(2)(A)(ii)(IV).
33 Pursuant to §707(b)(2)(A)(ii)(V).
34 Pursuant to §707(b)(2)(A)(iii)(I). Includes all secured debt that will become due in the 60 months after filing.
35 Pursuant to §707(b)(2)(A)(iii)(II). Includes arrearages due secured creditors. Other collateral includes other property necessary for the support of the debtor and the debtor's dependents.
36 Pursuant to §707(b)(2)(A)(iv).
37 $6,000 divided by 60.

entitled “Other Expenses.” The Other Expenses can also be found on the IRS web site.[27] The expenses listed do not exhaust the category of necessary expenses. Other expenses may be considered if they meet the necessary expense test; health and welfare and/or the production of income.[28] Additionally, §707(b)(2)(A)(ii)(I) states that such expenses shall include reasonably necessary health insurance, disability insurance and health savings account expenses for the debtor, the spouse of the debtor or the dependents of the debtor.[29]

Moreover, if it is demonstrated that it is reasonable and necessary, the debtor’s monthly expenses may also include an additional allowance for food and clothing up to 5 percent of the food and clothing categories as specified by the National Standards.[30] Logically, this potential additional allowance should be grouped with other allowances and not with actual expenses.

Additional expenses may include, if applicable, the continuation of actual expenses paid by the debtor, which are reasonable and necessary for care and support of an elderly, chronically ill or disabled household member or member of the debtor’s immediate family who is unable to pay for such reasonable and necessary expenses.[31]

Actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides up to 10 percent of the projected plan payments (as determined under schedules issued by the EOUST) can also be deducted.[32] There is some confusion over how to calculate the actual administrative expenses of administering a chapter 13 plan for this purpose, but the EOUST estimated in 2001 that such expenses would average approximately $100 per month.

Actual education expenses for each dependent child less than 18 years of age, not to exceed $1,500 per year per child, can also be deducted provided that the debtor can provide documentation and a detailed explanation of why such expenses are reasonable and necessary, and why they are not already accounted for in the National and Local Standards or Other Necessary Expenses.[33]

Actual monthly expenses for home energy costs in excess of the allowance specified by the Local Standards for housing and utilities may also be deducted if the debtor provides documentation and demonstrates that such actual expenses are reasonable and necessary.[34]

It appears that overlapping allowances and actual monthly expenses may exist that will only become fully known by the filing and reviewing of actual cases. Tax practitioners believe that basic to the understanding of allowances and actual monthly expenses is the concept that duplicate items cannot be counted twice. Despite this understanding, it is likely that actual cases will uncover issues not anticipated by Congress that will require examination by the court to resolve.

5. Reduce CMI by 1/60 of Secured Debts. The next step in the means test is to further reduce the debtor’s CMI by the debtor’s average monthly payments on account of secured debts.[35] This average is calculated by adding those payments that are contractually due to secured creditors for the 60 months following the debtor’s petition date and the arrearage that the debtor would have to pay to secured creditors under a chapter 13 plan to maintain possession of the debtor’s primary residence, motor vehicle or other property necessary for the support of the debtor and the debtor’s dependents.[36] This sum is then divided by 60 to determine the amount that may be deducted from the debtor’s CMI on account of secured debt.[37] Debtors with an expensive mortgage[38] or car payments would appear to benefit from this provision depending on the relative size of the actual payments as compared to the amounts to be deducted from allowances.

6. Reduce CMI by 1/60 of Priority Claims. Next, a debtor may reduce the CMI by the amount of the debtor’s monthly payment of all priority claims including priority child support and alimony claims.[39] The amount of those debts that are entitled to priority are added together and divided by 60.

7. Determine Whether a Presumption of Abuse Arises. Once the debtor’s CMI is determined and reduced by all of the foregoing allowances, actual monthly expenses and secured and priority claim deductions,[40] the number resulting from those calculations (net CMI) is multiplied by 60.[41] Abuse is presumed if that number is not less than the lesser of 25 percent of the debtor’s nonpriority unsecured claims or $6,000, whichever is greater; or $10,000.[42]

When applying the means test, it may be easier to use monthly numbers that are used in calculating allowances and actual expenses. In other words, if the debtor’s net CMI is less than $100 per month ($6,000 divided by 60), no presumption of abuse arises. If the debtor’s net CMI exceeds $166.66 per month ($10,000 divided by 60), a presumption of abuse always arises. If the net CMI falls in between those numbers, abuse is presumed if the net CMI is sufficient to pay at least 25 percent of the debtor’s general unsecured debts in the next 60 months. Once the debtor has negotiated through this complex web of analyses, the debtor will be required to show the calculations that determine whether a presumption of abuse arises.[43]

Rebut by Special Circumstances

Once a presumption of abuse is found, it can only be rebutted through demonstrating the existence of special circumstances that justify additional expenses or adjustments of CMI for which there is no reasonable alternative.[44] Examples of special circumstances noted in the Code include a serious medical condition or a call or order to active duty in the Armed Forces.[45] Each additional expense must be itemized, and documentation must be provided by the debtor together with a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.[46] Note also that the debtor must attest to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.[47]

Hypotheticals

Hypothetical I is based on an actual case.[48] It represents the case with the smallest actual earnings this author has previously referred to the UST for substantial abuse under old §707(b). However, a large tax refund was excluded from CMI in this hypothetical because it was received prior to the six-month period for determination of CMI. Similarly, the even-larger Social Security benefit was excluded from CMI by the explicit language of §101(10A)(B). Moreover, unemployment compensation was

27 *See* www.irs.gov/irm/part5/ch14s01.html.
28 *See* IRS Other Necessary Expenses.
29 Reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under §309 of the Family Violence Prevention and Service Act or other applicable federal law shall also be included under §707(b)(2)(A)(ii)(I), but must be kept confidential by the court.
30 §707(b)(2)(A)(ii)(I).
31 §707(b)(2)(A)(ii)(II).
32 §707(b)(2)(A)(ii)(III).
33 §702(b)(2)(A)(ii)(IV). Note, however, that educational expenses are almost never allowed by the IRS unless it is for a physically or mentally handicapped dependent, is not provided by public schools or is a condition of employment.
34 §707(b)(2)(A)(ii)(V).
35 §707(b)(2)(A)(iii).
36 *Id.*
37 *Id.*
38 However, arguments are already being made that mortgage payments are acquisition costs while the Housing & Utility Allowance is comprised of both acquisition and maintenance costs. (*See* Judge Wedoff’s article cited in footnote 9.) Consequently, deducting mortgage costs from a combined allowance may not be appropriate.
39 §707(b)(2)(A)(iv).
40 Logic dictates and tax practitioners advise that no duplicate deductions will be permitted.
41 §707(b)(2)(A)(i).
42 *Id.*
43 §707(b)(2)(C).
44 §707(b)(2)(B)(i).
45 *Id.*
46 Additionally, §707(b)(2)(D) states that the court may not dismiss or convert a case based on any form of means testing if the debtor is a disabled veteran and the indebtedness occurred primarily during a period in which he or she was on active duty or performing a homeland defense activity. §707(b)(2)(B)(ii).
47 §707(b)(2)(B)(iii).
48 The author believes that examination of actual case facts will prove more instructive than hypotheticals with invented facts.

also excluded from CMI because it appears that it is a benefit received under the Social Security Act pursuant to 42 USCA Ch. 7, Subch. IX. Consequently, a debtor who would have been able to pay 100 percent of his or her unsecured claims of $13,167 in a three-year chapter 13 plan under the old law would be able to successfully defend a motion to dismiss[49] and resist conversion to chapter 13 under the new law.

Hypothetical II is also based on an actual case. It represents the case with the highest actual earnings this author has previously referred to the UST for substantial abuse under old §707(b). A full-blown analysis including all seven steps is required to come to the conclusion that this debtor will also pass the means test.[50] Yet if the debtor in Hypothetical II had as little as $560 more income per month, the opposite result would have been achieved. The debtor would not have passed the means test, and a presumption of abuse would have arisen because the net CMI would have exceeded $166.66 per month.

Finally, with a slightly less additional income of $500 per month, the net CMI would have fallen to $108 per month (a number between $100 and $166.66 per month), and one final simple test would be required to determine whether a presumption of abuse exists, as follows:

- Multiply net CMI by 60
  ($108 per month x 60)
  $6,480
- Compare to 25 percent of the debtor's nonpriority unsecured claims of approximately $44,000
  $11,000

Since the debtor's net CMI multiplied by 60 would be less than 25 percent of the debtor's nonpriority unsecured claims, no abuse would be presumed. ■

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49 Unless the court considered this to be "bad faith" or an "abuse by the totality of the circumstances."

50 The author recognizes that debtors with different facts, including such items as leased cars or homes rather than secured debts to deduct, may not pass the mens test so handily.

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Timing Is Everything...or Is It?

Cortez Challenges the "Snapshot" Approach to Analyzing Abuse Pursuant to §707(b)

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"You can never plan the future by the past."
—Edmund Burke

It has been said that life is all about timing. This is especially true when examining someone's financial status. Someone could be solvent today and insolvent tomorrow (or vice versa). Timing is also crucial when analyzing a prospective debtor's chapter 7 bankruptcy options. When a debtor is consulting with counsel regarding financial options and bankruptcy eligibility, the present status of the debtor's assets, liabilities and income are carefully examined. The debtor's information is then usually processed to determine if nonbankruptcy options are feasible as an alternative to bankruptcy options. The bankruptcy analysis entails determining a debtor's eligibility to discharge debts, as well as an ability to exempt assets. In addition, a debtor's current monthly income and expenses are examined to ensure that it would not be "abuse" to grant the debtor a chapter 7 discharge pursuant to 11 U.S.C. §707(b). If the chapter 7 debtor appears to have the ability to repay his or her debts based on current income and expenses, grounds for dismissal pursuant §707(b) may exist. This analysis is crucial since the enactment of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), as the newly created "means test" enumerated in §707(b)(2) requires a more precise examination of the debtor's income for the six-month time period "ending on the last day of the calendar month immediately proceeding the date of the commencement of the case."

Justin H. Dion

About the Authors

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The Snapshot Approach to Analyzing §707(b)

Bankruptcy courts traditionally employed the "snapshot" approach when examining a chapter 7 debtor's eligibility pre-BAPCPA. Under the snapshot approach, the debtor is required to accurately disclose the accuracy of his or her debts, assets, income and expenses as of the day of the filing of the petition. In essence, this gives the court and creditors a financial snapshot of the debtor's status as of the petition date. Pursuant to this approach, most post-petition changes in the debtor's finances such as incurring new debt, purchasing assets and incurring a fluctuation (either up or down) in monthly expenses and/or income are irrelevant for purposes of determining eligibility to obtain a chapter 7 discharge. Traditionally, these post-petition changes are irrelevant due to the fact that they are outside of the snapshot that was created on the day the petition was filed. Although there are some exceptions to this principle,[1] generally post-petition financial changes have little effect on chapter 7 eligibility. Despite this long-standing snapshot principle, a recent decision from the U.S. Court of Appeals for the Fifth Circuit has altered the traditional view.

Looking into the Future with Cortez

In *U.S. Trustee v. Cortez,* 457 F.3d 448 (5th Cir. July 20, 2006), the Fifth Circuit affirmed the U.S. District Court for the Northern District of Texas' decision to reverse a bankruptcy court decision to exclude a post-petition increase in a debtor's income when evaluating abuse pursuant §707(b). The case was then remanded back to the bankruptcy court for further proceedings.

Feature

Procedurally, *Cortez* involved a husband and wife who filed a joint chapter 7 bankruptcy on April 8, 2004. Debtors' petition showed a secured claim for the mortgage on their house, and unsecured debt in the amount of $85,719 (the majority of which consisted of credit card debt). In addition, as of the date of filing, on Schedule I the debtors listed their net monthly income as $4,417, with Schedule J listing the monthly household expense payments as $5,320.

[1] For example, 11 USC §541(a)(5) requires that debtors must disclose information beyond the snapshot if they become the recipient of a gift, inheritance, divorce property settlement, or life insurance proceeds within 180 days following the date of the filing of the petition.

Due to Mr. Cortez's unemployment at the time of the bankruptcy filing, all of the income was attributed solely to Ms. Cortez's employment as a registered nurse. Prior to Mr. Cortez's unemployment, the debtors reported a combined annual income of $145,600 in 2003. The bottom of Schedule I requires the debtors to report "any increase or decrease of more that 10 percent in any of the above categories anticipated to occur within the year following the filing of this document. In response, debtors reported that Mr. Cortez "believes he will be employed this month, but he has not started working yet." In fact, four days after filing for bankruptcy, Mr. Cortez did in fact receive a job offer as a human resource director for a large company. There is no evidence that Mr. Cortez had been extended this job offer pre-petition. Mr. Cortez accepted the position and began working on April 24, 2004. The position reportedly paid $95,000 (or $5,896 per month), a $5,000 signing bonus after 60 days of employment, as well as making Mr. Cortez eligible to use a company car. After becoming employed, Ms. Cortez voluntarily reduced her hours, and thus her net monthly income fell to $750. These post-petition income changes resulted in the debtors' new income exceeding their monthly expenses as listed in the petition by $1,328 per month.

Upon request of the U.S. Trustee, the debtors provided documentation evidencing Mr. Cortez's post-petition employment position, and testified accurately regarding the same at the §341 meeting of creditors. Shortly after the §341 meeting, the trustee filed a motion to dismiss pursuant to §707(b) asserting abuse. Because this was a 2004 bankruptcy filing, the court applied §707(b) prior to being amended by BAPCPA. The pre-BAPCPA provision of §707(b) stated as follows:

> (1) After notice and a hearing, the court, on its own motion or on a motion by the U.S. Trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under §548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in §548(d)(4)).[2]

As expected, in response to the trustee's motion to dismiss pursuant to §707(b), the debtors invoked the snapshot defense—*i.e.,* that the petition was completely accurate as of the day of the bankruptcy filing, and that it would be error for the bankruptcy court to consider post-petition events in deciding whether or not to dismiss the case. On Nov. 5, 2004, the bankruptcy court agreed with the debtors' argument and denied the trustee's motion. Specifically, the bankruptcy court held that events that occur after the filing should not be considered when evaluating abuse under §707(b) "unless the events were clearly in prospect at the time of filing for bankruptcy." The court reasoned that analysis for abuse to be performed under §707(b) should occur at the commencement of the case because the statute utilizes the term "granting of relief," which the bankruptcy court indicated really meant granting an "order for relief," which occurs at the commencement of the case pursuant to §301. Thus, the bankruptcy court reasoned that it was required to perform the abuse analysis as of the day of filing, and therefore could not take into account Mr. Cortez's post-petition employment.

On appeal, the district court reversed the bankruptcy court, holding that the plain language of §707(b) makes it clear that post-petition events are to be taken into account because the statute specifically instructs courts not to consider whether a debtor has made, or continues to make, charitable contributions. According to the district court, this language is forward-looking and only restricts viewing the future as to charitable contributions, not changes to income.

The issue on appeal for the Fifth Circuit was whether dismissal for abuse pursuant to §707(b) includes consideration of post-petition events. The Fifth Circuit first examined the bankruptcy court's conclusion that the undefined term "granting of relief" was intended to refer to an "order for relief," thus requiring the court to conduct its abuse analysis based solely on the time the petition was filed. The Fifth Circuit disagreed, holding that although "granting of relief" is undefined, contextually it is referring to relief in the form of a discharge and not the relief afforded upon the initial filing of a petition. In addition, the Fifth Circuit found that §707(b) "does not condition dismissal on the *filing* of the bankruptcy being a 'substantial abuse' but rather on the *granting of relief,* which suggests that in determining whether to dismiss under §707(b), a court may act on the basis of any development occurring *before* the discharge is granted."

After determining that pursuant to §707(b), post-petition factors can be utilized to complete an abuse analysis, the Fifth Circuit then went on to examine other circuits' treatment of §707(b). According to the Fifth Circuit, several other circuits have ruled that a debtor's ability to repay their debts out of future earnings is abuse, and specifically courts can consider whether the debtor has sufficient disposable income to fund a chapter 13 plan. To bolster their position, the Fifth Circuit noted that to assist courts with bankruptcy eligibility, Congress enacted §521 in 1984, which requires a debtor to file a schedule of current income and expenditures with their bankruptcy schedules. In a chapter 13 case, debtors are required to amend their schedules to include subsequent income, even if it is unknown and unanticipated at the time of filing. In fact, the Fifth Circuit points out that examining post-petition income in chapter 13 cases is commonplace based on §1329, which allows the trustee to seek a subsequent modification of the plan based on an increase in the debtor's income so that ultimately more money is paid to the creditors.

In affirming the district court's ruling, the Fifth Circuit abandoned the snapshot approach as it applies to a chapter 7 debtor's income, and held that although post-petition earnings are not

2 Although it should be noted that BAPCPA did make textual modifications to §707(b), it is the author's belief that the changes are not substantial, nor would it have changed this analysis and outcome even if this were a post-BAPCPA case.

property of the estate under §541(a)(6), future earnings should be taken into account for purposes of determining abuse pursuant to §707.

The Impact of Cortez *Post-BAPCPA*

Although BAPCPA did make some changes to §707(b)(1) and added the complex means-test requirement pursuant to §707(b)(2), *Cortez* is still a relevant and important decision. In fact, if adopted by other circuits, *Cortez* could invoke a major change in the way chapter 7 bankruptcies are analyzed, planned and administered. *Cortez* has discredited the snapshot theory as it applies to examining a debtor's income.

*Duties of the Trustee Post-*Cortez

The *Cortez* holding now appears to require that bankruptcy trustees in the Fifth Circuit be burdened with additional investigative duties. For example, the trustees must investigate and look for post-petition improvements in income in order to determine if abuse exists up until the point at which the chapter 7 discharge is issued. In addition, if a post-petition improvement in income is discovered prior to discharge in which a debtor now fails the means test, the trustee appears obligated to file a motion to dismiss for abuse pursuant to §707. Thus, a debtor who was eligible for chapter 7 relief pursuant to the means test on the day the petition was filed may suddenly find themselves ineligible for chapter 7 relief if they experience a post-petition/pre-discharge change in income. If discovered, the trustee would then be required to file a motion to dismiss. Additional questions remain pertaining to the scope of the trustee's post-*Cortez* investigation duties. For example, does the trustee's abuse inquiry require that the trustee ask about an upward change in the debtor's post-petition income at the 341 hearing? Does *Cortez* extend beyond that, and require that the trustee do a last check immediately prior to the discharge issuing? If a post-petition debtor is actively seeking employment, can the trustee extend the time to object to a debtor's dischargability solely to buy more time so that the trustee can continue to check on possible future changes in income?

*Post-*Cortez *Planning for Debtors and Debtors' Counsel*

If *Cortez* is widely accepted, it will also have serious repercussions for debtors and debtors' counsel. The holding seems to encourage debtors to maintain their post-petition financial status quo. For example, if an unemployed debtor is eligible and files for chapter 7 relief, it would appear that the debtor is better off to remain unemployed until the discharge issues. As discussed previously, the concern is that if the debtor improves his post-petition income by becoming employed, he may in fact improve himself out of eligibility based on the means test. In addition, do grounds for dismissal exist if an employable debtor voluntarily remains unemployed/underemployed simply in order to maintain chapter 7 eligibility? It would appear that in addition to a debtor's counsel carefully examining a debtor's current income, a hypothetical analysis may need to be performed for the debtor regarding potential future income.

Cortez is not just a concern for unemployed debtors; the holding also has repercussions for certain employed debtors. For example, debtors who receive a post-petition pay raise, commission or bonus may all be susceptible to abuse dismissal motions. Should an employed debtor now conduct post-filing financial planning, such as deferring income increases until the discharge, and what is counsel's role in recommending this evasive move?

*Living in a Post-*Cortez *World*

Cortez appears to be statutorily well-reasoned, despite the fact that the outcome is contrary to most practitioners' concepts of chapter 7 timing and planning. If widely adopted, discarding the snapshot theory of income will likely increase the costs and time for debtors, debtors' counsel, the trustees and the bankruptcy court. As future income always has some degree of uncertainty, for the time being debtors in the Fifth Circuit will file chapter 7 bankruptcies without knowing their discharge eligibility until the final order is issued by the bankruptcy court. Until such time, debtors will have to rely on the adage "timing is everything," and hope their timing will allow everything to turn out as anticipated. ■

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Analyzing Chapter 7 Abuse Dismissal Motions Post-BAPCPA: A Reply on *Cortez*

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This article challenges the conclusions set forth in **Justin H. Dion**'s article, "Timing Is Everything...or Is It?: *Cortez* Challenges the 'Snapshot' Approach to Analyzing Abuse Pursuant to §707(b),"[1] which appeared in the October 2006 issue of the *ABI Journal*. In his article, Dion argues that, pursuant to the decision set forth by the U.S. Court of Appeals for the Fifth Circuit in *U.S. Trustee v. Cortez*,[2] post-petition changes in a debtor's financial circumstances must be considered for purposes of evaluating a §707(b)(1) abuse dismissal motion.

Cortez involved a chapter 7 case that was filed prior to the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and that was sought to be dismissed pursuant to the pre-BAPCPA version of §707(b). Dion asserts that the amendments made to §707(b) by BAPCPA were insubstantial and would not have altered the outcome had it been analyzed pursuant to the BAPCPA version of §707(b).[3] The argument that BAPCPA did not effectuate substantive changes to §707(b) leads Dion to overestimate *Cortez* with respect to the decision's impact on future §707(b)(1) abuse dismissal motions. If one properly takes account of the significant structural changes made to §707(b) by BAPCPA and their impact on judicial discretion, it becomes clear that these changes have rendered *Cortez* largely inapplicable in a post-BAPCPA world.

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Judicial Discretion under §707(b)

One of the most significant BAPCPA amendments to Code §707(b) was the broadening of the standard pursuant to which an individual debtor's chapter 7 case may be dismissed—namely, from *substantial abuse* to *abuse*. In conjunction with the expansion of the dismissal standard, Congress constrained in various ways the opportunity for judges to exercise their discretion to define what constitutes abuse. First, Congress created a mechanical and formulaic means test that gives rise to a presumption of abuse if a debtor's disposable monthly income exceeds certain amounts,[4] a presumption that may be rebutted only under a narrow set of circumstances and pursuant to highly specific, statutorily-defined procedures.[5] Second, for those cases where the presumption of abuse does not arise or is rebutted, Congress has mandated that a court consider whether the debtor filed for bankruptcy in bad faith or whether the totality of the circumstances of the debtor's financial situation demonstrates abuse.[6] Since the Code neither defines what constitutes bad faith nor provides an evaluative framework for courts to consider when the totality of circumstances demonstrates abuse, in those instances where the means-test presumption of abuse has not arisen or has been rebutted, judges retain some discretion to identify within the constraints of bad faith and totality of the circumstances—both vague and indeterminate standards—abuse that would justify dismissal of an individual debtor's chapter 7 case. A more detailed exploration of the manner in which judicial discretion may be exercised by a court in making the finding of abuse under §707(b)(1) will reveal why the Fifth Circuit's decision in *Cortez* does not have the far-reaching implications Dion suggests.

Feature

BAPCPA's Codification of the "Snapshot Approach"

Dion's argument builds on the straightforward and unquestionable proposition that the *Cortez* decision rejected the doctrine that had developed prior to BAPCPA for analyzing §707(b) dismissal motions—namely, the "snapshot approach" according to which "most post-petition changes in the debtor's finances such as incurring new debt, purchasing assets and incurring a fluctuation (either up or down) in monthly expenses and/or income are irrelevant for purposes of determining eligibility to obtain a chapter 7 discharge."[7] But irrespective of whether the Fifth Circuit correctly decided *Cortez*, one need look no further than the statutory language of the Code itself, as amended by BAPCPA, to reach the ineluctable conclusion that the decision's command—that is, that "post-petition

1 Dion, Justin H., "Timing Is Everything...or Is It?: *Cortez* Challenges the "Snapshot" Approach to Analyzing Abuse Pursuant to §707(b)," Am. Bankr. Inst. J., Oct. 2006, at 1.

2 457 F.3d 448 (5th Cir. 2006).

3 Dion, *supra* note 1, at 46 n.2.

4 11 U.S.C. §707(b)(2)(A)(i).

5 *Id.* §707(b)(2)(B).

6 *Id.* §707(b)(3)(A), (B).

7 *See* Dion, *supra* note 1, at 46.

improvements in earnings can be taken into account and should be taken into account up until the point at which the discharge is entered"[8]—has limited applicability for purposes of evaluating §707(b)(1) abuse dismissal motions. More specifically, by virtue of the statutory definition of "current monthly income," determining abuse pursuant to the means test generally prohibits judicial inquiry into upward post-petition increases that the debtor experiences in his or her income. On the other hand, such increases may be relevant and appropriately considered for purposes of determining whether the debtor filed the petition in bad faith or whether the totality of the debtor's financial circumstances demonstrates abuse. Each of these situations will be considered in turn.

The thrust of Dion's argument (*i.e.*, that "*Cortez* has discredited the snapshot theory as it applies to examining a debtor's income"[9]) targets the consequences of *Cortez* for application of the means test.[10] However, calculation of current monthly income, a central component to the means test,[11] makes it clear that statutory constraints will generally preclude a court from considering post-petition income fluctuations in screening for abuse under the means test. The Code defines "current monthly income" as the average monthly income received by the debtor from all sources, irrespective of whether taxable, during one of two possible six-month periods: For those debtors who file with the court a current schedule of income and expenditures,[12] the six-month period will end on the last day of the calendar month immediately preceding the petition date;[13] for those debtors who do not file such a schedule, the six-month period will end on the date on which the court calculates the debtor's current income.[14] Given that failure to file such a schedule will prompt dismissal of the debtor's case, either by motion of the U.S. Trustee[15] or by virtue of automatic dismissal,[16] it seems reasonable to conclude that the bulk of cases in which an abuse dismissal motion alleges that the debtor flunks the means test (*i.e.*, the debtor's current monthly income, reduced by certain specified amounts and then multiplied by 60, is greater than or equal to the statutory amount equated to an ability to repay) will involve a calculation of current monthly income based solely on pre-petition income received by the debtor—that is, income received during the six-month period ending on the last day of the calendar month immediately *preceding the petition date.*[17] Accordingly, the Code's definition of "current monthly income" implements a snapshot of a debtor's financial situation, a snapshot that encompasses a six-month period that will definitionally exclude post-petition income in the majority of cases. BAPCPA's codification of a snapshot approach to defining "current monthly income" has thus largely eliminated judicial discretion to consider post-petition income fluctuations for purposes of the means test.[18] This, in turn, has displaced and rendered partly inapplicable the mandate imposed by *Cortez* vis-à-vis §707(b)(1) abuse dismissal motions.

BAPCPA's Exceptions to Codification of the "Snapshot Approach"

There remain two important caveats regarding judicial discretion to consider post-petition income fluctuations for abuse dismissal purposes, but it is only by virtue of the second caveat that *Cortez* may have some vitality notwithstanding BAPCPA's codification of the "snapshot approach." First, for a debtor to whom the presumption of abuse under the means test applies, such a debtor may rebut the presumption "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."[19] Assuming that the debtor can demonstrate special circumstances, the presumption of abuse will only be rebutted if the additional expenses or income adjustments allow the debtor to pass the means test (*i.e.*, the debtor's current monthly income, reduced by certain specified amounts and then multiplied by 60, is less than the statutory amount equated to an ability to repay).[20] When one considers the mathematical structure of the means-test formula, it becomes clear that the presumption of abuse will be rebutted only when the debtor alleges one of three scenarios that result in the debtor's inability to repay the enumerated statutory amounts:[21] (1) special circumstances justifying a decrease in current monthly income, (2) special circumstances justifying an increase in additional expenses, or (3) special circumstances justifying (a) a decrease in current monthly income *and* (b) an increase in additional expenses. As none of these scenarios involves an *increase* in current monthly income, the type of fluctuation upon which the Fifth Circuit focused in *Cortez*, it seems that the judicial discretion to consider current monthly income adjustments under §707(b)(2)(B) will remain confined to consideration of *downward* fluctuations.[22]

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8 *Cortez*, 457 F.3d at 458.

9 *See* Dion, *supra* note 1, at 47.

10 *See Id.* ("[D]ebtors who were eligible for chapter 7 relief *pursuant to the means test* on the day the petition was filed may suddenly find themselves ineligible for chapter 7 relief if they experience a post-petition/pre-discharge change in income." (emphasis added)).

11 The means test provides:

> In considering under [§707(b)(1)] whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's *current monthly income* reduced by the amounts determined under clauses (ii), (iii) and (iv) [of §707(b)(2)(A)], and multiplied by 60 is not less than the lesser of...25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or...$10,000.

11 U.S.C. §707(b)(2)(A)(i) (emphasis added).

12 Among the duties imposed on a debtor when filing for bankruptcy, he or she must file with the court a schedule of current income and expenses. 11 U.S.C. §521(a)(1)(B)(ii).

13 *Id.* §101(10A)(A)(i).

14 *Id.* §101(10A)(A)(ii).

15 Section 707(a)(3) gives standing to the U.S. Trustee to move for dismissal of a chapter 7 debtor's case on the basis that the debtor failed to file within 15 days after the petition date (unless the court allows additional time) the documentation "required by paragraph (1) of §521." *Id.* §707(a)(3). While BAPCPA renumbered former Code §521(1) as Code §521(a)(1), it failed to update other provisions of the Code, such as §§707(a)(3) and 1307(c)(9), to reflect this change. While a literal-minded reader might be inclined to say that such provisions are now inoperative since they reference a nonexisting provision (*i.e.*, §521(1)), a more reasonable interpretation would be that those provisions continue to have operative effect and should be read in light of the renumbering of Code §521.

16 *See Id.*, §521(i)(1) (providing that individual debtor's chapter 7 case will be automatically dismissed on the 46th day after petition date if debtor fails to file all information required under Code §521(a)(1)). *But see id.*, §521(i)(4) (providing that the court may decline to dismiss individual debtor's chapter 7 case if the court finds, among other things, that the best interests of creditors would be served by continued administration of the case).

17 *Cf.* Wedoff, Eugene R., "Means Testing in the New §707(b)," 79 Am. Bankr. L.J. 231, 248 (2005) ("If the debtor does not file schedules required by §521(a)(1)(B)(ii), it is likely that the case will be dismissed for cause under §707(a)(3), making it unnecessary to pursue dismissal under any of the provisions of §707(b). Accordingly, the six calendar months prior to filing will be the period for measuring [current monthly income] in nearly every case." (footnote omitted)). It would be appropriate, of course, for a court to consider post-petition changes in the debtor's income for those cases where the six-month period used to calculate current monthly income ends on a day subsequent to the petition date. The statute clearly commands that income received by the debtor from all sources during the six-month period be incorporated into the current monthly income calculation regardless of when that period ends.

18 Admittedly, courts *do* retain some discretion to define current monthly income. For example, the statutory definition does not define what it means for a debtor to "receive" income. Does this include income that was due to the debtor during the six-month period but never actually received? More importantly, the Code does not define "income," thus permitting a court to define which monies received by a debtor during the applicable six-month period should be included in the current monthly income calculus.

19 11 U.S.C. §707(b)(2)(B)(i).

20 *Id.* §707(b)(2)(B)(iv).

21 That is, the lesser of (1) 25 percent of the debtor's nonpriority unsecured claims, or $6,000, whichever is greater; or (2) $10,000.

22 *See* Wedoff, *supra note* 17, at 279 (noting that, for purposes of rebutting presumption of abuse under means test, "courts will be required to make discretionary determinations as to whether the claimed [special] circumstances justify...*a reduction in income*" (emphasis added)). It may be necessary for a court to consider an upward post-petition income fluctuation when presented as evidence contesting the debtor's assertion that special circumstances warrant a downward adjustment of current monthly income. Such evidence, however, would only be presented in a case where the presumption of abuse under the means test had already arisen.

Given that Congress statutorily authorized departure from the "snapshot approach" for those instances in which a debtor seeks to *rebut* the presumption of abuse under the means test, and given that Congress did not enact a similar provision for those instances in which a party in interest would seek to establish that a post-petition income fluctuation would render a debtor *ineligible* for chapter 7 pursuant to the means test,[23] one must conclude that, contrary to *Cortez*, a court ought not consider *upward* post-petition fluctuations in income (except as required by the statutory definition of "current monthly income") when considering abuse dismissal motions predicated on an alleged violation of the means test.

There remains one exception to BAPCPA's codification of the "snapshot approach," an exception that seemingly would permit a court to consider both upward and downward post-petition income fluctuations in determining whether abuse sufficient to dismiss a debtor's chapter 7 case exists. If the presumption of abuse does not arise under the means test or if the presumption is rebutted, a court may nonetheless dismiss an individual debtor's chapter 7 case based on its finding that the debtor's bad faith in filing the petition or the totality of the debtor's financial circumstances indicates abuse.[24] Given the lack of statutory definitions or statutorily enumerated elements for making such a finding, Congress has arguably left the door open for a court to exercise its discretion in this context—including consideration of upward post-petition income fluctuations.[25] It would thus appear that *Cortez* remains applicable to those abuse dismissal motions predicated on bad faith or totality of the circumstances—a point overlooked by Dion in his article.

Conclusion

BAPCPA's changes to §707(b) undoubtedly have had a substantive impact on the provision's operative effect, particularly with respect to the manner in which courts retain discretion to define the requisite abuse for dismissal of an individual debtor's chapter 7 case. As outlined above, for abuse dismissal motions based on the means test, the statutory definition of "current monthly income" virtually eliminates judicial discretion for consideration of post-petition income fluctuations. Where the presumption of abuse arises under the means test and is sought to be rebutted by the debtor, the possibility will exist for consideration of *downward* fluctuations in the debtor's post-petition income. Only when the presumption does not arise or when it has been rebutted does it appear that a court will have a meaningful opportunity to evaluate the effect of a post-petition *increase* in the debtor's income. In light of these considerations, *Cortez* should have a limited effect on the manner in which courts analyze §707(b)(1) abuse dismissal motions. ■

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23 It is patently clear that, when it so desires, Congress knows how to draft a Code provision relating to a post-petition increase in a debtor's income. *See* 11 U.S.C. §521(a)(1)(B)(vi) (providing that debtor must file "a statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition").

24 *Id.*, §707(b)(3).

25 *See* Wedoff, *supra* note 17, at 281 ("Motions under §707(b) will continue to be determined by exercises of judicial discretion, under the totality of the circumstances and bad faith standards that apply when the means-test presumption does not arise or has been rebutted").

AMERICAN BANKRUPTCY INSTITUTE
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Applicable Commitment Period: Time or Money?

Last in Line

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Under the Bankruptcy Code prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), §1322(d),[1] "Contents of plan" stated:

> The plan may not provide for payments over a period that is longer than three years unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

BAPCPA deleted former §1322(d) and replaced it with an entirely new provision. Section 1322(d) now determines maximum plan length by reference to the debtor's (and the debtor's spouse's) current monthly income, multiplied by 12, and compared to the state's median income. Specifically, if the debtor and the debtor's spouse have combined current monthly income[2] above the median income, the debtor's plan may be no longer than five years. If income is below the median, then the plan may be no longer than three years or, with court approval, five years.

Alane A. Becket

A companion provision is found in new §1325(b), which introduced the term "applicable commitment period" (ACP). Section 1325(b)(1) states that if a trustee or unsecured creditor objects, a plan may not be confirmed unless the plan provides that "all of the debtor's projected disposable income to be received in the ~~three-year period~~ applicable commitment period...be applied to make payments to unsecured creditors under the plan."[3]

A debtor's ACP is defined in §1325(b)(4) as three years for debtors whose income (along with their spouses' income) is below the median, or not less than five years if the income of the debtor and the debtor's spouse combined is above the median income for a family of similar size. The applicable commitment period may be less than three or five years if all unsecured claims are paid in full over a shorter period. (§1325(b)(4)(B)). Under BAPCPA, a question important to all unsecured creditors is whether the applicable commitment period is a "temporal" requirement or a "monetary" requirement. In other words, does the applicable commitment period define how long a debtor's plan must be, or is it simply a formula for determining the minimum amount a debtor must pay to unsecured creditors in order to obtain a discharge?

Thomas A. Lee III

The scant legislative history addresses the provision, yet what is available illustrates the dilemma:

> **Sec. 318.** Chapter 13 Plans to Have a Five-Year Duration in Certain Cases. Paragraph (1) of §318 of the Act amends Bankruptcy Code §§1322(d) and 1325(b) to specify that a chapter 13 plan may not provide for payments over a period that is not less than five years if the current monthly income of the debtor and the debtor's spouse combined exceeds certain monetary thresholds. If the current monthly income of the debtor and the debtor's spouse fall below these thresholds, then the duration of the plan may not be longer than three years unless the court, for cause, approves a longer period up to five years. The applicable commitment period may be less if the plan provides for payment in full of all allowed unsecured claims over a shorter period. Section 318(2), (3) and (4) make conforming amendments to §§1325(b) and 1329(c) of the Code.[4]

The title of this section seems to indicate that the amendment is intended to govern a plan's *duration*. The text likewise mandates that above-median-income debtors make payments "over a period not less than five years." However, for below-median-income debtors, the text refers to the *maximum* time a plan may run, *i.e.*, "may not be longer than three years." This implies that for these debtors, plans may be shorter than three years.

The answer to this time/money

1 All references to "section" and "§" refer to Title 11 of the U.S. Code.

2 This article does not address the issue of whether a debtor's spouse has "current monthly income" as described in §1325(b)(4).

3 Showing additions and deletions made by BAPCPA.

4 H.R. Rep. no. 109-31(I), April 8, 2005.

question can have a significant impact on dividends payable to unsecured creditors. Under the view that the ACP determines the *amount* a debtor must pay into a plan, a debtor's monetary commitment is fixed at confirmation, potentially subject to early payoff as long as the monetary threshold is met. A debtor whose financial circumstances allow an early payoff will not be subject to having future income scrutinized on a yearly basis, and possibly captured by a trustee's request to modify the plan. On the other hand, interpreting the ACP as determining mandatory plan *length* allows unsecured creditors the benefit of a change in the debtor's finances for the better.[5] This article will examine the arguments for each position.

The "Applicable Commitment Period" Determines Mandatory Plan Length

Having lived through the last nine years of bankruptcy reform debate, it appears that Congress intended §1325 (b)(4), describing the applicable commitment periods, to set forth the *minimum time periods* for a chapter 13 plan. One of the strongest arguments for this is the addition of §1325(b)(4) itself. Prior to BAPCPA, plan length was set forth in §1325(b)(1)(B), which stated that upon the objection of the trustee or allowed unsecured creditor, the court may not approve a plan unless the plan provided for "all of the debtor's projected disposable income to be received in the three-year period beginning on the date of the first payment." As mentioned above, the ACP can be shortened if all unsecured creditors are paid in full. Therefore, if unsecured creditors are not paid in full, it stands to reason that ACP can not be shortened.

Also, as noted above, former §1322(d) set the maximum length of a plan at not longer than three years or, with court approval, five years. BAPCPA added §1325(b)(4) to reflect the *required* length of time for a plan, based on the debtor's income. Mandating that a debtor with income above the median commit future income for five years is in concurrence with the changes to §707(b). That provision subjects above-median-income debtors to the means test. Together, these provisions reflect Congress' intent that debtors who can afford to repay their creditors should be required to do so.

The applicable commitment period is just that—a time "period." BAPCPA does not describe an "applicable commitment amount" or an "applicable commitment payment." The plain meaning of the term "applicable commitment period" is, simply stated, a requirement for the time during which a debtor must pay into a chapter 13 plan.

Accepting the position that the applicable commitment period is merely a monetary threshold that a debtor must meet calls into question two additional BAPCPA provisions. First, §521(f) requires the debtor to provide to parties in interest copies of post-petition tax returns and, in chapter 13, annual financial statements. If BAPCPA merely requires completion of a worksheet that determines the dollar amount that a debtor must repay, there is no purpose for the additional financial information required by §521. Thus, clearly, it is a Congressional mandate that a debtor's financial situation be reviewed at least annually to determine if there is cause to require the debtor to repay more to his creditors as a result of an increase in income.

A periodic review of a debtor's finances may ultimately invoke §1329, which allows modification of a confirmed plan to decrease or increase the amount of payments. Section 1329 protects all parties from a change in circumstance, acknowledging that it is very difficult to project one's income and expenses over an extended period of time. Section 1329 allows debtors to reduce their payments if they fall on hard times, but it also allows the trustee or unsecured creditor to move for increased payments should the debtors do better than expected. If the ACP is interpreted to fix, at confirmation, an amount that must be paid, rather than a time limit during which all disposable income must be paid, §1329 could be nullified by payment of a lump sum equal to the debtor's disposable income multiplied by either 36 or 60 months. This result would be of particular benefit to wealthy debtors who might have exempt reserves, such as IRAs, from which to fund immediate completion of a chapter 13 plan upon confirmation with no regard to future increases in income.

Conversely, debtors whose B22C forms produce artificially low disposable income could use their excess income, which would be evident from a review of Schedules I and J, to accelerate completion of their plans. In either case, a debtor would be in a position to pay the plan off in less than the ACP, and thus avoid a possible modification increasing payments during the ACP.

This position is further supported by the fact that §1306(a)(2) specifically provides that "earnings from services performed by the debtor after commencement of the case, but before the case is closed, dismissed or converted," are property of the estate. Combined with the provision in §1322(a)(1) that the debtor submit "all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as necessary for execution of the plan," it seems clear that the future income of the debtor is available to the trustee. Post-BAPCPA, the ACP defines the term. Why else would Congress have included §1325(b)(4)(B), which allows plans for less than three or five years *only if* unsecured claims are paid in full during the shorter plans?

A debtor should not be permitted to simply pay off a plan at any time he chooses, especially if the debtor's ability to pay is underrepresented by the official form calculations or if his financial situation improves during the life of the plan. This is because the confirmed plan, providing for payments over a specified time period, binds not only the creditors, but the debtor as well.[6] If a debtor wishes to buy out the plan, he must file a motion to modify the plan to complete it early or, at minimum, a motion to sell or refinance property.[7] In either case, parties in interest will then have the opportunity to oppose the early payoff and instead require full payoff of all claims as a condition to approval. These cases have met with mixed results that are beyond the scope of this article. However, BAPCPA makes it clear that the focus of bankruptcy should be on a debtor's ability to pay, the means test being the clear example; thus, motions for early payoff at less than 100 percent should be denied according to the concept of "applicable commitment period" and the overarching goal of BAPCPA that debtors should be required to repay creditors to the best of their ability.

The "Applicable Commitment Period" Determines the Amount that Must Be Paid

First and foremost, this question must be viewed according to the basics of statutory interpretation. Statutory plain

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5 And, conversely, allows the debtors to reduce plan payments if his finances deteriorate.

6 11 U.S.C. §1327(a).

7 Some courts have treated a motion to sell property and pay off the plan as a motion to modify.

language and its straightforward meaning are determinative unless running *contra* to legislative intent,[8] and a court must enforce it in accord therewith.[9] Thus, "[u]nder the plain-meaning rule, the process is simple. If the language of the statute is unambiguous, courts then review the statutory language in a vacuum, guided only by the common usage of the words therein."[10] This is because legislative intent is most persuasively manifest by the words of the statute, "and their apparent meaning should be rejected only on substantial, unambiguous evidence supporting a contrary interpretation."[11]

A plain reading of §1325(b) does not lead to the conclusion that a plan must *last* for three to five years. Rather, §1325(b) merely states that a debtor must contribute to the plan all projected disposable income *that he receives* during the applicable time frame, either three or five years. Accordingly, as long as a debtor pays the required amount, presumably he may "pre-pay" or "buy out" his plan by tendering the full amount due in a shorter period of time. This was made possible pre-BAPCPA typically when a debtor refinanced or sold appreciated property. After Oct. 17, a debtor may have excess income over the "disposable income" calculated by using Form B22C in two situations. First, "current monthly income" (CMI) as defined by §101(10A) is not necessarily reflective of a debtor's actual monthly income. A debtor may have more income than the formula for CMI calculates. Second, the debtor may have excess income after deducting the standard expenses allowed by BAPCPA and the official form if the debtor's actual expenses are less than the allowances. In either of these circumstances, the amount required to be paid to the trustee each month under §1325 may be less than a debtor's actual excess income. By devoting the excess to plan payments, or by other means such as refinancing, a debtor may be able to complete a plan sooner. This is not dissimilar to cases pre-BAPCPA that have allowed a debtor to refinance in order to pay off a plan.

Support for this proposition can be found in §1328(f), which prohibits the court from granting a discharge to a debtor who has received a discharge in a chapter 13 case filed within two years of the second filing. At first blush, this provision may appear to be in error, since most plans typically last at least 36 months, and thus very few debtors would be subject to the two-year limit imposed by this provision. However, reading the applicable commitment period to be a monetary provision makes sense of §1328(f), since Congress realized that a debtor may be able to pay off a plan in less than 36 months. Thus, it prohibited repeat discharges for at least two years.

Under this interpretation, parties are not without recourse to increase the amount a debtor must pay into a plan. A diligent trustee or party may always petition the court for a modification of the plan to increase plan payments. There is a body of case law that holds that the disposable-income test does not apply to plan modifications on the theory that §1329, permitting modifications, details the Code sections with which a modification must comply, and §1325(b), containing the disposable-income test, is not one of the enumerated sections.[12] Thus, assuming a debtor has not already tendered full payment to the trustee, a court may require that a plan be modified to comport with a debtor's changed circumstances.

We have been directed to read a statute according to its plain meaning unless doing so would result in an absurd result. While completing a plan in less than three or five years without paying 100 percent to unsecured creditors may or may not be what Congress intended, the result certainly does not rise to the level of "absurd." Thus, the statute should be read strictly as merely dictating the total amount a debtor must pay, as opposed to requiring a specific plan length. "The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning."[13]

Conclusion

Without question, this is an issue of significant import to unsecured creditors. As with many of the provisions of BAPCPA, how the "applicable commitment period" ultimately will affect chapter 13 plans will be determined by bankruptcy courts across the country, potentially leading to a diversity of results. This, unfortunately, is a situation that Congress intended and attempted to avoid. ■

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8 *U.S. v. Ron Pair Enters. Inc.*, 489 U.S. 235, 242 (1989).

9 *Caminetti v. United States*, 242 U.S. 470, 485 (1917).

10 *680 Fifth Ave. Assocs. v. Mutual Benefit Life Ins. Co. in Rehabilitation* (*In re 680 Fifth Ave. Assocs.*), 156 B.R. 726, 734 (Bankr. S.D.N.Y. 1993).

11 *State Water Control Bd. v. Train*, 559 F.2d 921, 924 (4th Cir. 1977).

12 The opposing view holds that because §1325(a) makes reference to §1325(b), plan modifications must comply with §1325(b).

13 *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991).

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USTP's Top Priority: Making Bankruptcy Reform Work

Written by:
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The U.S. Trustee Program (USTP) is committed to fulfilling its mandate to make bankruptcy reform work for all stakeholders in the system: debtors, creditors and the general public. Congress gave the USTP the responsibility for carrying out many key features of the bankruptcy reform law. From the enactment of the BAPCPA on April 20, 2005, through the general effective date of Oct. 17, 2005, the USTP engaged in an extraordinary effort to develop comprehensive implementation plans and issue guidance necessary to accomplish our new and expanded responsibilities.

In addition to devoting top attention to the enforcement and implementation of the BAPCPA, the USTP continues to make considerable efforts to report on its activities to the bankruptcy community and to the Congress. On April 26, 2006, I testified before the House Judiciary Committee's Subcommittee on Com-mercial and Administrative Law during an oversight hearing that also included officials from the Department of Justice's Executive Office for U.S. Attorneys, Civil Division, and Environment and Natural Resources Division. At that hearing, I discussed the USTP's ongoing civil and criminal enforcement activities, as well as our BAPCPA implementation activities. In this article, I would like to share with you some observations about our progress that I made in my congressional testimony and in recent briefings for House and Senate Appropriations and Judiciary Committee staffs.

About the Author

Clifford White is the deputy director of the Executive Office for U.S. Trustees and is currently serving as its acting director.

Civil and Criminal Enforcement

For the past five years, the centerpiece of the USTP's anti-fraud and abuse efforts has been the National Civil Enforcement Initiative, which focuses on wrongdoing both by debtors and by those who seek to exploit debtors. Since FY 2003, more than 165,000 civil enforcement and related actions have been brought by the USTP, yielding $1.75 billion in monetary results. In FY 2005, more than 50,700 actions were initiated that generated nearly $594 million in potential returns to creditors through debts not discharged and other remedies. USTP attorneys prevailed in more than 96 percent of the actions resolved by judicial decision or consent in the key areas of dismissal for substantial abuse (11 U.S.C. §707(b)), denial of discharge (11 U.S.C. §727), fines against bankruptcy petition preparers (11 U.S.C. §110) and disgorgements of debtor attorneys' fees (11 U.S.C. §329).

Criminal enforcement is another key component of the USTP's efforts to promote the integrity of the bankruptcy system. In 2003, the Criminal Enforcement Unit (CREU) was established to coordinate the criminal referral responsibilities carried out by our 95 field offices and to directly assist prosecutors in pursuing bankruptcy crimes. The CREU has made a marked difference in the quality of our criminal program by providing extensive training, developing resource materials and enhancing coordination for the benefit of USTP staff, federal prosecutors and other law enforcement personnel. In FY 2005, the USTP made 744 criminal referrals, a 12 percent increase over FY 2004. In many cases, USTP lawyers directly prosecuted or assisted the prosecution team in cases initiated as a result of criminal referrals made by USTP offices. In addition, the majority of USTP field offices participate in bankruptcy fraud working groups, which are headed by U.S. Attorneys' offices and include other federal law enforcement and investigative agencies. Moreover, with the enactment of 18 U.S.C. §158 as part of BAPCPA, every U.S. Attorney's office is required to designate a prosecutor and every FBI field office an agent who will assume primary responsibility for bankruptcy fraud cases. This provision will strengthen existing bankruptcy fraud working groups by formalizing points of contact and will provide a foundation for establishing new working groups.

BAPCPA Filing Numbers

The unprecedented number of bankruptcy filings in the four weeks leading up to Oct. 17, 2005, surprised all observers and added substantially to the USTP's ongoing civil and criminal enforcement duties. In addition to handling the challenges of implementing bankruptcy reform after BAPCPA's general effective date, the USTP faced the burden of administering more than six times the normal volume of cases. In the four weeks before Oct. 17, 2005, more than 726,500 cases were filed in the 88 judicial districts covered by the USTP. By contrast, post-Oct. 17 filings have

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decreased substantially, with only about 140,000 cases filed between the BAPCPA's effective date and the end of March 2006. The filing rate is increasing at a moderate pace, but remains well below pre-BAPCPA levels. In addition, the mix of chapter 7 and chapter 13 cases has changed in the cases filed since the BAPCPA's general effective date. Pre-BAPCPA, about 70 percent of cases were filed under chapter 7 and about 30 percent were filed under chapter 13. Since BAPCPA took effect, about 45 percent of cases have been filed under chapter 7 and about 55 percent have been filed under chapter 13, although there are indications that the mix is changing back toward historic patterns.

No commentators predicted such a large bulge in pre-reform filings or such a fall-off immediately afterward. It is impossible to draw firm conclusions about filing trends or BAPCPA results based on the current anomalous situation. There are signs that bankruptcy reform is producing positive results, but the real test will come after a greater passage of time and when filing levels rise to more normal levels.

Means Testing

One of the USTP's primary new responsibilities under BAPCPA is the implementation of the means test in chapter 7. Means testing is helping to identify abusive cases and is providing the USTP with necessary enforcement discretion to decide whether to file or decline to file a motion to dismiss a "presumed abusive" case. Of the debtors who filed chapter 7 cases between Oct. 17, 2005, and March 31, 2006, about 5 percent had incomes above the applicable median state income and were therefore subject to the full means test to determine if the case was "presumed abusive." (Before Oct. 17, about 15 percent of cases—or three times the current percentage—were filed by debtors with income above the applicable state median income.) About 10 percent of the above-median cases filed under BAPCPA, or one-half percent of total cases, have been determined to be "presumed abusive" under the means-testing formula. The USTP filed motions to dismiss in approximately 70 percent of the "presumed abusive" cases that were not voluntarily converted or dismissed. Thus, U.S. Trustees exercised discretion to find that it would not be "appropriate" to file a motion against debtors in about 30 percent of the "presumed abusive" cases. The most common reasons for declining to file a motion to dismiss were that the debtor was a victim of Hurricane Katrina, which supported an expense adjustment as a "special circumstance," or that the debtor experienced a post-petition change in status, such as seasonal employment or disability, which supported an income adjustment as a "special circumstance."

The number of filings is relatively low and, due to the time frames for filing such motions, the pool of cases processed at this point is lower still. The decision to file a motion to dismiss must be made 30 days after the initial determination, which is made within 10 days after conclusion of the §341 meeting, which must be held within 40 days after filing. Accordingly, cases filed within the previous 80 days may just be approaching the filing date for a "presumed abusive" motion. In addition, a significant number of debtors have voluntarily dismissed their cases or converted their cases to chapter 13 after the U.S. Trustee filed a statement of "presumed abuse," rendering a motion to dismiss unnecessary. Further, to some extent, means testing may be self-enforcing. By performing the means-testing calculations, a debtor can determine if his or her case will be presumed abusive unless special circumstances are shown. This may affect the debtor's choice of chapter and/or the decision to file under any chapter.

Credit Counseling and Debtor Education

Another significant new responsibility for the USTP is the approval and monitoring of pre-filing credit counseling agencies and post-filing debtor education providers. The credit counseling and debtor education provisions of the reform law provide potentially salutary protections for consumer debtors by helping to ensure that debtors enter bankruptcy with full knowledge of their options and exit with information to help them avoid future financial calamity.

As of the end of March 2006, the USTP had approved 142 credit counseling agencies covering 88 judicial districts for pre-bankruptcy counseling. In addition to credit counseling agencies that offer Internet and telephonic access, there are 754 walk-in locations for credit counseling in 82 judicial districts. For post-bankruptcy debtor education, the USTP had approved 241 debtor education providers covering 88 judicial districts by the end of March 2006. In addition to debtor education providers offering Internet and telephonic access, there are 915 walk-in locations in 82 judicial districts. Agencies and/or providers offer services in nearly two dozen languages.

The USTP has been commended by consumer groups for developing an effective screening process to keep out unscrupulous providers. Applications and re-applications from credit counseling agencies and debtor education providers are received and processed continuously. The USTP is processing complete applications within 30 to 45 days of receipt, and USTP staff work with applicants where there are deficiencies to collect additional information as needed. About 200 applications for approval as a credit counselor or debtor education provider have been denied or withdrawn. Common reasons for denial of approval as a credit counselor include failure to turn over documents related to an ongoing IRS audit, lack of an independent board of directors, and improper financial tie-ins with third-party vendors. Delay or denial of debtor education provider applications generally relate to inadequate materials, failure to employ trained personnel and fee-disclosure issues. In the near future, the USTP will publish a notice of proposed rule-making in which we will seek public comments on more extensive regulations to be imposed upon providers.

The USTP monitors approved credit counseling agencies to ensure their conduct comports with the statutory requirements. For example, the USTP makes clear that credit counseling agencies may not provide legal advice except as authorized by law. We distinguish between explaining the general consequences of bankruptcy so that a debtor understands the alternatives to bankruptcy and advising a debtor about what will happen to the debtor's home, car and other property if a bankruptcy case is filed. Similarly, while the USTP does not prescribe the criteria for fee waiver by credit counseling agencies, we require agencies to disclose that services must be provided without regard to ability to pay, we review fee schedules and we act on complaints that agencies have refused to waive fees.

The USTP has exercised discretion in enforcing the requirement that a debtor provide a certificate of credit counseling when filing bankruptcy. We have filed about 900 motions to dismiss for failure to file a certificate. Enforcement varies

by district because local court rules vary. At the USTP's suggestion, the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States recommended changes to the bankruptcy petition to reduce dismissals for lack of knowledge of the credit counseling requirement. Chief Bankruptcy Judge **Eugene Wedoff** of the Northern District of Illinois developed an exhibit to the petition that would notify the debtor of the pre-filing credit counseling requirement and provide a simple "check the box" format to show that the statutory requirements were met. These recommendations will be considered by the Judicial Conference's Committee on Rules of Practice and Procedure.

Conclusion

This is a time of unprecedented opportunity for the USTP to make bankruptcy reform work for all stakeholders in the bankruptcy system, including debtors, creditors and the public. The new law provides many important tools that will help us enhance the integrity and efficiency of the bankruptcy system. Enforcement and implementation of the new law has created many daunting challenges, but we believe that the USTP is off to an excellent start. I look forward to providing updated reports on our progress, and I welcome comments and suggestions from the bankruptcy community. ■

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Judicial Discretion to Find Abuse under §707(b)(3)

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Editor's Note: *A longer version of this article will appear in the forthcoming issue of the* Missouri Law Review.

> *[T]here is nothing wrong with the means test. People who make high incomes—lawyers, doctors and accountants are examples—and file bankruptcy, wiping out all their debts, who don't care who got hurt by their failure to pay and they care only about themselves, this will crack down on those people.*
>
> —Statement of Sen. Jeff Sessions, March 8, 2005. Cong. Rec. S2219

Imagine a person with a high income—a corporate CEO, for example—whose company goes out of business and who finds him-self temporarily un-employed. While waiting for his next opportunity, he maintains his lifestyle by depleting his personal savings and incurring substantial debt, both secured (his normal annual purchase of a new Jaguar and new home equity loans) and unsecured (cash advances and other charges on his credit card, which has a very high limit). After a few months, he finds new employment, with even higher compensation than before, but he wonders if there isn't some way that he could avoid repaying some of the debt he incurred. Chapter 7 of the Bankruptcy Code[1] seems to present a good possibility; it offers an immediate discharge of all unsecured debts in exchange for the debtor's nonexempt assets.[2] That's no problem for our executive, because the remaining equity

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in his home is protected by a generous state exemption, his cash is gone (or in exempt retirement accounts), and his cars are encumbered by liens. There's nothing that a chapter 7 trustee could sell for debt repayment.

Indeed, the only problem the executive might seem to have is the means test that was added to §707(b) of the Code[3] by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[4] As reflected in the quotation from Sen. Sessions above, the means test was designed to "crack down" on debtors with sufficient income to repay a substantial portion of their debt. It does this through a formula that determines how much income a debtor may have available for debt repayment. If this amount exceeds defined levels, the debtor is presumed to be abusing chapter 7 and will be denied chapter 7 relief if the presumption is not rebutted. But as it turns out, the means-test formula is also no problem for our executive. It measures a debtor's income during the six months before a bankruptcy filing, and he would have been unemployed during most of this period. Moreover, it allows a deduction from income in the amount of whatever secured debt payments the debtor is obligated to make—even debts secured by luxury vehicles or other unnecessary items. So although the executive has plenty of income to pay his debts, he passes the means test; there is no presumption of abuse.

Hon. Eugene R. Wedoff

To discharge all of his unsecured debt in chapter 7, the executive needs to leap just one more hurdle. Section 707(b)(3) of the Code,[5] added by BAPCPA, governs situations in which the means-test presumption does not arise, and it provides that the court can find abuse in such situations by considering "the totality of the circumstances...of the debtor's financial situation." One might think that this provision allows a judge to look at how much money a debtor actually has available to pay debts and "crack down" on genuinely wealthy debtors who pass the means test.[6] But according to a recent article by Profs. Culhane and White,[7] that is not so. Once a debtor passes the means test, the article contends, the debtor's financial situation is irrelevant to a finding of "abuse;" relief can be denied only for dishonesty or similar "serious debtor misconduct."[8] Our executive, then, having told no lies and having made no lifestyle changes to facilitate bankruptcy, can both keep his income and discharge his unsecured debts in chapter 7.

This article suggests the contrary—that if the question is properly raised in

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1 11 U.S.C. §701, *et seq.*

2 *See* 11 U.S.C. §§541 (defining property of the debtor's estate and allowed exemptions); 704(a)(1) (requiring a chapter 7 trustee to collect and reduce to money the property of the estate); 727(a) (providing for the chapter 7 discharge); Fed R. Bankr. P. 4004(c) (providing for prompt entry of chapter 7 discharge).

3 11 U.S.C. §707(b).

4 Pub. L. No. 109-8, 119 Stat. 23 (2005).

5 11 U.S.C. §707(b)(3).

6 *See* Wedoff, Eugene R., "Means Testing in the New §707(b)," 79 Am Bankr. L. Rev. 231, 236 (2005) (reading §707(b)(3) to allow judicial determination of debt-paying ability).

7 Culhane, Marianne B. and White, Michaela M., "Catching Can-Pay Debtors: Is the Means Test the Only Way?" 13 Am. Bankr. Inst. L. Rev. 665 (2005).

8 *Id.* at 666, 687.

a §707(b) motion, bankruptcy judges have a duty to consider the actual financial situation of debtors who are not subject to a means-test presumption, that judges should find abuse where debtors can repay a sufficient amount of unsecured debt, and that the means test serves to guide—rather than foreclose—such determinations of abuse.

The Means Test as a Presumption of Ability to Repay Debt

The key to understanding the proper role of the means test in chapter 7 is to recognize that it is simply a mechanism for generating a presumption; it does not result in any final determination. Although the means test itself is complex, its function as a presumption is clear from the interaction of five provisions of §707(b):

- Paragraph (b)(1) provides that a court may deny chapter 7 relief "if it finds that the granting of relief would be an abuse of the provisions of this chapter."
- Subparagraph (b)(2)(A) calculates an amount of income that a debtor may have available to pay debts that are neither secured by liens on the debtor's property nor given a special priority by the Code. This available-for-ordinary-debt payment amount can be called "disposable" income, since it is the income not needed for living expenses and payment of secured and priority debts.[9] Put another way, disposable income equates to "ability to pay" unsecured debt. The means test calculates disposable income by subtracting specified allowances for living expenses and payments of secured and priority claims from the debtor's defined "current monthly income."[10]
- Clause (b)(2)(A)(i) provides that "the court shall presume abuse exists" if the debtor's monthly disposable income calculated under the means test is either (1) greater than $166.66 or (2) at least $100 and sufficient to pay 25 percent of the debtor's nonpriority unsecured claims in 60 months. These amounts of monthly disposable income can be referred to as the "abuse threshold," since a debtor who has disposable income at or above these amounts is presumed to be abusing chapter 7.
- Subparagraph (b)(2)(B) provides for the only possible rebuttal of the means test's presumption of abuse: The debtor must show "special circumstances that justify additional expenses or adjustments of current monthly income" that would cause the debtor's monthly disposable income to fall below the abuse threshold.
- Paragraph (b)(3) provides in full:

> In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider—
> (A) whether the debtor filed the petition in bad faith; or
> (B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

From these provisions, it is evident that the means test operates as a classic presumption—that is, a rule providing that proof of one fact (the "foundational" fact) is effective to establish another fact (the "presumed" fact).[11] For example, in one common presumption, the foundational fact that a child is born to a woman while she is married gives rise to a presumed fact that her husband is the biological father.[12] In the means-test presumption, the foundational fact is the amount of monthly disposable income calculated under the means test; the presumed fact is that the debtor actually has disposable income in the calculated amount.

Just as husbands can rebut a presumption of paternity by introducing evidence (such as a genetic test) demonstrating that they did not father children born during their marriages,[13] so chapter 7 debtors can rebut the amount of disposable income calculated under the means test by showing that their actual disposable income is less than that amount, either because the means test measured income at a level inaccurately high, or because it measured deductions for living expenses and payments of secured and priority debt at levels inaccurately low. And as with the presumption of paternity, the means test is not infallible. As noted above,[14] it measures income by averaging the debtor's income from the six months before filing bankruptcy. Whenever a debtor's income has been permanently reduced shortly before filing, this six-month average income will be higher than what the debtor actually has available.[15] And wherever the means test has a fixed allowance for a given expense, that allowance has the potential for being lower than what the debtor actually needs.

Thus, the provision for rebuttal in §707(b)(2)(B) reflects reality. It also brings into effect Rule 301 of the Federal Rules of Evidence. Under this rule, if a debtor contests a means-test presumption of disposable income by introducing evidence showing lower total income or higher necessary deductions, the party moving for relief under §707(b)(1) has the burden of showing actual disposable income at or above the abuse threshold. In such a situation, the court presiding over the contested motion determines—independent of the means-test measurements—the total income actually available to the debtor and the expenditures that the debtor must actually make to provide for reasonable support and pay secured and priority debts.

The status of the means test as a presumption has one final—and critical—feature. A presumption is merely one method of establishing a fact necessary to obtain relief. Where a presumption does not arise, the party seeking relief may prove the necessary fact directly, using the same kind of evidence that could be used to establish the fact in connection with a rebuttal of

9 *Cf.* 11 U.S.C. §1325(b)(2) (providing a similar definition of "disposable income" for use in chapter 13).

10 *See* 11 U.S.C. §110(10A) (defining "current monthly income" as the monthly average of income from all sources that the debtor receives, derived in the six calendar months prior to filing bankruptcy).

11 Park, Roger C., Leonard, David P. and Goldberg, Steven H., *Evidence Law* §4.08 at 106-07 (2004); *see, also, McCormick on Evidence* §342 (5th ed. 2003) (providing a similar explanation of presumptions).

12 *See McCormick on Evidence* §343 (5th ed. 2003); *see, e.g.,* 750 Ill. Comp. Stat. 45/5(a)(1) (2002).

13 *See, e.g.,* 750 Ill. Comp. Stat. 45/5(b) (2002), providing for rebuttal of the marital paternity presumption by clear and convincing evidence.

14 *See* n.9, *supra.*

15 *See* Wedoff, *supra* note 6 at 248-51 (giving examples of situations in which the defined "current monthly income" differs greatly from actually available income).

the presumption. A party asserting abuse under §707(b)(1) may seek to prove that the debtor's actual disposable income is at or above the abuse threshold, even if the means-test presumption does not arise, using the same type of evidence that would be presented if the debtor sought to show that the means-test presumption was inaccurate.

So, for example, a debtor subject to a means-test presumption might try to rebut it by showing housing expenses higher than what the means test allows, perhaps due to special assessments on a condominium or unusually high property taxes.[16] Conversely, a movant seeking to establish that the debtor's actual disposable income is above the abuse threshold might introduce evidence that the debtor owned a home in a community with very low property taxes, so that the debtor's actual home ownership expense was less than what the means test allowed. In either situation, the court would determine the debtor's actual housing expenses, using the same kind of evidence under the same judicially determined standards.

The language of §707(b), far from rejecting this conclusion, compels it. There is no provision in §707(b) stating that the means test is the only method through which the debtor's disposable income can be established. To the contrary, §707(b)(3) explicitly states that, in the absence of the means-test presumption, "the court shall consider...whether...the totality of the circumstances...of the debtor's financial situation demonstrates abuse." Given that the means test is directed at measuring debt-paying ability as a presumption, this direction confirms that where the presumption does not arise, the debtor's actual debt-paying ability must be assessed in ruling on a motion under §707(b)(1).

Guidance from the Means Test on Nonpresumptive Abuse

When judges assess the totality of a debtor's financial circumstances under §707(b)(3) for purposes of determining whether the debtor is abusing chapter 7, they will not be exploring a wilderness. As noted above, "totality of the circumstances" itself is a judicially created construct for determining "substantial abuse" under pre-BAPCPA §707(b), and the case law applying that concept lays out the general scope of the abuse to be determined.[17] The case law interpreting "disposable income" in chapter 13—an issue since 1984—provides another source of helpful precedent.[18] But the detailed provisions of the means test may also provide guidance in assessing the ability to pay that BAPCPA treats as abuse. Each of the elements of the means test, its threshold of abuse, its assessment of "current monthly income" and its allowed deductions—as well as its treatment of exempt property—can be examined for potential policy indications.

The Abuse Threshold

The clearest guidance from the means test is on the question of how much disposable income should lead to a finding of abuse. The abuse threshold set out in §707(b)(2)(A)(i) is irrebuttable. Section §707(b)(2)(B) only allows a debtor to rebut the means test's calculation of disposable income in an amount above the abuse threshold; it does not allow any argument that the threshold itself is too low. Disposable income of more than $166.66 per month, or disposable income of at least $100 per month, sufficient to pay 25 percent of the debtor's nonpriority unsecured debt in five years, is always an abuse requiring a denial of chapter 7 relief.[19] Since the abuse threshold cannot be challenged within the means test, there is a clear policy judgment that the threshold fixes the level at which debt-paying ability becomes abusive of chapter 7. When judges are required to make determinations of abuse under §707(b)(3), they should accordingly use the means-test threshold: If a debtor's actual disposable income, determined by the court, is below that threshold, there should be no finding of abuse based on debt-paying ability; if disposable income meets or exceeds the threshold, abuse should be found.

"Current Monthly Income"

Just as the abuse threshold is the aspect of the means-test presumption that most clearly should be incorporated into judicial determinations of nonpresumptive abuse, "current monthly income" is the aspect of the means test that most clearly should not be. When the court is determining the income that a debtor actually has available to pay nonpriority unsecured debt, it would be absurd to start with a total income figure that does not reflect the debtor's actual total income. Although an average of the debtor's income during the six months before bankruptcy can serve as a rough approximation of actual total income for purposes of the means-test presumption, it plainly will not be accurate in many situations.[20] Under §707(b)(2)(B), debtors can rebut a means-test presumption based on inaccurately high "current monthly income" by showing their actual monthly income during the bankruptcy case; judges assessing actual debt-paying ability under §707(b)(3) should likewise begin with an assessment of the debtor's actual total income. Thus, in the situation of a debtor who obtained new permanent employment shortly before filing bankruptcy, the salary of the new job—not average earnings during the prior six months—would be the relevant consideration.

A separate consideration is whether income items excluded from the definition of current monthly income in §101(10A)—most notably benefits under the Social Security Act—should be omitted from the actual income assessed by the court under §707(b)(3). It can be argued that the exclusion of Social Security Act benefits reflects a policy of protecting retirement income from creditors.[21] On the other hand, when a court makes a determination of actual disposable income, the special needs of retired persons can appropriately be dealt with by allowing increased deductions from income for

16 The means test uses housing allowances specified by the Internal Revenue Service as part of its Collection Financial Standards for collecting delinquent taxes. The housing allowance is based on a county-wide average and does not take into consideration the fact that costs in individual communities (or condominium developments) may vary greatly from the county average. *See* Wedoff, *supra* note 6 at 259-60 (discussing anomalies caused by county-wide averaging).

17 The Culhane/White article does not appear to propose any alternative definition of "totality of the circumstances...of the debtor's financial situation." At one point, it states that the phrase "must be read as limited to serious debtor misconduct." Culhane/White, *supra* note 7 at 666. At another, it suggests that the phrase "should encompass debtor actions...not illegal or necessarily dishonest [but] nonetheless manifestly unreasonable under the debtor's circumstances." *Id.* at 687. Neither of these suggestions is supported by any textual analysis and—wholly apart from the contrary case law—it is difficult to see how the "totality" of the circumstances bearing on a debtor's financial situation can be shriveled up to address only certain debtor misconduct. Indeed, since §707(b)(3) sets out "bad faith" as a ground for finding abuse separate from the "totality of the [debtor's financial] circumstances," it strongly suggests that debtor misconduct of any kind should be treated under "bad faith" rubric, leaving the "totality of the circumstances" to address the debtor's financial status—including disposable income most prominently.

18 The relevant case law is collected and discussed in Lundin, Keith M., *Chapter 13 Bankruptcy* §§163.1 -167.1 (3d ed. 2004).

19 However, the dollar amounts in §707(b) are subject to periodic adjustment for inflation under 11 U.S.C. §104(b)(1), and so the abuse threshold will likely rise over time.

20 *See* note 15, *supra*.

21 *See* Culhane/White, *supra* note 7 at 676.

food, health care, housing, transportation and other items potentially affected by age or disability. The means test's exclusion of Social Security Act benefits may well have served as a proxy for this sort of individualized determination of the needs of retirees and be inappropriate in a determination of actual disposable income. Social Security Act benefits are certainly part of the "totality" of the debtor's financial circumstances, and these benefits are available for paying expenses (and unsecured nonpriority debt) just as much as other income. The plain meaning of §707(b)(3) thus should be applied, requiring that Social Security Act benefits be considered in gauging nonpresumptive abuse.

Allowed Deductions

Turning from income to deductions, it is notable that most of the living expense deductions specified by the means test are limited to amounts "reasonable and necessary." These include expenses in the "other necessary expense" categories listed by the Internal Revenue Service, allowed as deductions by §707(b)(2)(A)(ii)(I),[22] as well as the special statutory deductions allowed by §707(b)(2)(A)(ii)(I)-(V) in addition to the IRS deductions.[23] The "reasonable and necessary" limitation of these allowances provides for judicial discretion to be exercised even when the allowances are used in the means test; that discretion would apply similarly in determining nonpresumptive abuse under §707(b)(3). Nevertheless, the inclusion of expenses in these categories as allowable deductions in the means test does have at least one impact on the nonpresumptive determination: Expenses in each of the categories must be recognized as at least potentially reasonable. Thus, a court would not be justified in concluding that contributions to health savings accounts are never necessary expenses, since "reasonably necessary" expenses of this kind are specifically allowed as deductions in §707(b)(2)(A)(ii)(I). On the other hand, where the statute limits the amount of the deduction for purposes of the means test—as in the annual limit of $1,500 per minor child for private elementary or secondary school—a court could find that a higher expenditure was reasonably necessary, both in determining actual disposable income under §707(b)(3) or in rebuttal of a means-test presumption under §707(b)(2)(B).

A more significant issue arises in connection with deductions for living expenses that the means test allows in fixed amounts. Under §707(b)(2)(A)(ii)(I), the means test allows deductions for food, clothing, housekeeping supplies, personal care and miscellany in a lump sum fixed by the "National Standards" of the IRS.[24] Deductions for housing and transportation are similarly allowed in amounts fixed by the IRS's "Local Standards."[25] Since these amounts do not vary with the debtor's actual needs, the means test's allowances for these expenses may well be inaccurate as applied in a given case.[26] Thus, judges would not be bound to accept them, either in means-test rebuttals or nonpresumptive determinations of abuse.

Perhaps the most debatable aspect of the means-test deductions is the unlimited one for current secured debt payment. As set out in §707(b)(2)(A)((iii)(I), the means test provides a deduction for 1/60 of "the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition." This allowance is not subject to any "reasonable and necessary" limitation and so, for purposes of the means test, debtors may deduct debt secured by vacation homes, pleasure boats and other items manifestly not necessary—and even include the entire amount of balloon mortgages in the secured debt amount that is divided by 60, as long as the mortgage became due in the five years following bankruptcy.

As with the exclusion of Social Security Act benefits from current monthly income, it can be argued that this secured-debt deduction reflects a general policy of BAPCPA—here, a policy favoring secured creditors over unsecured—so that in assessing the totality of the debtor's financial circumstances, a court should allow the full deduction for secured debt payments that the means test specifies.[27] However, as with its treatment of Social Security Act benefits, the means test's secured-debt deduction can more reasonably be understood as a proxy for more individualized determinations. Certainly, the means test evidences no policy that all secured obligations be repaid rather than enforced through repossession or foreclosure. To the contrary, if a debtor is in default, the means test allows a deduction for cure payments needed to retain the collateral only if the collateral is reasonably necessary for support of the debtor or the debtor's dependents.[28] The means test thus appears to use current payment status as a rough measure of the debtor's need for particular collateral, reflecting a judgment that debtors are less likely to default on loans secured by collateral necessary for their support. When an individualized determination of the totality of a debtor's financial circumstances is conducted, such presumptions are not appropriate, and the debtor's real need for collateral, whether or not the loan is in default, can properly be considered.

Exempt Property

The means test says nothing about the extent of a debtor's property, either exempt or nonexempt. However, in determining presumptive disposable income, the means test's starting point, current monthly income, includes income "from all sources...without regard to whether such income is taxable."[29] Thus, the means test requires inclusion of income received from any number of exempt sources, such as retirement accounts and life insurance proceeds.[30] This is in keeping with pre-BAPCPA case law, which considered exempt income in determining "substantial abuse."[31]

Consistent with the means test,

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22 *See* Wedoff, *supra* note 6 at 261-64.

23 *See Id.* at 264-71.

24 *See Id.* at 253-55.

25 *See Id.* at 255-61.

26 *See, e.g.,* the potential variances in housing costs discussed *supra* at note 7 and the accompanying text.

27 *See* Culhane/White, *supra* note 7 at 674.

28 *See* 11 U.S.C. §707(b)(2)(A)(iii)(II).

29 11 U.S.C. §101(10A)(A).

30 Tax-exempt retirement funds are generally exempted from a debtor's bankruptcy estate under 11 U.S.C. §522(a)(3)(C), added by BAPCPA. A debtor's right to receive life insurance proceeds from a former supporter of the debtor is part of a debtor's federal bankruptcy exemptions. *See* 11 U.S.C. §522(d)(11)(C). Section 541(b)(7)(B) provides that contributions made by debtors to certain retirement plans will not constitute current monthly income for purposes of chapter 13, but this limitation does not apply in chapter 7 and would not affect distributions from the retirement account in any event. The Culhane/White article appears to misconstrue §541(b)(7)(B) on this point. *See* Culhane/White, *supra* note 7 at 690 n.111.

then, a court determining actual disposable income under the "totality of the circumstances" may take into account the extent of a debtor's exempt property in determining the actual expenses that the debtor is required to incur. For example, the expenses incurred by a debtor for transportation can vary depending on the extent to which the debtor's automobile is exempt. If a debtor owns a valuable, lien-free automobile that can be fully exempted in bankruptcy, it is unlikely that the debtor would need to incur any vehicle-acquisition costs for the period after a bankruptcy filing, thus eliminating an expense allowed in the means test.[32] However, if the automobile could not be exempted, it would likely be sold by a chapter 7 trustee, eliminating any concern that the debtor's ownership of the vehicle was an abuse of chapter 7 and justifying a deduction for vehicle acquisition expenses in calculating actual disposable income. Pre-BAPCPA case law recognized the reality that the extent of debtors' exempt property can bear on their debt-paying ability.[33] There is no policy inherent in the means test that would prevent a court from considering the extent of exempt property in making a nonpresumptive determination of abuse under §707(b)(3).

Conclusion

Let's return to the recently re-employed CEO hypothesized at the beginning of this article. Despite his new salary, huge home and ample retirement accounts, he could pass the means test. However, he does not thereby evade consideration of his actual disposable income under §707(b)(3). If, as is highly likely, his actual disposable income is at the abuse threshold, the CEO will either have to pay his debts outside of bankruptcy or obtain a discharge through a payment plan under chapter 11 or 13.

In this hypothetical, the means test itself failed to accomplish the goal of its sponsors. And situations like the hypothetical will arise not infrequently, since the means test is inefficient in identifying likely abuse of chapter 7. However, BAPCPA did not exacerbate this flaw by making the absence of a means-test presumption conclusive of debt-paying ability. Section 707(b)(3) requires judges, when an abuse motion is raised, to determine the debtor's actual financial condition, including debt-paying ability. Ultimately, even when the means test does not presume abuse, genuinely wealthy debtors may be denied chapter 7 relief. ■

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31 *See, e.g., Taylor v. United States (In re Taylor),* 212 F.3d 395, 396 (8th Cir. 2000) ("The question of whether income from a pension is exempt from creditors is a wholly independent inquiry from the question of whether the pension income is reasonably necessary to support the debtor"); *In re Shields,* 322 B.R. 894, 898 (Bankr. M.D. Fla.) ("Social security benefits, disability benefits and retirement benefits should be treated as 'income' for purposes of determining whether a debtor has 'disposable income'...even though such benefits are exempt from the claims of the debtor's creditors").

32 *See* Wedoff, *supra* note 6 at 257-58.

33 *See, e.g., In re Kornfield,* 164 F.3d 778, 781 (2d Cir.1999) ("A totality-of-the-circumstances inquiry is equitable in nature, and the existence of an asset, even if exempt from creditors, is relevant to a debtor's ability to pay his or her debts").