AVOIDING THE APPLICATION OF THE CHAPTER 7 MEANS TEST; THE EVOLVING CASE LAW

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Since 2005 when the Bankruptcy Code was substantially overhauled by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), the so-called "Means Test", implemented by that statute, has become a critical factor in determining the availability of Chapter 7 relief to an individual debtor. Under the Means Test, debtors were no longer able to justify their lack of funds to pay creditors by illustrating a comparison of their monthly income and their monthly expenses. Instead, under the Means Test, irrespective of the amounts actually expended towards certain categories of expenses, the debtors were limited as to what they could take as deductions as against their current monthly income.

The impact of the "Means Test" is that if the difference between the Debtor's current monthly income and his allowed expenses is greater than a minimal threshold, the Debtor may not avail himself of a Chapter 7 liquidation case and is relegated to filing a Chapter 13 (or Chapter 11) case entailing monthly payments to his creditors over a period of time, ranging from 3 to 5 years in Chapter 13. However, the decision to file a Chapter 13 petition and the concomitant consequence to make monthly payments to creditors over a protracted period of time, is more expensive, both in legal fees and in the total payments to creditors, and therefore, as a general rule, less desirable.

Where there is an arguable violation of the Means Test, a party in interest may move under 11 U.S.C. § 707(b)(1) and (b)(2) of the Bankruptcy Code (11 U.S.C. § 707(b)(1), (b)(2)) to dismiss the Debtor's case. Subsection 707(b)(2) references the Means Test as the

standard to determine whether the court "must presume that abuse exists," and thus dismissal appropriate. Accordingly, if the Debtor "fails" the Means Test, the Bankruptcy Judge is constrained to dismiss the Debtor's Chapter 7 case. Insofar as the Means Test often times provides insufficient allowances for the debtor's basic expenses, the statutory mandate that the court must dismiss the Chapter 7 case where the Means Test yields excess monthly disposable income limits the availability of Chapter 7 to certain debtors.

Critically, § 707(b)(1) makes clear that the Means Test only applies to debtors "whose debts are primarily consumer debts." (emphasis added) Thus, to the extent that a debtor's debts are not primarily consumer debts, the Means Test will not constitute an impediment to a Chapter 7 bankruptcy filing. Thus, two issues are created by the language of the statute. First, how does one determine whether the debts are primarily consumer debts, i.e., what percentage is necessary before they are primarily consumer debts? Second, what are the categories of debt that have been determined not to be "consumer debt", so as to preclude the application of the Means Test to the debtor's Chapter 7 case.

The answer to the first question appears generally clear under existing case law. Courts have consistently held that debts are primarily consumer debts when a debtor's consumer debts exceed 50% of the total debt. See In re Jelinger, 2014 Bankr. LEXIS 968 (Bankr. N.D.Ohio 2014); citing In re Stewart, 175 F.3d 796, 808 (10th Cir. 1999) ("Stewart"); See also In re Kelly, 841 F.2d 908, 913 (9th Cir. 1988); In re Hlavin, 394 B.R. 441, 447-48 (Bankr. S.D.Ohio 2008); In re Martinez, 171 B.R. 264, 266 (Bankr. N.D.Ohio 1994). Certain additional cases have concluded that the 50% threshold must be met, not only as to the percentage of the debt, but as to the number of creditors as well. In re Aiello, 284 B.R. 756, 760 (Bankr. E.D.N.Y. 2002);

In re Vianese, 192 B.R. 61 (Bankr. N.D.N.Y. 1996).

Thus, the remaining issue centers on what is consumer debt and obversely what debt is excluded from consumer debt so that if sufficient in amount, it would render the Means Test inapplicable to an individual case.

Section 101(8) of the Bankruptcy Code, 11 U.S.C. § 101(8), defines "Consumer Debt" to be "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8). Thus, it would appear that to the extent other categories of debt exist, these would not constitute consumer debt and might be aggregated in determining whether or not a debtor is obligated to qualify under the Means Test.

First off, it appears relatively self-evident that business debt is not consumer debt. Various cases and substantial segments of the bankruptcy bar have summarily concluded that the distinction between consumer debt and non-consumer debt is basically identical to the distinction between consumer debt and business debt. For example, in United States Trustee v. Mohr, 436 B.R. 504 (S.D.Ohio 2010) the court equated the distinction between consumer debt and non-consumer debt to be equivalent to the "ratio of business to consumer debt". See e.g., In re Booth, 858 F.2d 1051, 1055 (5th Cir. 1988) ("[T]he test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family, or household purposes, is whether it was incurred with an eye toward profit."); In re Stewart, 175 F.3d at 806 ("non-consumer debt" is further distinguished from "consumer" debt as a debt incurred with a "profit motive."); see also In re Hartigan, 490 B.R. 437 (Bankr. S.D.Ga. 2013); In re Strausbough, 376 B.R. 631 (Bankr. S.D.Ohio 2007). Indeed, the most typical Chapter 7 analysis is to create a ratio of business debt to consumer debt to determine the applicability of the Means

Test to an individual case. However, as the case law continues to evolve, courts have determined that there exist other categories of debt, which while not constituting business debt, nevertheless should not be considered consumer debt.

It is now fairly ingrained that income tax debt is not consumer debt because it is "involuntarily imposed by the government for a public purpose" and results from earning money rather than from consumption. In re Westberry, 215 F.3d 589 (6th Cir. 2000). As stated by the Sixth Circuit: "Almost without exception, the bankruptcy courts that have addressed this question have determined that tax debt should not be considered consumer debt for purposes of the co-debtor stay." Numerous courts have thereafter utilized the same analysis for purposes of 11 U.S.C. § 707. See In re Jelinger, 2014 Bankr. LEXIS 968 (Bankr. N.D.Ohio 2014); In re Kintzele, 2013 Bankr. LEXIS 222 (Bankr. E.D.N.C. 2013); In re Brashers, 216 B.R. 59, 60-61 (Bankr. N.D.Okla. 1998) (income tax obligations are not consumer debts under § 707(b)); In re Dye, 190 B.R. 566, 567 (Bankr. N.D.Ill. 1995) ("federal tax liability is not consumer debt" for § 1301 purposes); In re Greene, 157 B.R. 496, 497 (Bankr. S.D.Ga. 1993); Goldsby v. U.S. (In re Goldsby), 135 B.R. 611, 613-15 (Bankr. E.D.Ark. 1992) (same); In re Traub, 140 B.R. 286, 288 (Bankr. D.N.M. 1992); In re Reiter, 126 B.R. 961, 964 (Bankr. W.D.Tex. 1991); Harrison v. IRS (In re Harrison), 82 B.R. 557, 558 (Bankr. D.Col. 1987); Pressimone v. IRS (In re Pressimone), 39 B.R. 240, 245 (N.D.N.Y. 1984). Although in a different context, Judge Matsumoto of the United States District Court, Eastern District of New York, concluded that real estate tax lien debt was similarly not consumer debt under the Fair Debt Collection Practices Act, 15 U.S.C. § 1692, et seq. [1] Boyd v. J.E. Robert Co., 2012 U.S. Dist. LEXIS 142688 (E.D.N.Y. 2012).

In similar vein, the efforts of a governmental entity to collect payments due under a probation program were held not to be consumer debt covered by the FDCPA on the ground that it did not constitute a "consensual transaction, where parties negotiate or contract for consumer-related goods or services." The court reasoned further that any obligation to pay a fine, fee or other expense as a consequence of the debtor being placed on probation does not come within the statutory definition. Bell v. Providence Cmty. Corr., Inc., 2011 U.S. Dist. LEXIS 61583 (M.D.Tenn. 2011) citing Beal v. Himmel & Bernstein, LLP, 615 F.Supp.2d 214, 217 (S.D.N.Y. 2009); Vaile v. Willick, 2008 U.S.Dist. LEXIS 5111 (W.D.Va. 2008).

Cases also have been decided evaluating the character of a debt arising from an automobile accident or under theories of tort generally. The case of In re Thongta, 401 B.R. 363 (Bankr. E.D.Wisc. 2009) concludes, albeit under 11 U.S.C. § 362 and 11 U.S.C. § 1301, that a claim arising from an automobile accident, while nevertheless a personal debt, is not a consumer debt. Similarly, in In re Franks, 2006 Bankr. LEXIS 4942 (Bankr. D.Md. 2006), the court held that a claim against the debtor arising under a theory of tort is also not a consumer debt.

What about a claim arising from a student loan? It appears while arguments exist that student loans are not consumer debts, whether they are consumer debts should be carefully considered by debtor's counsel. In In re Rucker, 454 B.R. 554 (Bankr. M.D.Ga. 2011), the Court dealt with the debtor's contention that student loan debts were not consumer debts by reviewing applicable case law. The court relied upon the Tenth Circuit decision in In re Stewart, 175 F.3d at 806 where the court rejected a per se rule categorizing student loans as consumer debts. Instead, the Court of Appeals held that the analysis was fact sensitive. To the extent the student loan funds were utilized for family living expenses then there appeared to be little dispute that

they were consumer debts. However, to the extent that unusual facts existed and under appropriate circumstances student loans might constitute a separate category of non-consumer debt.

While the Tenth Circuit in Stewart concluded, that under the facts of the case the student loan debt was a consumer debt, it acknowledged that the general issue was not free from doubt: "Little or no binding or persuasive authority exists to help us determine the characterization of educational expenses such as books, tuition and room and board as either consumer or business debt." 175 F.3d at 807. Thus, Stewart leaves open the door for various arguments including that a loan obtained to pay for higher education tuition may be non-consumer debt because the loan would have been incurred for the purpose of obtaining a high income career, and thus, arguably a business debt. But see In re Millikan, 2007 Bankr. LEXIS 4696 (Bankr. S.D.Ind. 2007) (holding that the "profit motive test" is unworkable as applied to student loans). Moreover, as none of the cited cases emanate from either the Second Circuit or the Eastern District, they are not binding authority.

The cases cited herein establish that there are various categories of debt beyond business debt which constitute non-consumer debt and which may be aggregated in determining a debtor's eligibility for Chapter 7 relief. It remains to be seen whether evolving case law will determine that other types of debt as well constitute non-consumer debt. For example similar arguments can be made as to debts in the nature of matrimonial maintenance, child support, equitable distribution awards, charitable commitments, and governmental forfeiture awards. It behooves the creative debtor's counsel to critically examine each of the debts his client seeks to discharge to determine whether arguments can be made that it constitutes non-consumer debt.

1. The FDCPA defines the term "debt" as "any obligation or an alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance or services which are the subject of the transaction are primarily for personal, family or household purposes." Thus, the definition of consumer debt under the FDCPA largely coincides with that found in the Bankruptcy Code.

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