



## MEANS TESTING AND SECTION 707 MOTIONS

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The 2005 Bankruptcy Act amends § 707(b) of the Code by adopting a “means test” formula to determine whether a debtor is presumed ineligible for a chapter 7 discharge.<sup>2</sup> Unlike current § 707(b) which screens for “substantial abuse” by comparing the debtor’s actual living expenses to income, the means test formula uses pre-determined budget amounts for certain expense items based on the Internal Revenue Service’s collection guidelines. The 2005 Act also makes several changes concerning the general abuse provisions in § 707(b). As under current law, the general abuse provisions (as well as the new presumption of abuse under the means test) apply only to a chapter 7 debtor whose debts are primarily consumer debts.<sup>3</sup>

### **No Means Test For Debtors Below Their State’s Median Family Income**

Debtors with incomes below their state’s median family income will not be subjected to the means test. New § 707(b)(7) provides that the bankruptcy judge, trustee (or bankruptcy administrator), and other parties in interest are prohibited from filing a motion seeking to apply the means test if the debtor’s current monthly income multiplied by 12 is equal to or less than the highest median family income for the debtor’s state as

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<sup>2</sup> 11 U.S.C. § 707(b)(2), added by Pub. L. No. 109-8 (2005), effective as to cases filed on or after October 17, 2005. Section 102 of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub L. 109-8 (2005).

<sup>3</sup> *E.g.*, *In re Stewart*, 175 F.3d 796 (10th Cir. 1999) (alimony debts, loan from father-in-law and some student loans used for living expenses were consumer debts); *Matter of Booth*, 858 F.2d 1051 (5th Cir. 1988) (test for whether a debt is a business obligation is whether debt was incurred with an eye toward profit; court looked to dollar amounts of debts rather than number of creditors to decide if debts primarily consumer debts); *In re Marshalek*, 158 B.R. 704 (Bankr. N.D. Ohio 1993) (debt arising from motor vehicle accident was not consumer debt); *In re Restea*, 76 B.R. 728 (Bankr. D.S.D. 1987) (debts not primarily consumer debts where 53 percent of debts were consumer debts); *In re Bell*, 65 B.R. 575 (Bankr. E.D. Mich. 1986) (applying numerical test in comparing amount of consumer debts to amount of business debts); *In re Campbell*, 63 B.R. 702 (Bankr. W.D. Mo. 1986) (principal liability of debtor was business debt); *In re Almendinger*, 56 B.R. 97 (Bankr. N.D. Ohio 1985). *But see In re Berndt*, 127 B.R. 222 (Bankr. D.N.D. 1991) (unsecured credit card debt used to invest in stock market is a consumer debt).

reported by the Bureau of the Census. This has been referred to as the Act's "second safe harbor."<sup>4</sup>

**A. Current Monthly Income.** The first step in determining whether the debtor falls within the safe harbor is to calculate the debtor's "current monthly income." The Act adds new § 101(10A) which defines "current monthly income" as the monthly average of all income (whether or not taxable) received by the debtor during the 6 month period ending on the last day of the calendar month preceding the bankruptcy filing. In addition to the debtor's gross wages, salary and commissions, income includes amounts paid to the debtor on a "regular basis" for household expenses of the debtor or the debtor's dependents.<sup>5</sup> It does not include benefits received under the Social Security Act<sup>6</sup> and payments to victims of war crimes, crimes against humanity, and acts of terrorism.

The Advisory Committee on Bankruptcy Rules could not agree whether unemployment compensation is a "benefit received under the Social Security Act," and therefore the new form Statement of Current Monthly Income and Means Test Calculation takes no position on whether it should be excluded from current monthly income. Instead, the form provides an alternative in which the debtor can list unemployment compensation as countable income or list it separately and not counted if the debtor "contends" it is a benefit under the Social Security Act.<sup>7</sup>

Since income is not otherwise defined by the legislation, and the safe harbor test compares the debtor's income to the Census Bureau median family income figures, courts may defer to the Census Bureau's definition of income to the extent there are questions not specifically addressed by the Code's definition of "current monthly income."<sup>8</sup> Thus, forms of payment to the debtor that are a substitute for wages earned as salary or hourly compensation will likely be considered, but income for this test should not include fringe benefits or other compensation in which no direct payment is made to the debtor, such as an employer's contribution to a debtor's health insurance or pension plan.

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<sup>4</sup> H. Rep. 109-31, 51 (2005).

<sup>5</sup> 11 U.S.C. § 101(10A)(B). The definition would appear to exclude child support received on a sporadic basis.

<sup>6</sup> Payments under the Social Security Act would include for example Supplemental Security Income (SSI) and other disability benefits, public assistance and foster care benefits, unemployment benefits, and benefits to families under certain social services block grants.

<sup>7</sup> See Interim Official Form B22A and Committee Note.

<sup>8</sup> The Census Bureau defines "total income" as "the sum of the amounts reported separately for wages, salary, commissions, bonuses, or tips; self-employment income from own nonfarm or farm businesses, including proprietorships and partnerships; interest, dividends, net rental income, royalty income, or income from estates and trusts; Social Security or Railroad Retirement income; Supplemental Security Income (SSI); any public assistance or welfare payments from the state or local welfare office; retirement, survivor, or disability pensions; and any other sources of income received regularly such as Veterans' (VA) payments, unemployment compensation, child support, or alimony."

If a joint case is filed, current monthly income would include all income received by the debtor and the debtor's spouse. Contrary to the Code's definition of "current monthly income," if a married debtor files alone, the nondebtor spouse's income is considered for purposes of the safe harbor test unless the debtor files a statement under oath that the debtor and the debtor's spouse are separated (and the separation is not for the purpose of evading the means test).<sup>9</sup> As noted earlier, an amount representing regular contributions to the debtor's household expenses from family members or unrelated individuals who may or may not be living with the debtor would be counted as income to the debtor.<sup>10</sup>

**B. Median Family Income.** The next step is to take the debtor's current monthly income multiplied by 12 and compare this with the Census Bureau figures for the state's highest median family income. The Census Bureau calculates and reports state median income by family size only after each decennial census and not as part of the annual surveys. As a result, the definition of "median family income" in § 101(39A) provides that if the Census Bureau figures are not available for the year in which the case is filed, the most recent figures are used and then adjusted by the percentage change in the Consumer Price Index for All Urban Consumers "during the period of years occurring after such most recent year and before such current year." Thus, a case filed in 2005 would use the 2000 decennial Census figures, which were calculated based on 1999 data, adjusted by the CPI percentage change to 2004.<sup>11</sup> The Executive Office of United States Trustee (EOUST) has provided on its website a chart of median income figures that are to be used for cases filed after October 17, 2005.<sup>12</sup>

While the Census Bureau median *family* income figures are used, § 707(b)(7) applies the safe harbor test by referencing *household* size. In the case of a "debtor in a household of 1 person," if the debtor's current monthly income as of the petition date multiplied by 12 is equal to or less than the median family income of the applicable State for "1 earner,"<sup>13</sup> the means test does not apply. In the case of a "debtor in a household of 2, 3, or 4 individuals," if the debtor's current monthly income multiplied by 12 is equal to or less than the median family income of the applicable State "for a family of the same

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<sup>9</sup> 11 U.S.C. § 707(b)(7)(B). See Line 2 of Interim Official Form B22A.

<sup>10</sup> See Line 2 of Interim Official Form B22A.

<sup>11</sup> A chart from the Dept. of Labor's website showing the changes to the CPI for All Urban Consumers is available at: <http://www.bls.gov/cpi/home.htm#overview>. This chart shows that the annual index was 166.6 for 1999 and 188.9 for 2004, resulting in a 22.3 change in index points and a 13.4 percent change.

<sup>12</sup> See [http://www.usdoj.gov/ust/bapcpa/bci\\_data/median\\_income\\_table.htm](http://www.usdoj.gov/ust/bapcpa/bci_data/median_income_table.htm).

<sup>13</sup> The Act uses the phrase "1 earner" because the decennial census reports median family income in a data set that covers only 2-person and larger families (e.g., PCT118. MEDIAN FAMILY INCOME IN 1999 (DOLLARS) BY FAMILY SIZE). The Act therefore had to reference another Census Bureau data set that tracks median incomes for workers (e.g., PCT115. MEDIAN FAMILY INCOME IN 1999 (DOLLARS) BY NUMBER OF WORKERS IN FAMILY IN 1999).

number or fewer individuals,” the means test does not apply. Since the Act does not define “household,” courts may use the Census Bureau definition.<sup>14</sup>

Because the Census Bureau figures for median family income in many states decline when family size is greater than 4, the Census figures for larger family sizes are not used. Section 707(b)(7) provides that if the household has more than 4 family members, the highest median income for a family of 4 shall be used, plus \$525 per month for each additional family member.<sup>15</sup>

If the debtor’s current monthly income falls below the state’s median family income, the debtor is protected by the safe harbor and the means test will not apply. All debtors whose debts are primarily consumer debts, all individual debtors in chapter 11, and all chapter 13 debtors are required to prepare and file a Statement of Current Monthly Income and Means Test Calculation, which is included in the Interim Rules and Forms adopted by the Judicial Conference for implementation of the 2005 Act.<sup>16</sup> In Part II of the Statement, the debtor lists the income information used in calculating current monthly income for the § 707(b)(7) safe harbor. If this current monthly income amount is below the state median income, as reflected on Part III of the Statement, the debtor is not required to fill out the remaining means test calculations in Part IV through VII of the form.

**C. Disabled Veterans.** The Act creates a separate safe harbor from the means test for debtors who are disabled veterans (as defined in 38 U.S.C. § 3741(1), if their “indebtedness occurred primarily” during a period when they were on active duty or “performing a homeland defense activity.”<sup>17</sup> Such debtors will not be required to file a statement concerning the means test calculations.<sup>18</sup>

## **Overcoming Presumption of Abuse When Safe Harbor Does Not Apply**

If the debtor is not protected by the safe harbor and has primarily consumer debts, the debtor’s income and expenses are plugged into the means test formula to determine whether a presumption of abuse exists.

**A. Current Monthly Income.** On the equation’s income side, the formula once again looks to the debtor’s “current monthly income.” This income figure is used even if some or all of the income counted during the 6-month test period is no longer available to the debtor because of job loss, temporary disability or seasonal employment. If a

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<sup>14</sup> The Census Bureau adopts the following distinction between family and household: “A family consists of two or more people, one of whom is the householder, related by birth, marriage, or adoption and residing in the same housing unit. A household consists of all people who occupy a housing unit regardless of relationship. A household may consist of a person living alone or multiple unrelated individuals or families living together.”

<sup>15</sup> This dollar amount will be adjusted for inflation pursuant to amendments to Code § 104(b). See § 102(j) of S.256.

<sup>16</sup> See Interim Official Form B22A.

<sup>17</sup> 11 U.S.C. § 707(b)(2)(D).

<sup>18</sup> See Line 2 of Interim Official Form B22A.

presumption of abuse arises due to this phantom income and a motion to dismiss is filed, the debtor will need to request that the court ignore the income definition, arguing that the unavailable income creates “special circumstances” that rebuts the presumption of abuse.<sup>19</sup>

**B. Monthly Deductions.** Section 707(b)(2)(A) provides a list of the debtor’s monthly expenses that are effectively deemed to be reasonable for purposes of the abuse analysis. For some items, budget amounts are determined based on the three categories of allowable expenses provided for in the Internal Revenue Service’s collection guidelines: National Standards, Local Standards, and Other Expenses.<sup>20</sup> Other budget items may be an allowable expense based on the debtor’s actual expenditures if they fall within one of the categories specifically referenced in the statute.

**Deductions Provided for Under IRS Guidelines** - The following items are provided for under the IRS guidelines:

- 1. IRS National Standards** - These standards provide for the debtor’s allowable living expenses in 5 categories: food, clothing and services, housekeeping supplies, personal care products and services, and miscellaneous items.<sup>21</sup> The expense amounts under the standard vary depending upon the debtor’s family size and gross income (debtors earning more are allowed higher expenses).<sup>22</sup> The following are the National Standard expenses for a family of 4 (effective January 1, 2005):

<b>Four Persons National Standards Based on Gross Monthly Income</b>								
<b>Item</b>	<b>less than \$833</b>	<b>\$833 to \$1,249</b>	<b>\$1,250 to \$1,666</b>	<b>\$1,667 to \$2,499</b>	<b>\$2,500 to \$3,333</b>	<b>\$3,334 to \$4,166</b>	<b>\$4,167 to \$5,833</b>	<b>\$5,834 and over</b>
Food	468	525	526	527	528	640	722	868

<sup>19</sup> 11 U.S.C. § 707(b)(2)(B). A more detailed discussion of the requirements for rebutting the presumption is provided later in this article.

<sup>20</sup> The IRS developed these standards as guidelines for its own debt collectors, subject to individual collector’s exercise of discretion and consideration of exceptions. The IRS Financial Analysis Handbook provides an overview of the collection standards and is available at : <http://www.irs.gov/irm/part5/ch14s01.html#d0e120202>. Sec. 103 of S.256 suggests as a “sense of Congress” that the IRS has authority to alter the standards to “accommodate their use under section 707(b).”

<sup>21</sup> The IRS National Standards for Allowable Living Expenses are available at: <http://www.irs.gov/businesses/small/article/0,,id=104627,00.html>. A separate standard is used for is Alaska and Hawaii.

<sup>22</sup> See Line 19 of Interim Official Form B22A.

<b>Four Persons National Standards Based on Gross Monthly Income</b>								
<b>Item</b>	<b>less than \$833</b>	<b>\$833 to \$1,249</b>	<b>\$1,250 to \$1,666</b>	<b>\$1,667 to \$2,499</b>	<b>\$2,500 to \$3,333</b>	<b>\$3,334 to \$4,166</b>	<b>\$4,167 to \$5,833</b>	<b>\$5,834 and over</b>
Housekeeping supplies	42	43	44	50	54	61	109	110
Apparel & services	146	169	170	171	174	189	217	317
Personal care products & services	37	42	43	45	46	53	62	81
Miscellaneous	188	188	188	188	188	188	188	188
<b>Total</b>	<b>\$881</b>	<b>\$967</b>	<b>\$971</b>	<b>\$981</b>	<b>\$990</b>	<b>\$1,131</b>	<b>\$1,298</b>	<b>\$1,564</b>

These amounts become the expenses for the debtor, the debtor’s dependents and the debtor’s spouse in a joint case, regardless of the amounts actually paid for such items. For example, a debtor with special dietary requirements prescribed by her doctor for health reasons having an actual food bill of \$350 per month will be limited to the IRS standard of \$258 per month (based on debtor with gross monthly income of \$1,667 to \$2,499). Section 707(b)(2)(A)(ii)(I) provides that a debtor can seek an additional allowance for food and clothing of up to 5% if the debtor can demonstrate that this is “reasonable and necessary.”<sup>23</sup> In this example, petitioning the court would at best result in a mere additional \$13 in the food allowance.<sup>24</sup>

- 2. IRS Local Standards for Housing and Utilities** - This category provides the allowable living expenses for housing and utilities.<sup>25</sup> Unlike the National Standards, the expense amounts are provided based on the state and county in which the debtor resides. For example, California debtors are provided a housing and utility allowance of \$987 per month (for family of 4) if living in Modoc County and \$2,874 if living in San Mateo County. Like the National Standards, the IRS figure for housing and utilities is the expense amount used in the means test formula even if the debtor’s actual rent and utilities are higher.

<sup>23</sup> See Line 39 of Interim Official Form B22A. The form indicates that the debtor must provide the trustee with documentation demonstrating that the additional amount claimed is reasonable and necessary.

<sup>24</sup> If a presumption of abuse arises for this debtor and a motion to dismiss is filed, this debtor may be better advised to rebut the presumption by seeking allowance of her total food expense under the “special circumstances” provision. See § 707(b)(2)(B).

<sup>25</sup> The IRS Housing and Utilities Allowable Living Expenses are available at: <http://www.irs.gov/businesses/small/article/0,,id=104696,00.html> (then search by state).

The IRS Financial Analysis Handbook states that “taxpayers will be allowed the local standard or the amount actually paid, whichever is less.” However, since new § 707(b)(2)(A)(ii)(I) states that the debtor’s expenses shall be the “applicable monthly expense amounts specified” under the IRS standards, as compared to the debtor’s “actual monthly expenses” for items specified as Other Necessary Expenses, the statutory language may be interpreted as allowing the full local housing and utilities standard even if the debtor’s actual expense is less.

The IRS housing and utilities standard is a lump-sum amount that has not historically been broken down between the separate housing and utilities components. However, the EOUST has published on its website the housing standards to be used for bankruptcy purposes separated into two categories: “non-mortgage” and “mortgage/rent.”<sup>26</sup> The most recent version of Interim Official Form B22A has been modified to provide for the separate allowances.<sup>27</sup> Section 707(b)(2)(A)(ii)(V) provides that a debtor may seek an additional allowance in excess of the IRS standard based on the debtor’s actual expenses for “home energy costs.”<sup>28</sup> The debtor must provide documentation of the actual expenses and demonstrate that such expenses are “reasonable and necessary.”<sup>29</sup>

- 3. IRS Local Standards for Transportation** – The IRS transportation standards differentiate between Ownership Costs, Operating Costs and Public Transportation Costs.<sup>30</sup> The Ownership Costs expense is provided as a national standard that is the same no matter where the debtor resides.<sup>31</sup> Based on the updated 2005 figures, the debtor is permitted an ownership expense of \$475 for the first car and \$338 for the second car. This IRS standard does not include personal property taxes, but this may be deducted under the “Other Expenses” category discussed below.<sup>32</sup>

The Operating Costs and Public Transportation Costs sections of the IRS transportation standards are provided by Census Region and Metropolitan Statistical Area (MSA).<sup>33</sup> A table provided on the IRS website lists the states that are included within each Census Region.<sup>34</sup> If the debtor lives within an

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<sup>26</sup> See <http://www.usdoj.gov/ust/bapcpa/meanstesting.htm>.

<sup>27</sup> See Lines 20A and 20B of Interim Official Form B22A.

<sup>28</sup> The phrase “home energy costs” is not defined. The IRS Financial Analysis Handbook describes “utilities” as including “gas, electricity, water, fuel, oil, bottled gas, trash and garbage collection, wood and other fuels, septic cleaning, and telephone.”

<sup>29</sup> See Line 37 of Interim Official Form B22A.

<sup>30</sup> The IRS Allowable Living Expenses for Transportation are available at: <http://www.irs.gov/businesses/small/article/0,,id=104623,00.html>.

<sup>31</sup> See Line 23 of Interim Official Form B22A.

<sup>32</sup> See IRS Financial Analysis Handbook, § 5.15.1.10.

<sup>33</sup> See Line 22 of Interim Official Form B22A.

<sup>34</sup> See <http://www.irs.gov/businesses/small/article/0,,id=104623,00.html>.

MSA (MSAs are defined by county and city), the MSA standard is applicable. If the debtor does not reside in an MSA, the regional standard is used. A dollar amount is provided based on whether the debtor has “no car,” “one car,” or “two cars.” For example, if the debtor lives in the Midwest Region and does not live in a MSA such as Chicago or St. Louis, the debtor would be allowed (based on 2005 figures): \$194 for public transportation costs if no car, \$251 for operating costs if one car is owned, and \$345 if two cars are owned. If the debtor lives in the Chicago MSA, the allowances are \$257 for public transportation costs, \$329 operating costs for one car, and \$422 for two cars.

4. **IRS Other Necessary Expenses** - New § 707(b)(2)(A)(ii)(I) also provides that the debtor may deduct the “actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service.” Since the legislative history makes clear that the IRS list of Other Necessary Expenses is “non-exclusive,” courts should have discretion to determine that other expenses necessary to a debtor’s health and welfare may be deducted in this category.<sup>35</sup> Items listed in the IRS Financial Analysis Handbook for Other Necessary Expenses include, but are not limited to: accounting and legal fees, child care, charitable contributions, court-ordered payments (alimony, child support, etc.), dependent care (including care of elderly or handicapped), taxes, internet provider/e-mail, health care, education, involuntary deductions (*i.e.*, union dues, uniforms), life insurance, optional telephones and telephone services (*i.e.*, cell phone, pager, call waiting), certain secured and unsecured debts,<sup>36</sup> and repayment of loans made for payment of federal taxes.<sup>37</sup>

**Other Expense Items That May Be Deducted** - In addition to expenses covered under the IRS guidelines, new Code § 707(b)(2)(A) and § 707(b)(1) provide a list of expense items that may be deducted from the debtor’s current income. Some of these items are covered under the IRS guidelines and presumably would not be double counted. These items include:

1. **Health Insurance** - The debtor’s monthly 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.<sup>38</sup>

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<sup>35</sup> H. Rep. 109-31, 14, n. 66 (2005).

<sup>36</sup> Section 707(b)(2)(A)(ii)(I) provides that: “Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts.” However, payments on secured and priority debts are an allowed expense pursuant to provisions in other clauses of new § 707(b)(2)(A).

<sup>37</sup> A complete list of expenses with full descriptions can be found in the IRS Financial Analysis Handbook, § 5.15.1.10, available at <http://www.irs.gov/irm/part5/ch14s01.html#d0e120202>.

<sup>38</sup> 11 U.S.C. § 707(b)(2)(A)(ii)(I). See Line 34 of Interim Official Form B22A.

- 2. Expenses to Maintain Safety from Domestic Violence** - The debtor's monthly expenses shall include the debtor's "reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 309 of the Family Violence Prevention and Services Act, or other applicable Federal law."<sup>39</sup> The legislation specifies that these expenses "shall be kept confidential by the court."
- 3. Support for Elderly and Disabled Family Members** - The debtor's expenses may include actual expenses paid by the debtor that 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 (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent).<sup>40</sup> The debtor must show that these individuals are unable to pay the expenses on their own. Since the statutory language provides for the "continuation" of these payments, the debtor will likely need to establish some record of payments on these expenses that predates the petition.
- 4. Administrative Expenses** - The debtor's monthly expenses may include the actual administrative expenses of administering a chapter 13 plan in the debtor's district, up to an amount of 10 percent of the projected plan payments.<sup>41</sup> The legislation requires the Executive Office for United States Trustees to issue a schedule of such expenses.<sup>42</sup>
- 5. Education Expenses** - The debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed \$1,500 per year per child, to attend a private or public elementary or secondary school.<sup>43</sup> The debtor must provide documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the IRS National Standards, Local Standards, or Other Necessary Expenses.
- 6. Secured Debt** - The debtor may also deduct the average monthly payments made on secured debts.<sup>44</sup> This amount is determined by taking the sum of (1) 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,<sup>45</sup> plus (2)

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<sup>39</sup> 11 U.S.C. § 707(b)(2)(A)(ii)(I). *See* Line 36 of Interim Official Form B22A.

<sup>40</sup> 11 U.S.C. § 707(b)(2)(A)(ii)(II). *See* Line 35 of Interim Official Form B22A.

<sup>41</sup> 11 U.S.C. § 707(b)(2)(A)(ii)(III). *See* Line 45 of Interim Official Form B22A.

<sup>42</sup> The EOUST has published on its website the multiplier for each district. *See* [http://www.usdoj.gov/ust/bapcpa/mt/ch13\\_exp\\_mult.htm](http://www.usdoj.gov/ust/bapcpa/mt/ch13_exp_mult.htm).

<sup>43</sup> 11 U.S.C. § 707(b)(2)(A)(ii)(IV). *See* Line 38 of Interim Official Form B22A.

<sup>44</sup> 11 U.S.C. § 707(b)(2)(A)(iii). This section does not provide an allowance for payments on an auto lease, so a deduction for such payments will be subject to the Ownership Costs expense under the IRS transportation standard.

<sup>45</sup> *See* Line 42 of Interim Official Form B22A.

any additional payments to secured creditors, such as adequate assurance payments and cure payments on arrears, that would need to be paid 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.<sup>46</sup> This total is then divided by 60 to determine the monthly amount.

One potential problem with the formula is that it would produce an unrealistic budget for a debtor having only 8 months remaining to be paid on a 5 year auto loan at the time the petition is filed. For example, if the debtor's payment is \$400 per month, the debtor would get a monthly deduction of only \$53.33. However, a reading of new § 707(b)(2)(A) consistent with the statutory language is that the debtor in this situation would also be entitled to deduct the remainder of the IRS standard for Ownership Costs.

7. **Priority Claims** - The debtor's expenses for payment of all priority claims (including priority child support and alimony claims) shall be deducted, which shall be calculated as the total amount of debts entitled to priority, divided by 60.<sup>47</sup>
8. **Charitable Contributions** - As under current law, the debtor may deduct charitable contributions to qualified religious and charitable entities and organizations.<sup>48</sup>

**C. Application of the Formula.** The final step is to subtract the allowed expenses from the debtor's current monthly income and multiply that amount by 60. The debtor "flunks" the means test, meaning that a presumption of abuse exists, if this amount exceeds:

- i) \$6,000 or 25% of nonpriority unsecured debt, whichever is greater; or
- ii) \$10,000<sup>49</sup>

Put another way, a debtor can file a chapter 7 case without a presumption of abuse if his or her monthly income after expenses is less than \$100 per month ( $\$6,000 \div 60$ ). On the other hand, a chapter 7 is presumed to be abusive if the debtor's income after expenses is greater than \$166.67 per month ( $\$10,000 \div 60$ ). If the debtor's income after expenses is between \$100 and \$166.67, this amount times 60 must be less than 25% of the nonpriority unsecured claims for the debtor to file without a presumption of abuse (*e.g.*, a presumption of abuse would exist if the debtor's income after expenses is \$100 and the debtor has nonpriority unsecured of \$24,000 or less; and if the debtor's income after expenses is \$166.67 and the debtor has nonpriority unsecured of \$40,000 or less).

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<sup>46</sup> See Line 43 of Interim Official Form B22A.

<sup>47</sup> 11 U.S.C. § 707(b)(2)(A)(iv). See Line 44 of Interim Official Form B22A.

<sup>48</sup> 11 U.S.C. § 707(b)(1). See Line 40 of Interim Official Form B22A.

<sup>49</sup> 11 U.S.C. § 707(b)(2)(A)(i).

Since the formula compares presumed income and expenses with the amount of unsecured debts, debtors with higher amounts of unsecured debt are more likely to pass the means test and will be permitted to obtain a chapter 7 discharge. For example, a debtor with current monthly income of \$5,000, allowed expenses of \$4,890, and unsecured debts of \$20,000 would flunk the means test and abuse will be presumed:

$$\begin{array}{r} \$5,000 \text{ (Income)} \\ - \quad \$4,890 \text{ (Expenses)} \\ = \quad \$110 \\ \times 60 = \$6,600, \text{ which is greater than } \$5,000 \text{ (25\% of } \$20,000) \end{array}$$

This same debtor, even with \$50 more in monthly income after expenses, would pass the means test if unsecured debts are \$40,000:

$$\begin{array}{r} \$5,000 \text{ (Income)} \\ - \quad \$4,840 \text{ (Expenses)} \\ = \quad \$160 \\ \times 60 = \$9,600, \text{ which is less than } \$10,000 \text{ (25\% of } \$40,000) \end{array}$$

**D. Rebutting the Presumption: Special Circumstances.** To rebut the presumption of abuse if a motion to dismiss or convert is filed, new § 707(b)(2)(B)(i) states that the debtor must demonstrate that “special circumstances” exist which would cause the debtor to fall below the presumed abuse tolerances set by the means test formula. The special circumstances must be those that “justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.” This may include a “serious medical condition or a call or order to active duty in the Armed Forces.”<sup>50</sup>

In order to establish special circumstances, the debtor must itemize each additional expense or adjustment of income and provide (accompanied by an oath as to the accuracy of any information provided):

- 1) documentation for such expense or adjustment to income; and
- 2) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.<sup>51</sup>

## Other “Abuse” Preventing a Chapter 7 Filing

**A. General Abuse.** Even if the presumption of abuse does not arise by application of the means test, the debtor may still be subject to the general abuse provisions in § 707(b)(1). The Act makes several significant changes to current law in this area.

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<sup>50</sup> This language was added to S.256 by an amendment made by Senator Sessions and approved during the Senate floor debate.

<sup>51</sup> 11 U.S.C. § 707(b)(2)(B)(ii).

Current law explicitly states that § 707(b) motions may be granted on the court's own motion or the motion of the United States Trustee, but not "at the request or suggestion of any party in interest." The 2005 Act permits creditors and other parties in interest, including panel trustees, to file dismissal motions under the general abuse provisions in new § 707(b)(1), and the means test under § 707(b)(2), if the debtor's income exceeds the median family income.<sup>52</sup>

If the debtor's income is below the median, interested parties are still precluded from bringing an abuse motion, and only the judge or United States Trustee (or bankruptcy administrator) may file a motion under § 707(b).<sup>53</sup> This has been referred to as the Act's "first safe harbor."<sup>54</sup>

The Act replaces the phrase "a substantial abuse" in current § 707(b) with simply "an abuse." Although this seemingly creates a less strict standard for the general abuse provision in § 707(b)(1) than under current law, it should be read in relation to the more specific Congressionally mandated presumption of abuse found in new § 707(b)(2). This would suggest, for example, that a challenge to the debtor's discharge under the general abuse provision should not be grounded on an allegedly excessive expense item if that item would be an allowed expense under the means test.

In cases in which the presumption of abuse "does not arise or is rebutted," new § 707(b)(3) additionally instructs the court when ruling on general abuse motions to consider whether the "debtor filed the petition in bad faith" or "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." Arguably this new provision would apply only in cases in which the presumption of abuse could possibly arise or be rebutted, which would exclude cases filed by debtors below the median family income.

The Act also strikes the language in current § 707(b) which establishes a presumption in favor of granting a discharge to the debtor.<sup>55</sup> The elimination of this presumption may lessen the evidentiary burden on the moving party in proving abuse or on the court in making findings of abuse.<sup>56</sup>

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<sup>52</sup> 11 U.S.C. §§ 707(b)(6) and (b)(7). The same median income figures used for the means test are applicable here.

<sup>53</sup> 11 U.S.C. § 707(b)(6). It should be noted that § 102(e) of the Act states: "Nothing in this title shall limit the ability of a creditor to provide information to a judge (except for information communicated *ex parte*, unless otherwise permitted by applicable law), United States trustee (or bankruptcy administrator, if any), or trustee." However, it does not appear that this language amends any section of the Code or that it will be codified as a Code provision.

<sup>54</sup> H. Rep. 109-31, 51 (2005).

<sup>55</sup> Current § 707(b) states: "There shall be a presumption in favor of granting the relief requested by the debtor."

<sup>56</sup> See *In re Voelkel*, 2005 WL 705230 (B.A.P. 9th Cir. 2005) (in applying current § 707(b), court noted that "presumption in favor of a debtor's right to bankruptcy relief

**B. Dismissal for Certain Crimes.** Finally, new § 707(c) provides that a victim of a “crime of violence”<sup>57</sup> or a “drug trafficking crime”<sup>58</sup> may file a motion seeking dismissal of a voluntary petition filed under chapter 7 by an individual debtor who was convicted of such crime. The court may dismiss the case “when it is in the best interest of the victim” that such case be dismissed. The court may not dismiss a case on these grounds if the debtor establishes by a preponderance of the evidence that the filing is necessary to satisfy a claim for a domestic support obligation.

## **Procedural Matters**

Section 707(b)(2)(C) requires the debtor to file additional information relating to the means test as part of the schedule of income and expenses now required under § 521. This section provides that the debtor must submit as part of the statement of current income and expenses a statement of the debtor’s “current monthly income” and the “calculations that determine whether a presumption arises..., that show how each such amount is calculated.” To implement this provision, the Judicial Conference Rules Committee has issued Interim Official Form B22A. Section 521(a)(1)(B)(v) states that the debtor shall also file a statement of the debtor’s “monthly net income.” Since “monthly net income” is not defined by any existing or new provisions of the Code, it is likely that this requirement will be read to mean “current monthly income.” The debtor is also required to file under new § 521 copies of all “payment advices” received within 60 days before the petition from any employer of the debtor.

In cases in which the debtor’s schedules indicate that the presumption of abuse under § 707(b) exists, section 342(d) requires that the bankruptcy court clerk send written notice to all creditors within 10 days of the filing of a chapter 7 petition advising that the presumption of abuse has arisen.

Section 704(b)(1) also establishes timeframes for the United States trustee (or bankruptcy administrator) to take certain action relating to the means test. Within 10 days of the meeting of creditors in an individual chapter 7 case, the United States trustee (or bankruptcy administrator) shall review all materials filed by the debtor and file with the court a statement as to whether the presumption of abuse exists under § 707(b). The filing of this statement triggers two additional deadlines. Within 5 days of the filing of the trustee statement, the bankruptcy court must provide a copy of the statement to all creditors. Within 30 days of the filing of the trustee statement, the United States trustee (or bankruptcy administrator) must either file a motion to dismiss or convert the case under § 707(b) or file a new statement setting forth the reasons why such a motion would not be appropriate.

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prevents dismissal for substantial abuse unless the court articulates and explains the ‘clear’ abuse it finds from the evidence before it”).

<sup>57</sup> The term “crime of violence” has the meaning given such term in 18 U.S.C. § 16.

<sup>58</sup> The term “drug trafficking crime” has the meaning given such term in 18 U.S.C. § 924(c)(2).

The 2005 Act also provides in § 707(b)(4)(A) that monetary sanctions, and attorney's fees and costs to the trustee, may be imposed on debtors' counsel under a Rule 9011 standard if a trustee's dismissal or conversion motion is granted. Since a trustee is not permitted to file an abuse motion if the debtor's income is below the median based on new § 707(b)(6), sanctions under this provision may be invoked only in cases in which the debtor is above the median. Of course, the 2005 Act includes significant other bill provisions that impact on attorneys who represent consumers in bankruptcy.