

**SUMMARY OF CHAPTER 5**

of the

Bankruptcy Code as Amended by  
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

*May 18, 2006*

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**SECTION 501**  
**Filing of Proofs of Claims or Interests**

Summary of Amendment

Section 501 is amended to add new paragraph (e) dealing with claims for international fuel taxes. Claims for international fuel use taxes that are assessed consistent with the requirements of 49 U.S.C. § 31705 may be filed as a single claim by the base jurisdiction designated by the International Fuel Tax Agreement (as defined in 49 U.S.C. § 31701).

Cross References

Applicable Nonbankruptcy Statutes

49 U.S.C. § 31701	[designation of base jurisdiction]
49 U.S.C. § 31705	[assessment of international fuel use taxes]

## SECTION 502 Allowance of Claims or Interests

### Summary of Amendment

**Chapter 13 Tax Claims.** Amended section 502(b)(9) adds language to address government tax claims related to returns filed under section 1308(a). Section 1308(a) requires a chapter 13 debtor to file delinquent tax returns due for tax periods ending during the 4-year period prior to the filing of the petition. These returns are due no later than the day before the first scheduled date for the meeting of creditors. Amended section 502(b)(9) gives a governmental unit 60 days from the filing of a tax return required under section 1308(a) to file its proof of claim for taxes related to that return. Note that section 1308 applies only in chapter 13 cases. See 11 U.S.C. § 103(i).

**Damages Under Security Agreements.** Section 502(g)(2) is amended to provide that a claim for damages calculated in accordance with 11 U.S.C. § 562 [calculating damages under swap agreements, securities, contracts, forward contracts, commodity contracts, repurchase agreements, and master netting agreements] shall be allowed under paragraphs (a), (b) or (c), or disallowed under paragraphs (d) or (e) of section 502, as if the claim had arisen before the filing date of the petition.

**Penalty for Failing to Negotiate.** In the final significant amendment, section 502(k) provides for a reduction of up to 20% of a claim for an unsecured consumer debt if the claim was filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment schedule proposed for the debtor by an approved non-profit budgeting and credit counseling agency. The offer must have been made at least 60 days before the filing of the debtor's petition and provided for payment of at least 60% of the amount of the debt over a period not to exceed the repayment period of the loan or a reasonable extension of the loan. No part of the debt “under the repayment schedule” may be nondischargeable. Paragraph (k) places the burden on the debtor to prove by “clear and convincing” evidence that the creditor unreasonably refused to consider the debtor's proposal and that the alternate payment proposal was made at least 60 days prior to the filing of debtor's petition.

### Litigation Points

1. With respect to section 502(b)(9), the question arises whether the deadline for filing the claim runs from the date the tax return is due from the debtor under section 1308(b) or the date it is actually filed if filed after that deadline. Section 502(b)(9) requires that the claim be filed no later than 60 days after “the return was filed as required.” What if the return is not filed “as required” by section 1308(b)? Suppose it is filed 30 days after the original setting of the first meeting. Does the 60-day period run from the date the return was filed or from when it should have been filed?

2. With respect to section 502(k), a number of questions may arise. What constitutes an “unreasonable refusal to negotiate” or a “reasonable alternative repayment schedule?” It is unclear how the “repayment period” of a loan will be calculated when the obligation is based on a revolving debt. What is a reasonable extension of the loan repayment period? If a debt is partially nondischargeable, can that portion of the obligation be severed in order to apply section 502(k) to the dischargeable portion? Does section 502(k)(1)(C) preclude the bifurcation of partially dischargeable claims or does it provide only that the portion under the repayment schedule must be dischargeable? If a creditor will only suffer a 20% reduction of its claim for unreasonably refusing to take a 60% compromise, the penalty may be more palatable than the compromise. Does this mean it is reasonable to be unreasonable?

### Cross References

#### New Defined Terms

**non-profit budget and credit counseling agencies**, 11 U.S.C. § 111.  
**transfer**, 11 U.S.C. § 101(54)

#### Bankruptcy Code

11 U.S.C. § 111	[credit counseling and financial management instructional courses]
11 U.S.C. § 523	[nondischargeable debts]
11 U.S.C. § 1308	[filing of pre-petition tax returns]

## SECTION 503 Allowance of Administrative Expenses

### Summary of Amendment

**Back Pay and Benefits.** Section 503(b)(1)(A) includes new subsection (ii), allowing as an administrative expense an award rendered by a court or the National Labor Relations Board for back pay and benefits attributable to the post-petition period “whether or not any services were rendered” unless the bankruptcy court determines that payment of such back pay and benefits will substantially increase the likelihood that current employees of the debtor will be laid off or that domestic support obligations will not be paid.

**Taxes Incurred by Estate.** Under section 503(b)(1)(C), taxes incurred by the estate, whether secured or unsecured, and including property taxes for which liability is in rem, in personam, or both, are administrative expenses.

Under section 503(b)(1)(D), a governmental unit will no longer be required to file a request for payment of an administrative expense under section 503(a) for taxes, or fines and penalties for such taxes, in order to obtain administrative status for the claim.

**Assumed Then Rejected Leases.** If a nonresidential real property lease first is assumed and then later rejected, the lessor is entitled to an administrative expense claim under section 503(b)(7). The lessor is permitted an administrative expense claim for all monetary obligations, excluding damages for failure to operate, for the 2-year period following the date of rejection or surrender, whichever is later, without reduction or setoff except for sums actually received or to be received from an entity other than the debtor. Any additional sum due the lessor is a claim under 11 U.S.C. § 502(b)(6).

**Health Care Business Closure.** Section 503(b)(8) is added to allow as an administrative expense the actual and necessary cost related to closing a health care business. This includes disposing of patient records and transferring patients to other health care facilities.

**Reclamation Administrative Claims.** Section 503(b)(9) gives administrative status to a claim for goods received by the debtor within 20 days of the filing of its case where the goods were sold to the debtor in the ordinary course of the debtor’s business. See 11 U.S.C. § 546(c) (relationship between reclamation right and administrative claim).

**Insider Bonus and Compensation.** Section 503(c) is added to prohibit payment of certain compensation, bonuses, severance payments, and other transfers as an administrative expense to insiders. Expenses incurred to induce an insider to remain with the debtor may not be paid unless the court concludes the expense is essential to retain the insider, the insider has a bona fide job offer from another business at the same or greater pay, the insider’s services are essential, and the amount does not exceed 10 times the amount paid to a nonmanagement employee for any purpose during the calendar year in which the debtor proposes to pay the

insider or, if no such payments were made to nonmanagement employees, the amount may not exceed 25% of the amount of similar payments to such insider during the preceding calendar year. Severance pay may not be paid to an insider unless it is part of a program for all employees, and is not greater than 10% of the mean severance pay paid to a nonmanagement employee during the same calendar year. No other transfer may be made to an insider outside the ordinary course of business unless it is justified by the facts and circumstances of the case.

### Litigation Points

1. Section 503(b)(1)(A)(ii) creates a conflict between the interest of those with wage claims based on prior violations of federal or state law and those employed by the debtor during the reorganization.

2. If government units are not required to file requests for administrative expenses for taxes incurred by the estate or fines or penalties related to taxes incurred by the estate, some mechanism will have to be created to provide notice of these post-petition obligations and a mechanism for resolution of any objection to them. While a proof of claim likely will be filed, there is no requirement that a proof of claim be filed, and if filed, that it be served on the debtor or any other party in interest.

3. The provisions of section 503(c) restricting insider compensation are complex and will likely result in litigation. This litigation may entail determining who is an insider, what forms of compensation are not entitled to administrative status, whether such payments can be paid as nonadministrative expenses, and applying the formulae laid out in section 503(c)(1) & (2). To the extent a future debtor attempts to sidestep these restrictions by paying retention bonuses and other compensation to insiders before the petition is filed, litigation will arise under section 548(a)(1). It permits the trustee to reach back 2 years and recover such payments not made in the ordinary course of business as fraudulent conveyances.

4. If reclamation claims are accorded administrative status by section 503(b)(3), does this mean that the holder of a reclamation claim is not entitled to “critical vendor” treatment (to the extent such treatment is available to anyone)? By providing this remedy does the Bankruptcy Code preclude this and other remedies?

### Cross References

#### New Defined Terms

**health care business**, 11 U.S.C. § 101(27A)  
**domestic support obligation**, 11 U.S.C. § 101(14A)  
**patient**, 11 U.S.C. § 101(40A)  
**patient records**, 11 U.S.C. § 101(40B)  
**transfer**, 11 U.S.C. § 101(54)

Bankruptcy Code

11 U.S.C. § 351	[disposal of patient records]
11 U.S.C. § 365	[assumption and rejection of unexpired leases]
11 U.S.C. § 507(a)(8)	[priority tax claims]
11 U.S.C. § 546(c)	[limits on avoiding powers re reclamation claims]

**SECTION 504**  
**Sharing of Compensation**

Summary of Amendment

Section 504(c) is added to make clear that the provisions of section 504 do not apply to the sharing of compensation with a bona fide public service attorney referral program that operates in accordance with non-federal law regulating such programs.

## **SECTION 505**

### **Determination of Tax Liability**

#### Summary of Amendment

Section 505(a)(2)(C) is added to prevent the bankruptcy court from determining the amount or legality of any tax arising in connection with an ad valorem tax on real or personal property of the bankruptcy estate if the applicable period for contesting or redetermining that amount under non-bankruptcy law has expired.

A federal, state, or local governmental unit responsible for the collection of taxes within a district may designate an address for service of requests to determine tax liabilities under section 505, and it may describe where further information concerning additional requirements for filing such requests may be found. Section 505(b)(1)(A) requires the clerk of the bankruptcy court to maintain a list containing this information. Interim Rule 5003(e) implements section 505(b)(1)(A). Under section 505(b)(1)(B), if a governmental unit does not designate an address where notices are to be sent, notices shall be sent to the address for the filing of a tax return or protest.

Section 505(b)(2) clarifies that the bankruptcy estate, not just the trustee, the debtor, and the debtor's successor, is discharged from tax liability if the trustee requests a determination of any unpaid liability of the estate for taxes incurred during the administration of the case. This determination is sought by submitting a tax return and a request for such a determination to the appropriate governmental unit then paying the tax specified in the return or the tax determined by the court or the governmental unit to be due.

#### Cross References

##### Interim Rules

Interim Rule 5003(e)	[requires court clerk to maintain a list of addresses designated by tax entities for service]
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#### Administrative Burdens Imposed on Court

The clerk of court will be required to maintain a list of addresses for various governmental tax agencies. This is likely to be a slight burden as the clerk is presently required by Fed. R. Bankr. P. 5003(e) to maintain a register of mailing addresses for federal and state governmental units.

## SECTION 506 Determination of Secured Status

### Summary of Amendment

**Replacement Valuation.** Section 506(a)(2) is new. It applies to chapter 7 or 13 cases filed by individuals. It provides that the value of personal property securing an allowed claim shall be based on its replacement value as of the petition date without deduction for costs of sale or marketing. If the personal property is acquired for personal, family, or household purposes, the replacement value is the price a retail merchant would charge for property of the same kind, considering its age and condition at the time the value is determined.

Thus, there are two valuation dates. For personal property purchased for consumer purposes, valuation is as of the date value is determined. For business or commercial personal property, valuation is as of the petition date.

Note that the retail merchant standard is mentioned only in connection with personal property held for consumer purposes.

As a practical matter, despite the reference to chapter 13 in section 506(a)(2), section 506(a) will have limited applicability in chapter 13 cases. Absent an agreement with a secured creditor or the satisfaction of a secured claim by surrender of collateral, a chapter 13 plan must provide that the holder of a secured claim retain its lien until either the debtor has paid the “underlying debt determined by nonbankruptcy law” or the debtor has obtained a discharge. See 11 U.S.C. § 1325(a)(5)(B)(i). Further, the amount by which a debt exceeds the replacement value of the collateral securing it cannot be stripped from its collateral if the creditor’s lien is a purchase money security interest in a motor vehicle “acquired for the personal use of the debtor” provided the debt was incurred within 910 days of the filing of the petition. See 11 U.S.C. § 1325(a)(9). For other types of secured claims, use of section 506 in chapter 13 cases to strip off the under-collateralized portion of the debt is prohibited if the debt was incurred during the 1-year period preceding the filing of the petition. Id.

Schedules A, B, C, and D, all parts of Official Form 6, have been amended to delete the word “market” from the columns in which the debtor reports property values. This change was necessitated by the directive in section 506(a) that the debtor report “replacement” rather than “market” value for certain property.

**Interest on Statutory Claims.** An oversecured creditor is permitted by section 506(b) to add interest and reasonable fees, costs, or other charges provided under an agreement to its claim. Section 506(b) is amended to allow interest, fees, costs, and charges permitted by a state statute, not just an agreement. Thus, if a state taxing authority has filed a tax lien, it will be allowed to add interest, fees, costs, and charges to its claim provided such is permitted by applicable law and to the extent its claim is less than the value of the encumbered property.

**Surcharges.** Section 506(c) is amended to permit surcharges based on the payment of ad valorem property taxes benefitting a creditor's collateral.

#### Case Authority Impacted by the Amendment

Section 506(a)(2) appears to be a legislative interpretation of, and gloss upon, Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L. Ed.2d 148 (1997).

#### Litigation Points

1. In order for a vehicle to qualify for the "anti-strip down" provision of section 1325(a)(2), the vehicle must have been "acquired for the personal use of the debtor." What if the debtor's nonfiling spouse, or child, is the exclusive user of the vehicle?

2. What market must a debtor base a replacement valuation on? As indicated above, the price charged by a retail merchant is only mentioned in connection with property held for consumer purposes. Can valuation be based on what the debtor would pay to a private party for a comparable vehicle? Or, must the debtor base the valuation on what a dealer would charge? Or does this depend on whether the vehicle is for business or personal use?

3. As to household personal property, replacement value is based on what a retailer would charge for the property considering its age and condition. What if the collateral is a type of property that retailers generally do not sell in used condition?

#### Cross References

##### Bankruptcy Code

11 U.S.C. § 1325(a)(5)(B)(i) [retention of lien in chapter 13]

##### Official Forms

Official Form 6

[Schedules A-J]

## SECTION 507 Priorities

### Effective Date

Subparagraphs (a)(4) & (a)(5) of amended section 507 apply to cases filed on or after the date of enactment, April 20, 2005. All other amendments to section 507 are effective in cases filed on or after October 17, 2005.

### Summary of Amendment

**Priority Hierarchy.** Amended section 507(a) creates a new distribution hierarchy for priority claims. Basically, claims based on domestic support obligations have vaulted from the seventh to the first priority level, and those claims formerly at the first through six levels have moved down one level. The only qualification concerns the trustee's compensation. It must be paid before a domestic support obligation "to the extent the trustee administers assets that are otherwise available for the payment of" the domestic support obligations. The new priority hierarchy is as follows:

- a. Allowed unsecured domestic support obligations, subject to the trustee's compensation due for administering assets that might otherwise be used to pay the support obligations;
- b. Administrative expenses allowed under 503(b);
- c. Unsecured claims allowed under section 502(f);
- d. Unsecured claims for wages, salaries, commissions, vacation, severance, sick leave;
- e. Unsecured contributions to employee benefit plans;
- f. Unsecured claims of grain growers and fishermen;
- g. Unsecured consumer deposits;
- h. Unsecured claims of governmental units;
- i. Unsecured claims based upon commitment by debtor to a federal depository institution; and
- j. Claims for personal injury or death arising out of the operation of a motor vehicle, boat, or aircraft while under the influence of alcohol, drugs, or another substance.

**Domestic Support Obligations.** Domestic support obligation is a term defined at 11 U.S.C. § 101(14A). It is a claim for support, including government assistance, owed to or recoverable by a spouse, former spouse, a child or a child's parent, responsible relative, or guardian, or a governmental unit, whether the debt arises or is established before, on, or after the order for relief, in a court order, determination by a governmental unit, or a separation agreement, divorce decree, or property settlement. If interest accrues under applicable nonbankruptcy law, the claim includes "interest that accrues on [a domestic support obligation] . . . notwithstanding any other provision of this title." Claims assigned to governmental units are not domestic

support obligations unless the assignment is voluntary and for the purpose of collecting the claim on behalf of the person entitled to the support.

**Employee Claims.** The monetary cap on wage and employee benefit claims is increased from \$4,925 to \$10,000. The look-back period for wage claims has been extended from 90 days to 180 days. As a result, larger portions of vacation, severance, and sick leave will be entitled to priority payment. The cap on employee benefits similarly is increased to \$10,000 per employee. See 11 U.S.C. § 507(a)(4), (a)(5). The amounts specified in paragraphs (a)(4) and (a)(5), like all other dollar amounts specified in section 507(a), are subject to tri-annual adjustment under 11 U.S.C. § 104(b)(1).

**Farmers & Consumers.** The maximum priority claim held by a grain grower or a fisherman is reduced from \$4,925 to \$4,000. See 11 U.S.C. § 507(a)(6). Similarly, the priority given for consumer deposit amounts (lay-away accounts) under section 507(a)(7) is reduced from \$2,225 to \$1,800.

**Tax Claims.** Section 507(a)(8)(A) makes three changes. First, the 240-day assessment period is extended for any period during which a stay was in effect in a prior case, plus 90 days. Second, all time periods set out in section 507(a)(8)(A) - (G) are suspended for any period the governmental unit is prohibited from collecting the tax as a result of a request for hearing or an appeal by the debtor, plus 90 days. Third, all time periods are suspended for any period the governmental unit is stayed by a prior bankruptcy case or is precluded by a confirmed plan from taking collection action, plus 90 days.

Section 507(a)(8)(B) is amended to eliminate the confusion caused by use of the word “assessed” when referring to claims for real property taxes. Because some state and local statutes do not use the word “assessed,” the word “incurred” has been substituted. Thus, a claim for property taxes incurred, even if not assessed under applicable law, before the petition date and last payable without penalty within one year before the petition date, is a priority claim.

Section 507(a)(10) creates a new tenth priority for claims based on death and personal injury arising from the operation of a motor vehicle, boat, or aircraft while under the influence of drugs or alcohol. This amendment may have a substantial impact in some chapter 13 cases. Even though such claims may not be excepted from a chapter 13 discharge (but see 11 U.S.C. § 1328(a)(4)), priority claims must be paid in full. See 11 U.S.C. § 1322(a)(2).

#### Case Authority Impacted by the Amendment

The amendments to Section 507(a)(8)(A) attempt to clarify the ambiguities of the current code regarding the tolling of time periods used to determine whether an unsecured income tax is a priority tax. See Young v. United States, 535 U.S. 43, 122 S. Ct. 1036, 152 L. Ed.2d 79 (2002); Brickley v. United States (In re Brickley), 70 B.R. 113 (B.A.P. 9<sup>th</sup> Cir. 1986); In re Cowen, 207 B.R. 207 (Bankr. E.D. Cal. 1997). Section 507(a)(8)(A) essentially codifies Young.

## Litigation Points

1. The phrase in section 507(a)(1)(C) giving the trustee's compensation priority over a domestic support obligation "to the extent the trustee administers assets that are otherwise available for the payment of" a domestic support obligation, may create some issues. Does this mean that if the trustee administers an asset that does not yield money that can be used to pay a domestic support claim, the trustee's compensation, to the extent based on the money derived from the disposition of that asset, will not prime the domestic support obligation? This situation might arise when the trustee liquidates an asset that is totally encumbered by a lien and the lien holder receives all of the liquidation proceeds.

2. The inclusion of interest accruing on domestic support obligations in the definition of such claims may conflict with 11 U.S.C. § 502(b)(2). Section 502(b)(2) requires the disallowance of unmatured interest on claims.

3. Section 1322(a)(10) permits a chapter 13 plan to provide for interest on nondischargeable obligations as long as all other claims are paid in full. Section 1328(a)(2), incorporating section 523(a)(5), makes domestic support obligations nondischargeable in a chapter 13 case. If interest is, by definition, part and parcel of a domestic support obligation, can such interest be paid in a chapter 13 case without paying all other claims in full?

4. If interest accrues after the filing of the petition on domestic support obligations, does applicable nonbankruptcy law supply the interest rate or will some other rate, such as the federal judgment rate, apply? See In re Beguelin, 220 B.R. 94 (B.A.P. 9<sup>th</sup> Cir. 1998).

## Cross References

### New Defined Terms

**domestic support obligation**, 11 U.S.C. § 101(14A)

### Bankruptcy Code

11 U.S.C. § 523(a)(5)	[dischargeability of domestic support obligations in chapter 7 cases]
11 U.S.C. § 1322(a)(2)	[payment of priority claims in chapter 13]
11 U.S.C. § 1322(a)(10)	[payment of interest on nondischargeable claims]
11 U.S.C. § 1328(a)(4)	[dischargeability of domestic support obligations in chapter 13 cases]
11 U.S.C. § 1328(a)(4)	[dischargeability of damages awarded as result of willful and malicious injury causing personal injury or death in chapter 13 cases]

Official Forms

Official Form 6

[Schedule E is amended to reflect the changes to § 507 including the addition of the new priority claim for claims for death and injury caused while the debtor is intoxicated]

**SECTION 508**  
**Effect of Distribution Other Than Under This Title**

Summary of Amendment

Former section 508(a) is stricken in its entirety. The former section halted distributions to a creditor who had received a partial distribution in a foreign proceeding until other creditors in the domestic case had received proportional distributions in the domestic proceeding. This rule, however, will not prejudice a creditor's secured claims. Former section 508(a) is replaced by new section 1532, which preserves the substance of former section 508(b).

Cross References

New Defined Terms

**foreign proceeding**, 11 U.S.C. § 101(23)

Bankruptcy Code

11 U.S.C. § 1532

[rule of payment in concurrent domestic-foreign proceedings]

## SECTION 511 Rate of Interest on Tax Claims

### Summary of Amendment

Section 511 is new and provides that the interest rate payable on a tax claim or an administrative tax expense is determined by applicable nonbankruptcy law. The new section further provides that if taxes are paid pursuant to a confirmed plan, then the interest rate is set as of the calendar month in which the plan is confirmed.

This amendment means that counsel in chapter 11, 12, and 13 cases will be required to research nonbankruptcy law for each type of tax claim to determine the appropriate interest rate, and then adjust that rate as of the date of confirmation.

### Litigation Points

1. By negative inference, does section 511 mean that if applicable nonbankruptcy law provides for an adjustable interest rate, then the interest due on tax claims and expenses in chapter 7 cases is also adjustable?

2. Because different laws may be applicable, there may be significant variances in interest rates paid on state, federal, and local tax claims even though they are the same type of tax claim.

3. Interest rates provided by applicable nonbankruptcy law may bear no relation to market interest rates and may be set at a level calculated to coerce payment of taxes. Will such coercive interest rates be entitled to priority treatment if the underlying tax claim is a priority claim? See 11 U.S.C. § 507(a)(8)(G).

4. In chapters 11, 12, and 13 cases, interest will be determined as of the date a plan is confirmed. If applicable nonbankruptcy law provides an adjustable interest rate, and the rate changes between the filing of the plan and its confirmation, an amendment of the plan will be necessary. In these circumstances, objections to confirmation from tax agencies can be expected to insure that the plan, when confirmed, reflects the appropriate and current interest rate.

### Information Necessary to Apply Amended Section

While section 511 requires reference to nonbankruptcy law to determine the interest rate due on a tax claim or expense, it does not require that data be gathered from some source before the amendments can be applied to a particular case. Most tax agencies maintain web pages with information regarding interest rates.

The Board of Equalization's web page at [www.boe.ca.gov/sutax/interates.htm](http://www.boe.ca.gov/sutax/interates.htm), for instance, gives the current and historical rates it charges on delinquent sales and use taxes. For

interest rates on delinquent income taxes, the Franchise Tax Board posts its current and historical rates at [www.ftb.ca.gov/individuals/faq/ivr/617.html](http://www.ftb.ca.gov/individuals/faq/ivr/617.html). The interest rate charged by the Internal Revenue Service on underpayments of income taxes can be determined from periodic bulletins posted on its Internet site. The bulletin for the quarter beginning on July 1, 2005 can be found at [www.irs.gov/pub/irs-irbs/irb05-24.pdf](http://www.irs.gov/pub/irs-irbs/irb05-24.pdf).

The interest due on delinquent California real property taxes is set by statute. For each installment of real property taxes not timely paid, a 10% penalty is assessed. See Cal. Rev. & Tax. Code §§ 2617, 2618, 2705. In addition, a “redemption” penalty of 1 1/2% per month is added to the tax bill. See Cal. Rev. & Tax. Code § 4103(a). For purposes of a claim in a bankruptcy case, Cal. Rev. & Tax. Code § 4103(b) provides that “the assessment of penalties . . . constitutes the assessment of interest.”

## **SECTION 521 Debtor's Duties**

### Effective Date

With one exception, amended section 521 is effective in cases filed on or after October 17, 2005. The exception concerns the requirement of audits and the audit procedures laid out in section 603 of the 2005 Act. Section 603 of the Act requires the Attorney General to establish audit procedures “to determine the accuracy, veracity, and completeness of petitions, schedules, and other information” debtors file in bankruptcy cases. Section 521 of the Bankruptcy Code requires the debtor to cooperate with the auditor as well as surrender recorded information relating to property of the estate. Section 727(d)(4) of the Bankruptcy Code is also amended to provide for the revocation of a chapter 7 discharge if the debtor fails to make financial information available to the auditor. All provisions regarding audits are effective 18 months after the date of enactment, April 20, 2005.

Section 315(c) of the 2005 Act requires the Administrative Office of the U.S. Courts to establish procedures for safeguarding the confidentiality of any “tax information” that section 521 requires the debtor to provide to parties or file with the court. These procedures must be in place by October 17, 2005.

### Summary of Amendment

The amendments made to section 521 fall into three categories. First, debtors are required to file significantly more financial information, both at the inception and throughout the case, and in many instances the failure to provide this information may result in dismissal or conversion. Second, cases like *In re Parker* 139 F.3d 688 (9<sup>th</sup> Cir. 1998), holding that an individual debtor may retain property that is collateral for a consumer secured debt without reaffirming the debt, are no longer good law. Third, if the debtor is an administrator of an ERISA employee benefit plan at the time a petition is filed, section 521(a)(7) requires the debtor, except when a trustee is serving in a case, to continue performing the administrator's obligations under the terms of the plan. Amendments related to the first two categories are discussed in detail below.

### **New Filing Requirements**

In addition to the list of creditors, schedule of assets and liabilities, the statement of financial affairs, and the statement of intention required by existing law, the debtor must file:

1. A schedule of current income and current expenditures that includes a schedule of “current monthly income” [a term defined at 11 U.S.C. § 101(10A) as an average of the debtor's income over the 6-month period preceding the petition date] and the calculations that determine whether a presumption of abuse arises under the means test. See 11 U.S.C. §§ 521(a)(1)(B)(ii), 707(b)(2)(A)(i) &

(b)(2)(C); Interim Rules 1007(b)(4), (b)(5), & (b)(6); Official Forms 22A, B & C Statement of Current Monthly Income, etc. This schedule must be filed by every individual debtor within 15 days of the order for relief. See Interim Rule 1007(c).

2. If section 342(b) applies [debtors who are individuals with primarily consumer debts], a certificate by the debtor's attorney or petition preparer, or by the debtor if the debtor does not have an attorney or petition preparer, attesting that the statement required by section 342(b) [advising the debtor of the relief available under the different chapters, the services available from credit counseling agencies, and the consequences of concealing assets and making false statements] was delivered to the debtor. See 11 U.S.C. § 521(a)(1)(B)(iii). Official Form 1, the voluntary petition form, has been amended in the signature sections to require the debtor, the debtor's attorney, and the debtor's petition preparer to make the declarations required by section 342(b). See also Official Form 19A, Declaration and Signature of Non-Attorney Bankruptcy Petition Preparer, and Official Form 19B, Notice to Debtor by Non-Attorney Bankruptcy Petition Preparer.

3. Copies of all employer "payment advices" or other evidence of payments from the debtor's employer within 60 days of the petition date. See 11 U.S.C. § 521(a)(1)(B)(iv); Interim Rule 1007(b)(1)(E).

4. A statement of "monthly net income" [an undefined term] showing how that amount was calculated. See 11 U.S.C. § 521(a)(1)(B)(v). Note that Schedule J, part of Official Form 6, has been amended to include a "statement of monthly net income." This is the total monthly income reported on Schedule I, less the debtor's current monthly expenses reported on Schedule J. See Official Form 6, Schedule J, Line 20.

5. A statement disclosing any "reasonably anticipated increase of income or expenditures" for the 12 months following the petition date. See 11 U.S.C. § 521(a)(1)(B)(vi). Note that Schedules I and J, part of Official Form 6, have been amended to require the debtor to report any increase or decrease in income or expenses that can reasonably be anticipated in the coming year. See Official Form 6, Schedules I and J, Lines 17 and 19. Note also that Schedule I has been amended to require the listing of a nonfiling spouse's income in cases filed under chapters 7 and 11 as well as chapter 13.

6. A "certificate" from an approved nonprofit budget and credit counseling agency describing the services provided under section 109(h) and a copy of any repayment plan developed by the agency. See 11 U.S.C. § 521(b); Interim Rule 1007(b)(3). This certificate must be filed with the petition and should not be confused with the statement regarding post-petition completion of a course on personal financial management that all individual chapter 7 and 13 debtors are required to file. See 11 U.S.C. §§ 727(a)(11) & 1328(g)(1); Interim Rule 1007(b)(7) & (c); Official Form 23. Interim Rule 1007(c) requires that the

statement of completion be filed within 45 days after the meeting of creditors in a chapter 7 case. Interim Rule 4004(c)(1)(H) requires that a chapter 7 debtor's discharge not be entered unless the statement required by Interim Rule 1007(b)(7) has been filed. In chapter 13 cases, this statement is due no later than the last plan payment by the debtor or by the filing of a motion for entry of a hardship discharge pursuant to section 1328(b). See Interim Rule 1007(c). As in chapter 7 cases, until the statement is filed, no discharge may be entered. See Interim Rule 4004(c)(1)(H). See In re Granda, 2005 WL 3348878 (Bankr. W.D. Pa. 2005) and In re Skarbek, 2005 WL 3348879 (Bankr. W.D. Pa. 2005) [debtors filed statements indicating that they had completed courses on personal financial management when they should have filed certifications that they had received pre-petition credit counseling].

7. A "record" of any interest in an education individual retirement account or under a state tuition program. See 11 U.S.C. § 521(c); Interim Rule 1007(b)(1)(F); Official Form 6, Schedule B, Line 11.

8. If requested by the court, United States Trustee, or any party in interest in a chapter 7, 11, or 13 case filed by an individual debtor, federal income tax returns for each tax year ending while the case is pending, federal tax returns for the 3 years prior to the filing date that had not been filed prior to the filing date, and any amendments to the foregoing returns, all of which must be made available for inspection and copying by the U.S. Trustee, trustee, and any party in interest. See 11 U.S.C. § 521(f)(1)-(3) & (g)(2).

9. If requested by the court, United States Trustee, or any party in interest in a chapter 13 case without a confirmed plan, 90 days after the end of a tax year or 1 year after the petition date, whichever is later, a statement of income and expenditures for the year most recently concluded showing the amount and sources of income, identifying those responsible for the support of a dependent of the debtor, and identifying persons who contributed and the amounts contributed to the debtor's household. See 11 U.S.C. § 521(f)(4) & (g)(1).

10. If requested by the court, U.S. Trustee, or any party in interest in a chapter 13 case, not later than 45 days after confirmation of a plan and annually thereafter, a statement of income and expenditures for the year most recently concluded showing the amount and sources of income, identifying those responsible for the support of a dependent of the debtor, and identifying persons who contributed and the amounts contributed to the debtor's household. See 11 U.S.C. § 521(f)(4) & (g)(1).

The documents required by section 521(f)(4) will impose record keeping and reporting obligations on consumer debtors with which their attorneys may need to provide substantial assistance.

Section 521(a)(1)(B)(ii) requires the debtor to file a statement of “current income and current expenditures.” Section 521(a)(1)(B)(v) requires the debtor to file a statement of “monthly net income” which itemizes how that amount was calculated. Section 707(b)(2)(C) requires a schedule of “current monthly income” that shows the calculations determining whether a presumption of abuse arises under the means test. See Statement of Current Monthly Income and Means Test Calculation. Are these statements and schedules providing the same or different information?

The Schedule of Current Income and Current Expenditures gives the debtor’s income and expenses as of the petition date and asks the debtor whether these amounts are likely to change significantly over the next year. See Official Forms B6I & B6J (Schedules I and J).

“Current monthly income” is defined by section 101(10A) as average income, whether or not taxable, from all sources for the 6-month period prior to the petition date. It is not “net” of anything. It is simply an average of income from all sources. Consequently, it is also not a measure of “current” in the sense that it is the debtor’s income on the date of the petition.

The means test of section 707(b)(2)(A) subtracts from “current monthly income” those expenses permitted by Internal Revenue Service standards when negotiating compromises with taxpayers, as well as the debtor’s actual secured debt payments. See 11 U.S.C. § 707(b)(2)(A)(ii) - (iv). These expenses are determined as of the date relief is ordered. Id.

In the chapter 7 context, if a debtor’s gross income exceeds the “median family income” as defined in section 101(39A), and if the means test shows that the debtor has sufficient remaining income to repay defined amounts to unsecured creditors [see section 707(b)(2)(A)(i)], the debtor is a presumed abuser of relief under chapter 7.

In the chapter 13 context, the means test defines the outer limit of what must be paid to holders of unsecured claims. They must receive no less than the present value of what would be paid to them in a chapter 7 liquidation [see section 1325(a)(4)], but they are entitled to receive more if the debtor’s projected disposable income will yield more than this hypothetical liquidation dividend [see section 1325(b)].

In both contexts, however, the means test is not determining the amount of money the debtor actually has available to pay debts. The means test necessarily produces an artificial number for three reasons. First, as noted above, it does not begin with the debtor’s actual income. It uses an historical average. Second, rather than use the debtor’s actual expenses to determine net income available to pay claims, the debtor is required to use the IRS standards. Actual expenses may be higher or lower than these standards. Third, even though the debtor’s actual payments on secured debts are used in the means test, those expenses are averaged over a 60-month period. So, for example, the balance on a car loan with 12 months remaining on its term will be averaged over a 60-month period. As a result, the deduction of payments on secured debts from current monthly income will not reflect the debtor’s actual monthly obligations on secured debts as of the petition date.

Thus, the new Statement of Current Monthly Income and Means Test Calculation, Official Form 22, is unlikely to give the court, the trustee, and creditors an accurate picture of the debtor's actual monthly income. The Schedule of Current Income and Current Expenditures (Schedules I and J) will be more useful in this regard.

As noted above, the term monthly net income is not defined, either in section 521 or section 101. The Interim Rules do not fill this definitional void. All that can be surmised from the phrasing of this undefined term is that the word "net" suggests that something must be deducted from some measure of the debtor's income.

The changes to Schedules I and J indicate that monthly net income is nothing more than what remains from the income reported on Schedule I after the expenses reported on Schedule J are deducted. That is, it is gross monthly income as of the petition date as reported on Schedule I, less the taxes also reported on Schedule I, less the expenses reported on Schedule J.

### **Copies of Documents**

Section 521 gives various parties the right to receive copies of the above-mentioned documents as well as other documents:

1. Section 521(e)(1) permits a "creditor" to file a request to receive a copy of "the petition, schedules, and statement of financial affairs filed by the debtor." If requested, "the court" must make those documents "available" to such creditor.
2. Section 521(e)(3) requires the court to provide to a "creditor" in a chapter 13 case, at reasonable cost, not later than five days after a request is filed, a copy of the debtor's plan.
3. Section 521(g)(2) requires that the income tax returns and the statement of income and expenditures described in section 521(f)(1)-(4) "be available to the United States Trustee, . . . the trustee, and any party in interest for inspection and copying" subject to procedures to be promulgated by the Administrative Office of the U.S. Courts to safeguard the confidentiality of any "tax information."
4. If requested by the U.S. Trustee or the trustee, the debtor must provide photo identification or other personal identifying information establishing the debtor's identity. See 11 U.S.C. § 521(h). Interim Rule 4002(b)(1) implements section 521(h). It requires individual debtors to bring two forms of personal identification to the meeting of creditors under section 341. This identification must consist of a picture identification issued by a governmental unit or "other personal identifying information that established the debtor's identity." See Interim Rule 4002(b)(1)(A). The debtor must also produce evidence of a social security number or a written statement that such documentation does not exist. See Interim Rule 4002(b)(1)(B).

5. Not later than 7 days before the first date set for the creditors' meeting, the debtor must "provide" the trustee with a copy of the federal income tax return (or transcript of the return) for the most recent pre-petition tax year for which a return was required. See 11 U.S.C. § 521(e)(2)(A); Interim Rule 4002(b)(3).

There may be an ambiguity in section 521(e)(2)(A) as to what return a debtor is obligated to provide to the trustee. One commentator has suggested that section 521(e)(3)(A) "require[s] a tax return or transcript only for the most recent year, and to not require it if no return was required or filed in that year." See 4 Lawrence P. King, Collier on Bankruptcy, ¶ 521.20 (15<sup>th</sup> ed. Rev. 2005). However, the legislative history indicates that the must "provide the trustee . . . a copy of his or her Federal income tax return or transcript (at the election of the debtor) for the latest taxable period ending prior to the filing of the bankruptcy case for which a tax return was filed. See H.R. Rep. No. 109-31, pt. I, at 78 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88. See In re Ring, 2006 WL 1171984 n.5 (Bankr. D. Me. 2006).

If a creditor "timely" requests it, at the same time the debtor provides this return to the trustee, a copy must be provided to the creditor. See 11 U.S.C. § 521(e)(2)(A)(ii). Interim Rule 4002(b)(4) defines "timely." A creditor must request the return at least 15 days before the first date set for the meeting of creditors. What if the debtor provides the return to the trustee sooner than 15 days before the meeting and before any request for a copy by the creditor? Section 521(e)(2)(A)(ii) specifies that "at the same time the debtor" provides a copy to the trustee, "a copy of such return . . . [must be provided] to any creditor that timely requests such copy." If the debtor has already given the copy to the trustee, how can the debtor give a copy "at the same time" to the creditor?

Note that unlike the returns required to be filed with the court by section 521(f)(1)-(3), section 521(e)(2) does not require that this return be filed with the court. Interim Rule 4002(b)(5) specifies that the debtor's obligation to provide tax returns to the trustee and requesting creditor is subject to procedures safeguarding the confidentiality of the tax information. These procedures are not included in the Interim Rules. They are to be established by the Director of the Administrative Office of the United States Courts.

### **Dismissal for Failure to File and Provide Copies of Documents**

Section 521 includes three separate provisions requiring dismissal when the debtor fails to file documents or to provide copies to parties in interest. One of these provisions is self-executing. That is, dismissal does not require notice, a hearing, or even an order.

First, section 521(e)(2)(B) & (C) requires the court to dismiss a petition if an individual chapter 7 or 13 debtor fails to provide to the case trustee, or to a creditor making a timely request, a copy of the debtor's federal income tax return for the most recent tax year ending before the filing of the petition. This return must be produced seven days prior to the date first set for the meeting of creditors.

However, the court may decline to dismiss the case if the debtor demonstrates that the failure to provide a copy of the return was due to circumstances beyond the control of the debtor. See Interim Rule 4002(b)(3) & (4) [permitting the debtor to provide a written statement that the return or other documentation does not exist]. In In re Merrill, 2006 WL 1071751 (Bankr. D.N.H. 2006), the debtor had given his tax return to his attorney for timely transmittal to the trustee. The attorney neglected to give it to the trustee until the eve of meeting of creditors. The court held that the failure to transmit the return timely was “beyond the control of the debtor.”

Given this possible defense to dismissal, it appears that dismissal requires notice and a hearing even though section 521(e)(2)(B) & (C) does not so provide. This is the conclusion reached by the few courts interpreting section 521(e)(2)(B) & (C). For example, in In re Duffus, 339 B.R. 746, 748 (Bankr. D. Ore. 2006), the bankruptcy court determined that the debtor’s failure to provide the return to the trustee does not result in the automatic dismissal of the case. Rather, “[t]he ordinary predicate for any order is a motion.” See, also In re Ring, 2006 WL 1171984 (Bankr. D. Me. 2006) [also making clear that notice and hearing on the dismissal is necessary]. Further, the trustee may exercise “prosecutorial discretion” and determine that it is not in the best interests of the estate to request dismissal. Duffus, 339 B.R. at 748.

Second, if a debtor under any chapter fails to file a tax return that becomes due after the case is filed, or to obtain an extension of the due date for filing such return, the taxing authority may “request” that the court enter an order converting or dismissing the case. See 11 U.S.C. § 521(f)(1) & (j). If the debtor fails to file the return or obtain an extension within 90 days after the request by the taxing authority is filed, the court must dismiss or convert the case, whichever is in the best interests of creditors and the estate. Once again, section 521(j) does not mention notice or a hearing. However, given the need to determine whether conversion or dismissal is appropriate, notice and a hearing seems necessary.

Third, if an individual debtor in a voluntary chapter 7 case or in a chapter 13 case fails to file “all of the information required under” section 521(a)(1) [list of creditors, schedule of assets and liabilities, schedule of current income and current expenditures, statement of financial affairs with section 342(b) certificate, copies of employer payment advices, statement of monthly net income, statement of reasonably anticipated increases in income or expenditures] within 45 days of the filing of the petition, the case “shall be automatically dismissed effective on the 46<sup>th</sup> day.” See 11 U.S.C. § 521(i)(1). If any party in interest requests entry of an order confirming that the case has been dismissed, one must be entered not later than 5 days after the request. See 11 U.S.C. § 521(i)(2).

Dismissal under section 521(i) may be averted in one of two ways. First, if within the 45 day period the debtor “requests” additional time, not to exceed a further 45 days, to file these documents and if “the court finds justification,” an extension may be granted. The statute does not specify that notice and a hearing is necessary. See 11 U.S.C. § 521(i)(3). Second, if the debtor files everything required by section 521(a)(1) except copies of employer payment advices, the trustee may move during the 45-day period, or any extension of it, that the case not be dismissed provided the debtor attempted in good faith to file the employer payment advices and the best interests of creditors would be served by permitting the case to remain pending. See 11

U.S.C. § 521(i)(4).

In the absence of a timely motion under section 521(i)(3) or section 521(i)(4), motions under Fed. R. Bankr. P. 9006(b) for an enlargement of time to file documents, whether made before the 45-day deadline expires or after its expiration on the grounds of excusable neglect cannot be granted. See In re Fawson, 338 B.R. 505 (Bankr. D. Utah 2006); In re Ott, 2006 WL 1152339 (Bankr. D. Colo. 2006); In re Abdul Muhaimin, 2006 WL 1153898 (Bankr. D. Md. 2006).

Section 521 does not contain an express provision permitting or requiring dismissal because a debtor fails to file a record of an interest in an education individual retirement account or in a qualified state tuition program or the certificate from the approved nonprofit budget and credit counseling agency. See 11 U.S.C. § 521(b) & (c). Nor does section 521 contain an express provision permitting or requiring dismissal because a debtor fails to file the documents specified in section 521(f)(2)-(4) [previously unfiled federal income tax returns and amendments to them for the 3 years prior to the petition, as well as statements of post-petition income and expenditures by chapter 13 debtors]. Such failures might be cause for dismissal under section 707(a) or 707(b)(1) & (3), or dismissal or conversion under 1307(c).

### **Statement of Intention**

Current law requires an individual chapter 7 debtor to file a statement of intention with reference to property that secures a consumer debt. The statement must be filed within 30 days of the filing of the petition or by the date of the meeting of creditors, whichever is earlier. The debtor must disclose in the statement whether he or she intends to retain or surrender such property, whether the property is claimed as exempt, and whether the debtor intends to redeem such property or reaffirm the debt it secures. See 11 U.S.C. § 521(a)(2)(A).

Amended section 521(a)(2) requires the statement of intention be filed whether or not the secured debt is a consumer debt. The statement of intention is necessary for any claim secured by property of the estate. The property may be real or personal property.

Section 521(a)(2)(B) requires that a chapter 7 individual debtor, within 30 days after the first date set for the meeting of creditors, perform his or her intention with respect to such property. The 30-day period may be extended if the debtor requests an extension before the 30-day period expires.

If the property securing the debt is personal property and an individual chapter 7 debtor fails to file a statement of intention, or fails to indicate in the statement that he or she either will redeem the property or enter into a reaffirmation agreement, or fails to timely surrender, redeem, or reaffirm, the automatic stay is automatically terminated and the property is no longer property of the bankruptcy estate. See 11 U.S.C. § 362(h). However, if the creditor refuses to enter into a reaffirmation agreement with the debtor on the original contract terms, section 362(h) is not triggered and the automatic stay remains in place. See 11 U.S.C. § 362(h)(1)(B). It is unclear whether the redemption or the reaffirmation must be completed within the 30-day period or

whether the debtor need only file the necessary motion within that period.

The trustee may avoid automatic termination of the automatic stay by filing a motion within whichever of the two 30-day periods set by section 521(a)(2) is applicable, and proving that such property is of consequential value or benefit to the estate. If proven, the court must order appropriate adequate protection of the creditor's interest in its collateral and order the debtor to deliver possession of the property to the trustee. If not proven, the automatic stay terminates upon the conclusion of the hearing on the trustee's motion. See 11 U.S.C. § 362(h)(2).

The operation of section 362(h) is limited to personal property that is security for a debt [or, as discussed more fully in the summary of section 362, that is the subject of an unexpired lease]. It does not apply to real property secured by loans or real property leases. Consequently, there is no automatic termination of the automatic stay or other consequence if a debtor fails to file a statement of intention, or fails to timely surrender, redeem, or reaffirm with reference to a real property secured debt.

In a chapter 7 case filed by an individual debtor, the debtor is prohibited from retaining possession of personal property encumbered by a purchase money security interest held by a creditor with an "allowed claim" unless the debtor, not later than 45 days after the first meeting of creditors, either enters into a reaffirmation agreement or redeems the property. See 11 U.S.C. § 521(a)(6).

There are two ambiguities in section 521(a)(6). First, it is unclear whether this 45-day period runs from the first date set for the meeting of creditors or the date it concludes. It will behoove the practitioner to calculate the 45-day deadline correctly because, unlike the 30-day deadline set by section 521(a)(2)(B), section 521(a)(6) makes no provision for an extension of the 45-day deadline and failing to act within that deadline has a significant consequence (see below). Second, it is unclear whether the holder of the purchase money security interest may assert a right to repossess the personal property without first filing a proof of claim. Section 521(a)(6) requires an "allowed claim." Section 502(a) provides that a claim is allowed only if a proof of claim is filed.

If the debtor fails to reaffirm or redeem within the 45-day deadline, the automatic stay is automatically terminated and the personal property is no longer property of the estate unless, within the 45-day period, the trustee files a motion and demonstrates that the property is of consequential value or benefit to the estate. If proven, the court must order appropriate adequate protection of the creditor's interest in its collateral and order the debtor to deliver possession of the property to the trustee. If not proven, the automatic stay terminates upon the conclusion of the hearing on the trustee's motion. See 11 U.S.C. § 521(a)(6).

It is unclear whether the redemption or the reaffirmation must be completed within the 45-day period or whether the debtor need only file the necessary motion within that period.

Section 521(a)(6), unlike section 362(h)(1)(B), makes no exception to the automatic termination of the automatic stay for those cases where the creditor refuses to enter into a reaffirmation agreement with the debtor on the original contract terms.

Sections 521(a)(2)(B) and 362(h) appear to be inconsistent with section 521(a)(6) in another respect. Absent an extension, the 30-day deadline set by section 521(a)(2)(B) for an individual chapter 7 debtor to redeem or reaffirm in connection with personal property secured claims will always expire before the 45-day deadline to redeem or reaffirm in connection with claims secured by purchase money security interests in personal property.

This inconsistency might be eliminated by interpreting sections 362(h), 521(a)(2), and 521(a)(6) as follows:

- a statement of intention must be filed for all debts secured by property of the estate within the earlier of 30 days from the filing of the petition or the date of the meeting of creditors. See 11 U.S.C. § 521(a)(2).
- if personal property is security for a debt, including a debt secured by a purchase money security interest in personal property, and if a statement of intention is not filed within 30 days after the filing of the petition or by the meeting of creditors, whichever is earlier, or if the statement is filed timely but fails to indicate whether the debtor will surrender or retain the personal property and, if the debtor is retaining the property, that it will be redeemed or the debt reaffirmed, the automatic stay will automatically terminate subject to the trustee's right to move to preserve the automatic stay. See 11 U.S.C. §§ 362(h)(1) & 521(a)(2)(A).
- if personal property is security for a debt, excluding a debt secured by a purchase money security interest in personal property, and if the debtor fails to surrender, reaffirm, or redeem within 30 days after the first date set for the meeting of creditors (or within any period extended by the court), the automatic stay will automatically terminate subject to the trustee's right to move to preserve the automatic stay. See 11 U.S.C. §§ 362(h)(1)(B) & 521(a)(2)(B).
- if a debt is secured by a purchase money security interest in personal property, and if the debtor fails to surrender, reaffirm, or redeem within 45 days after the meeting of creditors, the automatic stay will automatically terminate subject to the trustee's right to move to preserve the automatic stay. See 11 U.S.C. § 521(a)(6).

If an individual chapter 7 debtor fails to act timely under section 521(a)(6) [purchase money security interests in personal property], or section 362(h) [all other personal property secured claims and leased personal property], or section 365(p) [assumption of personal property by debtor after lease rejected by trustee], the creditor/lessor may enforce a provision in a security agreement or lease placing the debtor in default because of the debtor's insolvency or the debtor's filing of a bankruptcy petition. See 11 U.S.C. § 521(d).

Section 521(a)(6) differs from section 362(h) insofar as it prohibits a debtor from retaining possession of personal property that is encumbered by a purchase money security interest unless the debtor redeems the property or reaffirms the debt. If the security agreement does not contain an ipso facto clause making insolvency or bankruptcy an event of default, and if the debtor has not otherwise defaulted, on what basis can the debtor be compelled to relinquish possession?

### Case Authority Impacted By Amendment

In re Parker, 139 F.3d 688 (9<sup>th</sup> Cir. 1998), holding that an individual debtor may retain property that was collateral for a consumer secured debt by voluntarily maintaining contract payments and without reaffirming the debt or redeeming the collateral, is overruled by section 521.

### Litigation Points

1. If a chapter 11 debtor in possession is serving as an administrator of a plan under ERISA, and if section 521(a)(7) also requires the debtor in possession to perform the obligations of the administrator, there is the possibility, perhaps even a likelihood, that the fiduciary duties imposed on a debtor in possession will conflict with those required under ERISA. Consider those cases where a chapter 11 debtor moves to terminate future obligations under a pension plan.

2. A case trustee is not given express standing to request that an individual debtor file federal income tax returns for each tax year ending while the case is pending, federal tax returns for the 3 years prior to the filing date that were unfiled when the case was commenced, and any amendments to the foregoing returns. However, the case trustee is identified as one of the persons entitled to inspect and copy these documents. See 11 U.S.C. § 521(f)(1)-(3) & (g)(2). Is the case trustee dependent on the U.S. Trustee to request these documents in the first instance?

3. If a creditor “timely” requests it, at the same time the debtor provides the federal income tax return for the most recent pre-petition year to the trustee, the debtor is required to give a copy to the creditor. See 11 U.S.C. § 521(e)(2)(A)(ii). Can the debtor demand prior payment of the costs related to satisfying any such request for a copy? How soon must the request for a copy be made relative to the production to the trustee? Can a request for a copy be made after the return has been provided to the trustee? Interim Rule 4002(b)(4) requires the creditor to make the request at least 15 days prior to the meeting of creditors. The rule does not specify how the request must be made and it is silent as to the cost of the copy.

4. Section 521(e)(2)(B) & (C) requires dismissal if an individual chapter 7 or 13 debtor fails to provide to the case trustee, or to a creditor making a timely request, a copy of the debtor’s federal income tax return for the most recent tax year ending before the filing of the petition. The court may decline to dismiss the case if the debtor demonstrates that the failure to provide a copy of the return was due to circumstances beyond the control of the debtor. Does this mean that notice and a hearing is necessary? Or, is it incumbent on the debtor to obtain an order

preventing dismissal? Because the return is not filed, only given to the trustee and possibly to some creditors, how is the court to know that dismissal is appropriate?

5. If a debtor under any chapter fails to file a tax return that becomes due after the case is filed, or to obtain an extension of the due date for filing such return, the taxing authority may “request” that the court enter an order converting or dismissing the case. See 11 U.S.C. § 521(f)(1) & (j). Is a request a motion that must be granted before the debtor is required to do anything? Or, is it a cue for the debtor to act within 90 days to file the return(s)? If the debtor fails to file the return, does the court then hold a hearing? Who notices it? The debtor? The taxing authority?

6. Automatic dismissal under section 521(i) for the failure to file any documents required by section 521(a)(1) [list of creditors, schedule of assets and liabilities, schedule of current income and current expenditures, statement of financial affairs, section 342(b) certificate, statement of monthly net income, employer payment advices, and a statement of reasonably anticipated increases in income and expenditures], may be averted if within the 45 days the debtor “requests” additional time, not to exceed an additional 45 days, to file this information, and if “the court finds justification” for granting the extension. What is sufficient justification? Is notice and a hearing necessary to obtain an extension? See 11 U.S.C. § 521(i)(3). And, while section 521(i) provides for automatic dismissal for failure to file the documents required by section 521(a)(1), section 521(a)(1) permits the court to order otherwise and permit a debtor to not file a schedule of assets and liabilities, a schedule of current income and current expenditures, the statement of financial affairs, section 342(b) certificate, a statement of monthly net income, employer payment advices, and a statement of reasonably anticipated increases in income and expenditures and schedules of assets and liabilities. If the court orders otherwise, does this trump section 521(i)? Must such an order be entered during the 45-day period?

7. Automatic dismissal under section 521(i) has the potential for a great deal of confusion. Considering the number and complexity of the documents required by section 521(a)(1), it may be unclear from the court’s file whether or not the debtor has failed “to file all of the information.” Yet, creditors conceivably can take the position that the case has been dismissed even if no order is entered. Also, the court may be unaware that a petition should be (has been) dismissed unless and until a creditor or other party in interest requests a “comfort” order pursuant to section 521(i)(2) confirming the dismissal.

8. Section 521 does not authorize dismissal or conversion when a debtor fails to file a record of an interest in an education individual retirement account or in a qualified state tuition program, a certificate from the approved nonprofit budget and credit counseling agency, or the documents specified in section 521(f)(2)-(4) [previously unfiled federal income tax returns and amendments to them for the 3 years prior to the petition, as well as statements of post-petition income and expenditures by chapter 13 debtors]. See 11 U.S.C. § 521(b), (c), (f), & (i). Are such failures nonetheless cause for dismissal or conversion? Under section 707(a)? Under sections 707(b)(1) & (3) or 1307(c)?

9. Section 521(a)(2)(B) permits a chapter 7 individual debtor to obtain an extension of the 30-day period to perform his or her intention to surrender, reaffirm, or redeem. To obtain the extension, is notice and a hearing necessary? What showing must be made to receive an extension?

10. To avoid automatic termination of the automatic stay under section 362(h), must the redemption or the reaffirmation be completed within the 30-day period? Or, is it only necessary that a motion to redeem or reaffirm be filed within the 30-day period? The same issues arise concerning section 521(a)(6) and the 45-day period to redeem or reaffirm in connection with personal property encumbered by a purchase money security interest.

11. The trustee may avoid automatic termination of the automatic stay under 362(h) by filing a motion and making the showing specified in section 362(h)(2). If the trustee is unable to make such showing, the automatic stay terminates upon the conclusion of the hearing on the trustee's motion. See 11 U.S.C. § 362(h)(2). What if the court takes the matter as submitted? Is an order necessary? Note that a similar provision at section 521(a)(6) dealing with personal property that is the subject of a purchase money security interest does not include similar language.

12. A chapter 7 debtor is prohibited from retaining possession of personal property encumbered by a purchase money security interest unless the debtor, not later than 45 days after the first meeting of creditors, either enters into a reaffirmation agreement or redeems the property. See 11 U.S.C. § 521(a)(6). Does this 45-day period run from the first date set for the meeting or the date it concludes? May the 45-day deadline be extended? Section 521(a)(2)(B) permits an extension of the 30-day period while section 521(a)(6) makes no provision for an extension of the 45-day deadline. Section 521(a)(6) differs from section 362(h) insofar as it prohibits a debtor from retaining possession of personal property absent a redemption or reaffirmation. Will a debtor be precluded from possessing property without redemption or reaffirmation if the security agreement does not contain an ipso facto clause making insolvency or bankruptcy an event of default? If so, on what basis will the debtor be compelled to relinquish possession?

13. Section 521(a)(6) is limited in its application to creditors with "allowed claims" secured by purchase money security interests. Does this mean that section 521(a)(6) is not triggered if the creditor fails to file a proof of claim?

14. Section 521(a)(6), unlike section 362(h)(1)(B), makes no exception to the automatic termination of the automatic stay for those cases where the creditor refuses to enter into a reaffirmation agreement with the debtor on the original contract terms. Is such an exception nonetheless possible?

15. Sections 521(a)(2)(B) and 362(h) are inconsistent with section 521(a)(6). Absent an extension, the 30-day deadline set by section 521(a)(2)(B) for an individual chapter 7 debtor to redeem or reaffirm in connection with personal property secured claims will always expire before the 45-day deadline to redeem or reaffirm in connection with claims secured by purchase money

security interests in personal property. Can this inconsistency be reconciled? See the discussion above.

16. What if a purchase money security interest is avoidable? Will section 521(a)(6) still operate to strip the encumbered property from the estate and to terminate the automatic stay?

17. The amendments to section 521 impose administrative burdens on the debtor and the debtor's attorney. Many debtors do not keep their pay stubs and will have to obtain copies from less than motivated employers. See 11 U.S.C. § 521(a)(1)(iv).

18. Section 521(a)(1)(B)(vi) requires the debtor to file a statement disclosing any "reasonably anticipated increase of income or expenditures" for the 12 months following the petition date. However, nothing else in the Bankruptcy Code makes use of this statement or the information in it. What will be its use?

19. If requested by the court, U.S. Trustee, or any party in interest in a chapter 7, 11, or 13 case filed by an individual debtor, any delinquent federal income tax returns for the 3 years prior to the filing date must be made available for inspection and copying when they are filed with the taxing authority. See 11 U.S.C. § 521(f)(2). However, section 521(f)(2) does not require that they be filed with the taxing authority. It provides only that if the returns are filed with the taxing authority, copies must be provided to the court, U.S. Trustee, or any party in interest.

## Cross References

### New Defined Terms

**current monthly income**, 11 U.S.C. § 101(10A)

**median family income**, 11 U.S.C. § 101(39A)

### Bankruptcy Code

11 U.S.C. § 109(h)	[briefing by an approved nonprofit budget and credit counseling agency]
11 U.S.C. § 111	[approved nonprofit budget and credit counseling agency]
11 U.S.C. § 110(b)(2)	[bankruptcy petition preparer]
11 U.S.C. § 342(b)	[written notice re bankruptcy/nonbankruptcy alternatives]
11 U.S.C. § 362(a)	[automatic stay]
11 U.S.C. § 362(h)	[termination of automatic stay absent timely redemption or reaffirmation]
11U.S.C. § 502(a)	[allowance of claim]
11 U.S.C. § 522(f)	[lien avoidance]
11 U.S.C. § 524(c)	[reaffirmation agreements]

11 U.S.C. § 541(b)(5)	[education IRA]
11 U.S.C. § 541(b)(6)	[state tuition program]
11 U.S.C. § 707(a)	[dismissal of chapter 7 petition for cause]
11 U.S.C. § 707(b)	[dismissal of chapter 7 petition for presumed abuse]
11 U.S.C. § 722	[redemption]
11 U.S.C. § 727(a)(11)	[statement of completion of course on personal financial management]
11 U.S.C. § 1328(g)(1)	[statement of completion of course on personal financial management]

#### Applicable Nonbankruptcy Statutes

28 U.S.C. § 586(f)	[authorizing the United States Trustee to contract with auditors to perform audits pursuant to section 603(a) of the 2005 Act. See discussion below in connection with sections 107, 112, 727.]
29 U.S.C. § 1001, et seq.	[ERISA employee benefit plans]

#### Interim Rules

Interim Rule 1007(b)(1)(E)	[filing copies of employer payment advices]
Interim Rule 1007(b)(3)	[filing certificate from approved nonprofit budget and credit counseling agency]
Interim Rule 1007(b)(4)	[individual chapter 7 debtors must file statement of current monthly income on Official Form 22A]
Interim Rule 1007(b)(7)	[filing of statement regarding completion of course on personal financial management]
Interim Rule 1007(c)	[statement of current monthly income, Official Form 22A, must be filed within 15 days of order for relief]
Interim Rule 4002(b)(1)	[proof of personal identification to be produced at first meeting]
Interim Rule 4002(b)(2)	[financial information the debtor must produce at the meeting of creditors]
Interim Rule 4002(b)(3)-(5)	[provision of the debtor's most recent tax return to the trustee and any requesting creditor]
Interim Rule 4004(c)(1)(H)	[delay of chapter 7/13 discharge until Rule 1007(b)(7) statement filed]

#### Official Forms

Official Form 1	[voluntary petition form]
Official Form 6I & J	[Schedules I and J amended to include "total monthly income," "total monthly expenses," "monthly net income," and statements of "reasonably anticipated increase of income or

	expenditures]
Official Form 19A	[Declaration and Signature of Non-Attorney Bankruptcy Petition Preparer, and Official Form]
Official Form 19B	[Notice to Debtor by Non-Attorney Bankruptcy Petition Preparer]]
Official Form 22A	[statement of current monthly income and means test calculation for use in chapter 7 cases]
Official Form 22B	[statement of current monthly income for use in chapter 11 cases filed by individuals]
Official Form 22C	[statement of current monthly income and disposable income calculation for use in chapter 13 cases]
Official Form 23	[statement regarding post-petition completion of course on personal financial management]

### Drafting Issues and Problems

Section 521(e)(2)(C) and section 521(e)(2)(B) are redundant.

### Administrative Burdens Imposed on Court

Significant administrative burdens will be imposed on the court clerk by section 521. If nothing else, section 521 will increase the number of documents filed by debtors in connection with petitions. Second, automatic termination of the automatic stay and abandonment pursuant to sections 521(a)(2)(B) & (a)(6) and 362(h) will require monitoring by the clerk. However, it may develop that fewer motions seeking termination of the automatic stay will be filed, thereby reducing the net burden on the clerk. Third, section 521(e)(1) & (3) require the clerk to make copies of schedules, statements, and plans available on request. This burden will be a slight one given the easy and inexpensive availability of documents over the Internet. Fourth, section 521(f) permits the court, U.S. Trustee, or any other party in interest to request that individual chapter 7, 11, and 13 debtors file copies of any income tax returns filed during the case. This is likely to impose a significant burden on the clerk because section 315(c) of the Act requires that new procedures be created by the Administrative Office to protect the confidentiality of tax information. These procedures will undoubtedly be implemented at the local level by the clerk. Fifth, the provision in section 521(i) for automatic dismissal if the debtor fails to file the documents required by section 521(a)(1), may impose a moderate burden on the clerk. The possibility of dismissal is likely to prompt motions by debtors seeking an extension of time to file the documents, and motions by case trustees to forestall dismissal. See 11 U.S.C. § 521(i)(3)(4).

## SECTION 522 Exemptions

### Effective Date

Paragraphs (o), (p), and (q) of section 522, dealing with homestead exemptions, apply to cases filed on or after the date of enactment, April 20, 2005. The remainder of amended section 522 applies to cases filed on or after October 17, 2005.

### Summary of Amendment

**Domicile Requirements.** If a debtor is claiming exemptions under state law, the debtor must have resided in that state for the 730 days preceding the filing of the petition. If the debtor has not been a domicile of a state for the requisite 730 days, the debtor's exemptions are determined by the exemptions allowed by the state in which the debtor was domiciled for the majority of the 180 days that preceded the 730-day period. See 11 U.S.C. § 522(b)(3)(A). If these domiciliary requirements mean that a debtor is not eligible for any state's exemptions, then the "hanging paragraph" after section 522(b)(3)(C) permits the debtor to claim exemptions under section 522(d) even if the debtor is a resident of a state that has opted out of the section 522(d) exemptions.

This hanging paragraph also is worded awkwardly. It might be read to provide that if the domiciliary requirements prevent the debtor from claiming a particular exemption, the debtor may claim exemptions under section 522(d) even if the debtor is a resident of a state that has opted out of the section 522(d) exemptions. However, the more logical interpretation is that if the debtor is prevented by the domiciliary requirements of section 522(b)(3) from claiming any exemption under any state's exemption laws, then the "hanging paragraph" after section 522(b)(3)(C) permits the debtor to claim exemptions under section 522(d) even if the debtor is a resident of a state that has opted out of the section 522(d) exemptions.

**Retirement Accounts.** Amended section 522 permits a debtor to exempt funds in retirement accounts if they are exempt from taxation under sections 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code regardless of whether the debtor is claiming exemptions under state law or under section 522(d). See 11 U.S.C. § 522(b)(3)(C). With the exception noted below, retirement accounts recognized by the Internal Revenue Code, including accounts that are in substantial compliance with the requirements of these sections, are exempt in their entirety. See 11 U.S.C. § 522(b)(4). If funds from one account are exempt from taxation, their rollover or transfer does not preclude their exemption in a bankruptcy case. See 11 U.S.C. § 522(b)(4)(C) & (D).

The exception to the rule that the entire retirement account is exempt involves individual retirement accounts under sections 408 and 408A of the Internal Revenue Code. The maximum amount in an IRA that may be exempted is \$1,000,000. See 11 U.S.C. § 522(n). This amount is subject to tri-annual adjustment under 11 U.S.C. § 104(b)(1). The \$1,000,000 limit is also

subject to increase “if the interests of justice so require.” See 11 U.S.C. § 522(n).

**Household Goods.** The definition of household goods for purposes of avoidance of nonpossessory, nonpurchase money security interests under section 522(f) is limited to clothing, furniture, appliances, 1 VCR, 1 television, 1 radio, linens, china, crockery, kitchenware, educational materials, medical equipment and supplies, furniture for the exclusive use of minor children and disabled dependents, personal effects (toys, wedding rings) and 1 personal computer. Household goods do not include works of art, entertainment equipment not specified above, jewelry with an aggregate fair market value greater than \$500 excluding wedding rings, computer equipment other than the 1 computer permitted above, tractors, lawn tractors, boats and other recreational vessels and vehicles. See 11 U.S.C. § 522(f)(4). The \$500 limit on jewelry set by section 522(f)(4) is subject to tri-annual adjustment pursuant to 11 U.S.C. § 104(b)(1).

**Homesteads.** Three limitations are imposed on homestead exemptions. First, by virtue of 11 U.S.C. § 522(o), a homestead exemption will be reduced by the value attributable to property disposed of by the debtor with the intent to hinder, delay, or defraud creditors during the 10 years prior to the petition date to the extent that property was not otherwise exempt. See In re Maronde, 332 B.R. 593 (Bankr. D. Minn. 2005).

Second, homestead exemptions will be capped at \$125,000 to the extent the debtor acquired “an interest” in the property within 1215 days prior to filing the petition. See 11 U.S.C. § 522(p). Schedule C, part of Official Form 6, has been amended to require a debtor to disclose at the top of the schedule whether an exemption in excess of \$125,000 has been claimed.

What if the debtor acquires a home outside the 1215-day period but because the debtor makes regular mortgage payments during the 1215-day period, the debtor’s equity increases? In In re Blair, 334 B.R. 374 (Bankr. N.D. Tex. 2005), the court held the accumulation of additional equity due to the payment of a mortgage during the 1215 days prior to the petition was not subject to the \$125,000 cap. The reference to an “interest” in the homesteaded property is to the acquisition of title.

The \$125,000 cap does not apply: (1) if the debtor is a family farmer [11 U.S.C. § 522(p)(2)(A)]; or (2) to the extent the exempted equity is attributable to proceeds from a sale of the debtor’s prior residence as long as it was acquired more than 1215 days prior to the filing of the petition and the prior residence was located in the same state as the current residence [11 U.S.C. § 522(p)(2)(B)].

There may be a third situation in which the cap does not apply. One court, in the first published decision concerning the 2005 Act, has held that if the debtor cannot elect, pursuant to section 522(b)(3)(A), between exemptions allowed under state law or under section 522(d), the \$125,000 cap does not apply. See In re McNabb, 326 B.R. 785 (Bankr. D. Ariz. 2005). However, a second court in In re Kaplan, 331 B.R. 493 (Bankr. S.D. Fla. 2005), in the second published decision concerning the 2005 Act, has come to the opposite conclusion. See also In re Wayrynen, 332 B.R. 479 (Bankr. S.D. Fla. 2005); In re Virissimo, 332 B.R. 201 (Bankr. D. Nev. 2005). Note that there are only two states, Texas and Minnesota, with homestead exemptions in

excess of \$125,000 that have not opted out of the federal exemption scheme.

Third, regardless of when the debtor acquired the homesteaded residence, the \$125,000 cap applies if the debtor has been convicted of a felony demonstrating that the petition was an abuse of title 11, or the debtor owes a debt for violation of state or federal securities laws or a debt arising from a criminal act or an intentional tort causing serious physical injury or death to another in the preceding 5 years. See 11 U.S.C. § 522(q)(1). The cap will not apply in these situations, however, where the debtor demonstrates that a homestead exemption in excess of \$125,000 is reasonably necessary for the support of the debtor and any dependent of the debtor. See 11 U.S.C. § 522(q)(2).

Interim Rule 4003(b)(2) permits objections to homestead exemptions under section 522(q) to be filed anytime before the closing of the case. If an exemption is claimed for the first time in a reopened case, the objection may be filed anytime before the reopened case is closed. Thus, the deadline for all other objections to exemptions set by Fed. R. Bankr. P. 4003(b)(1) [within 30 days of the conclusion of the meeting of creditors] is not applicable to objections based on section 522(q).

The \$125,000 cap imposed by paragraphs (p) and (q) is subject to tri-annual upward adjustment pursuant to section 104(b)(1).

Included in the terms defined in section 101 is the term “**incidental property.**” This definition is given with reference to a “**debtor’s principal residence,**” which is also a term defined in section 101. See 11 U.S.C. § 101(13A) & (27B). The former term appears nowhere in the Bankruptcy Code other than in the definition of “debtor’s principal residence.” A debtor’s principal residence is defined as a residential structure, including incidental property without regard to whether it is attached to the real property. Neither term is used in section 522. It seems somewhat anomalous to have two defined terms dealing with a debtor’s residence that are not used in the section dealing with the exemption of a debtor’s residence.

**Liability of Exempt Property.** Property exempted by the debtor is nonetheless liable for tax and domestic support obligations made nondischargeable by 11 U.S.C. § 523(a)(1) & (a)(5), respectively, even if that property is not liable for such obligations under applicable nonbankruptcy law. See 11 U.S.C. § 522(c)(1).

### Litigation Points

1. Litigation over whether a debtor has satisfied the domiciliary requirements for a homestead is likely. Establishing residency will require the debtor to gather evidence for a period of more than three years in the past. The issue of a debtor’s domicile will be complicated in situations where a debtor claims his or her absence from a state is temporary only, perhaps necessitated by a college attendance, a job transfer, or military service.

2. If a retirement plan does not meet the requirements of sections 401, 403, 408, 408(A), 414, 457, or 501 (A) of the Internal Revenue Code, then the familiar litigation over whether the

account is “reasonably necessary” for the support of the debtor will still have to be waged, at least if the debtor is using the exemptions under section 522(d). Section 522(d)(10)(E) was not deleted or amended.

3. Can the \$1,000,000 cap for IRAs be doubled to \$2,000,000 for joint debtors? The exemption of retirement accounts granted by section 522(b)(3)(C) is in addition to state exemptions. Section 522(m) directs that section 522 applies separately to joint debtors except as state law may specify otherwise. State law would not be applicable to the exemption of retirement accounts granted in section 522(b)(2)(C).

4. If there is more than \$1,000,000 in an IRA, may the amount exceeding \$1,000,000 still be exempted if it is reasonably necessary to the debtor’s support and state law or section 522(d) permits such an exemption? See Cal. Civ. Proc. Code § 704.115(e) and 11 U.S.C. § 522(d)(10)(E).

5. Section 522(f)(1)(B)(i) lists jewelry as a separate category of property that can be held primarily for the personal, family, or household use of the debtor or a dependent of the debtor. However, the new enumeration of what is included within “household goods” at section 522(f)(4)(B)(iv) also includes jewelry but limits its aggregate value to \$500. Can avoidance of a nonpossessory, nonpurchase money security interest in jewelry exceeding \$500 in value be accomplished by considering such jewelry under the “jewelry” category rather than the “household goods” category? There are other duplications between sections 522(f)(1)(B)(i) and 522(f)(4) – household furnishings/furniture, wearing apparel/clothing, and appliances/appliances.

6. If jewelry has a value of \$501, may a nonpossessory, nonpurchase money lien be avoided at \$500 in value but not \$1 in value, or is the debtor precluded from avoiding any portion of the lien by virtue of the wording of section 522(f)(4)(B)(iv) [precluding the avoidance of liens on “jewelry with a fair market value of more than \$500 in the aggregate”]?

7. Does VCR (video cassette recorder) include a DVR (digital video recorder) or a DVD (digital video decoder)?

## Cross References

### New Defined Terms

**family farmer**, 11 U.S.C. § 101(18)

**transfer**, 11 U.S.C. § 101(54)

### Bankruptcy Code

11 U.S.C. § 104(b)

[tri-annual adjustment of dollar amounts]

11 U.S.C. § 523(a)(1) & (5)

[nondischargeable claims for taxes and for domestic support obligations]

### Applicable Nonbankruptcy Statutes

18 U.S.C. § 3156	[definition of federal felony]
18 U.S.C. § 1964	[RICO criminal statute]
26 U.S.C. § 401	[retirement account not subject to income tax]
26 U.S.C. § 403	[retirement account not subject to income tax]
26 U.S.C. § 408	[retirement account not subject to income tax]
26 U.S.C. § 408A	[retirement account not subject to income tax]
26 U.S.C. § 414	[retirement account not subject to income tax]
26 U.S.C. § 457	[retirement account not subject to income tax]
26 U.S.C. § 501(a)	[tax exempt organizations]
28 U.S.C. § 7805	[tax determinations re retirement plans]
C.C.P. § 704.115(e)	[California exemption statute for retirement plans]

### Bankruptcy Rules

Fed. R. Bankr. P. 4003(b)(1)	[deadline for objections to exemptions other than objections pursuant to § 522(q)]
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### Interim Rules

Interim Rule 4003(b)(2)	[objections to homestead exemptions under § 522(q) permitted anytime prior to closing of case]
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### Drafting Issues and Problems

As noted above, there is a paragraph following section 522(b)(3)(C) that is detached from subparagraph (C) and the remainder of section 522(b)(3). This hanging paragraph also is worded awkwardly. It might be read to provide that if the domiciliary requirements prevent the debtor from claiming a particular exemption, the debtor may claim exemptions under section 522(d) even if the debtor is a resident of a state that has opted out of the section 522(d) exemptions. However, the more logical interpretation is that if the debtor is prevented by the domiciliary requirements of section 522(b)(3) from claiming any exemption under any state's exemption laws, then the "hanging paragraph" after section 522(b)(3)(C) permits the debtor to claim exemptions under section 522(d) even if the debtor is a resident of a state that has opted out of the section 522(d) exemptions.

The end of section 522(b)(1) provides that if joint debtors cannot agree, they shall be deemed to elect exemptions under paragraph (b)(1). The paragraph referred to should be (b)(2).

Included in the terms defined in section 101 is the term "**incidental property.**" This definition is given with reference to a "**debtor's principal residence,**" which is also a term defined in section 101. See 11 U.S.C. § 101(13A) & (27B). The former term appears nowhere in the Bankruptcy Code other than in the definition of "debtor's principal residence." A debtor's principal residence is defined as a residential structure, including incidental property without

regard to whether it is attached to the real property. Neither term is used in section 522. It seems somewhat anomalous to have two defined terms dealing with a debtor's residence that are not used in the section dealing with the exemption of a debtor's residence.

## SECTION 523 Exceptions to Discharge

### Effective Date

Section 523(a)(19) is effective retroactive to July 30, 2002, the date of enactment of the Sarbanes-Oxley Act, and applies to all cases, including pending cases. All other amendments to section 523 are effective October 17, 2005.

### Summary of Amendment

Eleven subparagraphs of section 523(a) have been amended.

**Taxes and Customs Duties.** Section 523(a)(1) makes certain taxes and customs duties nondischargeable. Whether or not certain taxes are dischargeable hinges on whether the required return was filed or filed timely. The amendment more precisely defines “return” and makes clear that the return may be “filed” or “given.” A return includes any return that satisfies nonbankruptcy law including a return under 26 U.S.A. § 6020(a) but not a return under 26 U.S.C. § 6020(b), or similar state or local laws. A return under section 6020(a) is prepared by the IRS and signed by the taxpayer. The second is prepared by the IRS but not signed by the taxpayer. Note that the language concerning returns under section 6020 does not appear in subparagraph (a)(1). It appears at the end of section 523(a), immediately after subparagraph (a)(19).

**Consumer Debt.** Section 523(a)(2)(C), dealing with consumer debt, is amended to make debts owed to a single creditor aggregating \$500 (a decrease from \$1,225) for luxury goods or services and incurred within 60 days (rather than 90 days) of the petition date presumptively nondischargeable. Also presumptively nondischargeable are cash advances under an open end credit plan aggregating \$750 (down from \$1,225) and taken within 60 days (rather than 70 days) of the filing of the petition.

The dollar amounts in section 523(a)(2)(C) are subject to adjustment every three years pursuant to 11 U.S.C. § 104(b)(1).

**Domestic Support Obligations.** Section 523(a)(5), has been amended by striking the existing paragraph making a debt for support and maintenance owed to a spouse, former spouse, or child of the debtor nondischargeable, and replacing it with a simple statement that a domestic support obligation is nondischargeable.

Section 101(14A) defines a domestic support obligation as a debt for support, including government assistance, owed to or recoverable by a spouse, former spouse, a child or a child’s parent, responsible relative, or guardian, or a governmental unit, whether the debt arises or is established before, on, or after the order for relief, in a court order, determination by a governmental unit, or a separation agreement, divorce decree, or property settlement. If interest accrues under applicable nonbankruptcy law, the claim includes “interest that accrues . . .

notwithstanding any other provision of this title.” Claims assigned to governmental units are not domestic support obligations unless the assignment is voluntary and for the purpose of collecting the claim on behalf of the person entitled to the support.

**Student Loans.** The discharge exception for student loans in section 523(a)(8) has been expanded to include any qualified education loan as defined by 26 U.S.C. § 221(e)(2). This encompasses education loans extended or guaranteed by, not only governmental entities and nonprofit institutions, but also nongovernmental entities and for-profit institutions.

The criteria for a qualified education loan under 26 U.S.C. § 221(d)(1) are: (1) an indebtedness incurred by the taxpayer solely to pay qualified higher education expenses; (2) incurred on behalf of the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer as of the time the debt was incurred; (3) the education expenses were paid or incurred within a reasonable period of time before or after the indebtedness was incurred; and (4) the expenses were attributable to an education furnished to a recipient who was an eligible student.

**Operation of Vehicles, Vessels, Aircraft While Intoxicated.** The exception to discharge in section 523(a)(9) for debts arising from death or personal injury caused by the debtor’s operation of a motor vehicle while intoxicated has been expanded to include such debts arising from the operation of a vessel or aircraft as well as a motor vehicle.

**Debts Incurred To Pay Tax.** Section 523(a)(14) has been divided into three parts. The first two parts of section 523(a)(14) concern debts incurred to pay taxes. Existing law providing that a debt incurred to pay a tax to the United States is nondischargeable remains intact at section 523(a)(14). Section 523(a)(14)(A) expands this exception to discharge to cover debts incurred to pay taxes owed any other governmental unit.

**Debts Incurred to Pay Federal Election Law Fines.** Section 523(a)(14)(B) excepts debts incurred to pay fines or penalties imposed under federal election law.

**Nonsupport Debts.** Section 523(a)(15) excepts debts owed to a spouse, former spouse, or child of the debtor incurred in connection with a divorce or separation, other than domestic support obligations [which are made nondischargeable by section 523(a)(5)], from an individual debtor’s discharge. The provision in the former section permitting a discharge of domestic nonsupport obligations if a discharge would cause less of a “hardship” to the former spouse or child than an exception to discharge would entail for the debtor has been deleted.

**Condo Fees.** Section 523(a)(16) post-petition fees and assessments owed to a membership association with respect to a debtor’s interest in a residential condominium, cooperative corporation, or homeowner’s association are nondischargeable for as long as the debtor or the trustee has a legal, equitable, or possessory interest in a unit. Dischargeability no longer hinges on whether the debtor occupies or rents out the unit.

**Litigation Costs Assessed Against Prisoners.** Section 523(a)(17) has been amended to clarify that this exception to discharge applies only to prisoners against whom fees, costs, or

expenses are imposed pursuant to the federal in forma pauperis statute, 28 U.S.C. § 1915(b) or (f)(2), or a comparable state law, such as California's in forma pauperis statute, Cal. Govt. Code § 68511.3. This exception to discharge does not apply costs taxed to civil litigants who are not prisoners.

Former section 523(a)(18) regarding obligations owed to a state in the nature of support and enforceable under part D of title IV of the Social Security Act, 42 U.S.C. § 601 *et seq.*, has been deleted. The dischargeability of domestic support obligations is governed by section 523(a)(5).

**Debts Owed to Pension.** Amended section 523(a)(18) excepts from discharge debts owed to a pension, retirement, profit-sharing, stock bonus, or other plan established under 26 U.S.C. §§ 401, 403, 408, 408A, 414, 457, or 501(c), as well as loans permitted under section 408(b)(1) of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1108(b)(1), or subject to 26 U.S.C. § 72(p), and loans from a thrift savings plan that satisfy the requirements of 5 U.S.C. § 8433. A loan made under a governmental plan under section 414(d) or a contract or account under section 403(b) of the Internal Revenue Code are not excepted from discharge.

In a related amendment, section 362(b)(19) has been added as an exception to the automatic stay. The automatic stay notwithstanding, withholding from the debtor's wages may continue for the benefit of a retirement plan sponsored by the debtor's employer in order to repay a loan from that plan. Further, a chapter 13 plan may not "materially" alter the terms of such a loan and the funds due on account of the loans are not considered disposable income. See 11 U.S.C. § 1322(f).

**Securities Fraud.** Section 523(a)(19) clarifies that a debt for securities fraud is made nondischargeable whether the judgment, order, settlement agreement, or administrative order upon which it is based was entered before, on, or after the date of the petition. This exception to discharge is retroactive to July 30, 2002.

**Exclusive Jurisdiction and Section 523(a)(15).** Section 523(c)(1) deletes section 523(a)(15), debts arising from a divorce or separation that are not domestic support obligations, from the list of obligations that the bankruptcy court must determine to be nondischargeable. As a result, both domestic support and nonsupport obligations may be adjudicated and determined to be nondischargeable by nonbankruptcy courts.

The elimination of the bankruptcy court's exclusive jurisdiction to determine the dischargeability of domestic nonsupport obligations resolves an inconsistency in section 523(a)(3)(B). Under section 523(a)(3)(B), if a debt is not scheduled in time for the creditor to file a complaint to determine dischargeability under section 523(a)(2), (a)(4), or (a)(6), that is, for all debts section 523(c) requires a timely dischargeability complaint be filed in the bankruptcy court, the debtor forfeits the right to have the bankruptcy court determine dischargeability. See, e.g., Fidelity Nat'l Title Ins. Co. v. Franklin (In re Franklin), 179 B.R. 913 (Bankr. E.D. Cal.1995). In 1994, when the Bankruptcy Reform Act added subparagraph (a)(15) to the list of nondischargeable debts, it also amended section 523(c) to give the bankruptcy court the exclusive

jurisdiction to determine the dischargeability of such debts. However, the Bankruptcy Reform Act of 1994 neglected to add subparagraph (a)(15) to section 523(a)(3)(B), raising the possibility that a creditor holding a domestic nonsupport obligation might not be given notice of the petition in time to file a timely dischargeability complaint and yet that creditor's claim would be discharged. This problem is eliminated by ending the bankruptcy court's exclusive jurisdiction to determine the dischargeability of domestic nonsupport obligations.

#### Case Authority Impacted by the Amendment

See the above discussion regarding domestic nonsupport obligations and section 523(a)(3)(B).

The Omnibus Consolidated Rescissions and Appropriations Act of 1996 added subparagraph (17) to section 523(a). In addition to amending the federal in forma pauperis statute, 28 U.S.C. § 1915, to require a prisoner to pay costs assessed in connection with a judgment entered against the prisoner, the 1996 Act made those costs nondischargeable in any chapter 7 petition filed by the prisoner. However, the language of subparagraph (a)(17) was too broad. It appeared to make nondischargeable all costs taxed to a civil litigant who thereafter filed a petition. It was not limited to debtors who were also prisoners. Despite the ambiguity, most courts limited the application of this discharge exception to prisoners. See, e.g., Hough v. Fry (In re Hough), 239 B.R. 412 (B.A.P. 9<sup>th</sup> Cir. 1999).

#### Litigation Points

1. Given the expansion of the discharge exception for student loans to include all qualified education loans, regardless of whether they are extended by non-profit or governmental entities, there is likely to be more litigation concerning the hardship discharge. This litigation will occur in chapter 13 cases, as well as the chapter 7 context, because section 1328(a)(2) also excepts student loans from a chapter 13 discharge and section 1322(b)(10) permits the payment of interest on nondischargeable debts.

2. It is debatable whether the amendments to the exception to discharge for presumptively fraudulent consumer debts, section (a)(2)(C), will have a significant impact. For one thing, many creditors will not, as a matter of litigation economics, file suit to collect debts of \$500 to \$750. Also, given the requirement that individual debtors receive a pre-filing briefing from a credit counseling agency, and given that a debtor is likely to be more than 90 days past due on debts when the petition is filed, section 523(a)(2)(C) will have a negligible impact.

#### Cross References

##### New Defined Terms

**domestic support obligation**, 11 U.S.C. § 101(14A)

## Bankruptcy Code

11 U.S.C. § 104(b)	[tri-annual adjustment of dollar amounts]
11 U.S.C. § 704(c)(1)(C)	[chapter 7 trustee reports to domestic support claim holder]
11 U.S.C. § 1106(c)(1)(C)	[chapter 11 trustee reports to domestic support claim holder]
11 U.S.C. § 1206(c)(1)(C)	[chapter 12 trustee reports to domestic support claim holder]
11 U.S.C. § 1302(d)(1)(C)	[chapter 13 trustee reports to domestic support claim holder]
11 U.S.C. § 1322	[mandatory and permissive provisions in chapter 13 plans]
11 U.S.C. § 1328(b)	[scope of chapter 13 discharge]

## Applicable Nonbankruptcy Statutes

5 U.S.C. § 8433	[thrift savings plans]
15 U.S.C. § 78c(a)(47)	[definition of federal <b>securities laws</b> ]
15 U.S.C. § 1602(h)	[definition of <b>consumer</b> in 11 U.S.C. § 523(a)(2)(C)]
15 U.S.C. § 1602(c)	[definition of <b>credit</b> in 11 U.S.C. § 523(a)(2)(C)]
15 U.S.C. § 1602(i)	[definition of <b>open end credit plan</b> in 11 U.S.C. § 523(a)(2)(C)]
26 U.S.C. § 72(p)	[loans treated as distributions from retirement accounts for taxation purposes]
26 U.S.C. § 221(d)(1)	[qualified education loan]
26 U.S.C. § 401	[retirement account not subject to income tax]
26 U.S.C. § 403	[retirement account not subject to income tax]
26 U.S.C. § 408	[retirement account not subject to income tax]
26 U.S.C. § 408A	[retirement account not subject to income tax]
26 U.S.C. § 414	[retirement account not subject to income tax]
26 U.S.C. § 457	[retirement account not subject to income tax]
26 U.S.C. § 501(c)	[tax exempt organizations]
26 U.S.A. § 6020(a), (b)	[substitute tax returns]
28 U.S.C. § 1915	[federal in forma pauperis statute]
29 U.S.C. § 1108(b)(1)	[loans permitted by ERISA]

## Drafting Issues and Problems

Pursuant to sections 704(c)(1)(C), 1106(c)(1)(C), 1202(c)(1)(C), and 1302(d)(1)(C), trustees must report to the holder of a domestic support obligation and the state child support enforcement agency all obligations that a debtor has not discharged under section 523(a)(2), (a)(4) or (a)(14A) at the time a debtor is granted a discharge. However, this may not be known, at least as to debts falling under subparagraphs (a)(2) and (a)(4), at the time the discharge is

issued because dischargeability actions are rarely concluded by that time.

Structurally, section 523(a)(1) is awkward. The language appearing after subparagraph (a)(19) is positioned as if it is applicable to subparagraphs of section 523(a)(1). However, this language deals with substitute tax returns and is applicable only to subparagraph (a)(1). Given the placement of this language, its applicability to section 523(a)(1) will be very easy to overlook.

#### Administrative Burdens Imposed on Court

Sections 704(c)(1)C, 1106(c)(1)C, 1202(c)(1)C, and 1302(d)(1)C impose an obligation on a case trustee to report to the holder of a domestic support obligation and the state child support enforcement agency all debts excepted from the debtor's discharge under section 523(a)(2), (a)(4) or (a)(14A). This report must be given "at such time as the debtor is granted a discharge." Because complaints objecting to the discharge of debts falling under subparagraphs (a)(2) and (a)(4) are rarely resolved by the time the debtor's discharge is entered, this reporting requirement may have the effect of delaying the debtor's discharge, or delaying the closing of the case and the discharge of trustee in order that the trustee can make the report at the time the debtor's discharge is entered.

## SECTION 524 Effect of Discharge

### Summary of Amendment

The amendments made to section 524 concern both the discharge injunction and reaffirmation agreements.

### **The Discharge Injunction**

The discharge injunction, as provided in section 524(a)(2), is amended by the addition of sections 524(i) and 524(j).

Crediting Plan Payments. Section 524(i) provides that a creditor's willful failure to credit payments in accordance with a confirmed plan is a violation of section 524(a)(2) if this failure causes material injury to the debtor, confirmation of the plan has not been revoked, the plan is not in default, and the creditor received the payments.

Payment on Home Loans. The post-discharge injunction provided by section 524(a)(2) will not apply to an act in the ordinary course of business by a creditor holding a claim secured by a lien on the debtor's principal residence provided the act is limited to seeking or obtaining periodic payments in lieu of seeking "in rem relief" to enforce the lien. See 11 U.S.C. § 524(j).

The phrase "in rem relief" is not a reference to 11 U.S.C. § 362(d)(4). Section 362(d)(4) permits the court to terminate or modify the automatic stay with respect to real property if the filing of the petition was part of a scheme to delay, hinder, and defraud creditors that entailed either transferring all or part of the property without the consent of the secured creditor or court approval, or filing multiple bankruptcy petitions. If the order is recorded, it will be binding in any future case filed not later than 2 years after entry of the order. If another case is filed, the debtor may move for relief from the in rem order after giving notice and a hearing, by demonstrating that the debtor's circumstances have changed or for other good cause.

Because section 524(a)(2) operates post-discharge, this ground for termination of the automatic stay has no logical applicability. After discharge, there is no automatic stay as to the debtor. See 11 U.S.C. § 362(c)(2)(C).

The phrase "in rem relief" in section 524(j) must be a reference to a creditor's right to proceed against its collateral as opposed to in personam relief against the debtor. Unlike the right to pursue a claim against the debtor, a creditor's right to pursue its collateral is undiminished by the debtor's discharge.

Rejected Personal Property Leases. The discharge injunction is also modified by 11 U.S.C. § 365(p)(2)(C). If a trustee rejects a personal property lease, the lessor does not violate the discharge injunction by notifying an individual chapter 7 debtor that the lessor will permit the

debtor to assume the lease and negotiate a cure of any lease default by debtor.

### **Reaffirmation Agreements**

In General. In order to reaffirm a debt, the debtor and the creditor must enter into a reaffirmation agreement before the granting of the debtor's discharge, the debtor must receive the disclosures required by section 524(k) at or before signing the agreement, the agreement must be filed with the court, and the debtor must not have rescinded the agreement. See 11 U.S.C. § 524(c)(1)-(4). If the debtor is represented by an attorney, the agreement must be accompanied by the attorney's declaration attesting that the agreement represents an informed and voluntary agreement by the debtor, that it will not impose an undue hardship on the debtor, and that the attorney advised the debtor of the legal consequences of the agreement and a default under it. See 11 U.S.C. § 524(c)(3). If the debtor does not have an attorney, the debtor must appear at a hearing and the court must advise the debtor of the legal effect and consequences of entering into and defaulting under the agreement, and determine that the debtor's agreement is voluntary and was not compelled. If the court finds that the agreement will not impose an undue hardship on the debtor and is in the debtor's best interests, and the above requirements are met, it may approve the reaffirmation agreement. See 11 U.S.C. § 524(c)(5)-(6) & (d).

The disclosures required by section 524(c)(2) are enumerated in a five-part form laid out in section 524(k). The creditor may vary the order of these disclosures and, other than the terms "Amount Reaffirmed" and "Annual Percentage Rate" [see below], may use different terminology. See 11 U.S.C. § 524(k)(2). "The requirements of subsections (c)(2) and (k) shall be satisfied if disclosures required under those subsections are given in good faith." See 11 U.S.C. § 524(k)(3).

The disclosures required by section 524(c)(2) are contained within a disclosure statement in the form required by section 524(k)(3) [Part A of the prescribed form], a reaffirmation agreement complying with section 524(c) & (k)(4) [Part B of the prescribed form], the debtor's attorney's certification required by section 524(c)(3) & (k)(5) [Part C of the prescribed form], the debtor's statement required by section 524(k)(6) [Part D of the prescribed form], the motion to approve the reaffirmation agreement for use in cases where the debtor is not represented by an attorney in the form required by section 524(k)(7) [Part E of the prescribed form], and an order approving the agreement in the form required by section 524(k)(8).

Creditor's Disclosure Statement. The creditor's disclosures must be in writing. See 11 U.S.C. § 524(k)(2). They must be clear and conspicuous. See 11 U.S.C. § 524(k)(2). They must be provided to the debtor before or at the time the debtor signs the reaffirmation agreement. See 11 U.S.C. § 524(c)(2). The "disclosure statement" given by the creditor to the debtor must include the following information:

- A summary of the reaffirmation agreement including the "Amount Reaffirmed" and the "Annual Percentage Rate" both of which must be made "more clearly and conspicuously" than the other disclosures. See 11 U.S.C. § 524(k)(2) & (3)(A)-(F).

- If the debt is secured by an unavowed security interest, the property subject to the security interest and its original purchase price or the amount of the original loan if the security interest is not a purchase money security interest. See 11 U.S.C. § 524(k)(3)(G).
- At the election of the creditor, a statement of the repayment schedule. See 11 U.S.C. § 524(k)(3)(H).
- A statement advising the debtor that the debtor should consult an attorney if he or she has questions or, if the debtor has no attorney, the judge will explain the consequences of reaffirming a debt. See 11 U.S.C. § 524(k)(3)(I).
- A statement admonishing the debtor that entering a reaffirmation agreement is a “serious financial decision,” and instructing the debtor to read the creditor’s disclosure [Part A], sign the reaffirmation agreement [Part B], sign the debtor’s statement [Part D], file the attorney’s certification [Part C] if the debtor was represented by an attorney in connection with the negotiation of the reaffirmation agreement, complete, sign, and (presumably) file the motion to approve the reaffirmation agreement [Part E] if not represented by an attorney, and file the original disclosure statement. See 11 U.S.C. § 524(k)(3)(J).
- A statement that if the debtor was represented by an attorney during the negotiation, the reaffirmation agreement will become effective on its filing with the court unless reaffirmation is presumed to be an undue hardship (see discussion below). See 11 U.S.C. § 524(k)(3)(J).
- A statement that the debtor has a right to rescind (cancel) the reaffirmation agreement if such is done any time before entry of the discharge or within 60 days of the date the agreement is filed with the court. See 11 U.S.C. § 524(k)(3)(J).
- A statement that the debtor is not required to enter into a reaffirmation agreement. See 11 U.S.C. § 524(k)(3)(J).
- A statement that any lien held by the creditor will not be eliminated by the debtor’s discharge and that if the debtor does not reaffirm the secured debt, the creditor may be able to take its security. See 11 U.S.C. § 524(k)(3)(J).
- A statement that the debtor may have the right to redeem any property securing the debt. See 11 U.S.C. § 524(k)(3)(J).

The Reaffirmation Agreement. The agreement must state that the debtor is reaffirming the debt arising under a credit agreement. The reaffirmation agreement must include the following: a brief description of the credit agreement; a description of changes to the credit agreement made by the reaffirmation agreement; the names of the borrower and co-borrower (if the co-borrower is also reaffirming), the signatures of the parties and the date signed; a statement

that the creditor has accepted the reaffirmation and the date of that acceptance. See 11 U.S.C. § 524(k)(4).

Attorney Certification. If an attorney represented the debtor during the negotiation of the reaffirmation agreement, that attorney must certify in a signed and dated statement whether the agreement represents an informed and voluntary agreement by the debtor, whether the agreement will impose an undue hardship on the debtor, and that the attorney has advised the debtor of the legal effect and consequences of the agreement and a default under it. See 11 U.S.C. § 524(k)(5).

Debtor's Statement. The debtor must sign a statement in support of the reaffirmation agreement confirming that the debtor believes it will not impose an undue hardship, that the debtor can afford to make the payments on the debt, and that the debtor received the creditor's disclosure statement and a signed and dated reaffirmation agreement. The statement must also include the debtor's total monthly income and actual current monthly expenses. These amounts are to be taken from Schedules I and J. See Interim Rule 4008 If, after deducting expenses from income, the debtor does not have the apparent ability to make the payments required by the reaffirmation agreement, the debtor's statement must explain how the payments will be made. See 11 U.S.C. § 524(k)(6).

Presumption of Undue Hardship. In those instances where the debtor does not have sufficient income to make the payments required by the reaffirmation agreement, the agreement is presumed to be an undue hardship and must be reviewed by the court. See 11 U.S.C. § 524(k)(6) & (m)(1). This review is not limited to cases in which the debtor is not represented by an attorney.

The presumption is temporary. The court has 60 days from the filing of the reaffirmation agreement (the 60-day period may be extended by noticed motion) to review the matter. The presumption "may" be rebutted by the debtor's statement if it includes an explanation as to how the debtor will be able to make the payments. If the presumption is not rebutted "to the satisfaction of the court, the court may disapprove such agreement," but only after notice and a hearing. The hearing must be concluded before entry of the debtor's discharge.

Given that the presumption of undue hardship is only temporary, if the court fails to disapprove the reaffirmation agreement within 60 days of the filing of the agreement at a hearing concluded before the entry of the discharge order, the presumption evaporates and the reaffirmation agreement becomes enforceable at least in those cases where the debtor was represented by an attorney during the negotiation of the agreement. In such cases the court is not required to approve the reaffirmation. If the debtor was unrepresented, the court is required to approve the reaffirmation agreement before it can become effective. See 11 U.S.C. § 524(d).

This problem is compounded by the fact that section 524 does not set a deadline for filing the reaffirmation agreement. Section 524(c)(1) requires only that the agreement be "made before the granting of the discharge." Consequently, in a case where there is a presumption of undue hardship, a debtor represented by counsel could file a reaffirmation agreement one day before the entry of the discharge and, given the requirement that a hearing be concluded before the

discharge, the court would have no practical ability to “disapprove” the agreement.

Section 524(d) requires a motion to approve a reaffirmation agreement only in those instances where the debtor was not represented by an attorney during the negotiation of the agreement. See 11 U.S.C. § 524(d) & (k)(7). What if the debtor was represented by counsel but a shortfall in income reflected on the debtor’s statement raises the temporary presumption of undue hardship? Nothing requires the filing of a motion to approve the reaffirmation agreement in this situation. Presumably, then, the court is expected to review every reaffirmation agreement filed, whether or not a motion for its approval also is filed, as well as the accompanying debtor’s statements and, if a presumption of undue hardship is apparent from that statement, set and conclude a hearing on the agreement prior to entry of a discharge.

Motion to Approve Reaffirmation. As noted above, a motion must be filed to approve the reaffirmation agreement in those cases where the debtor was not represented by counsel during the negotiation of the agreement. See 11 U.S.C. § 524(d) & (k)(7). Section 524(c) requires only that the reaffirmation agreement be made before a discharge order is entered. There is no deadline set in the Bankruptcy Code for filing the reaffirmation agreement and Fed. R. Bankr. P. 4008 permits a debtor to file a motion to approve a reaffirmation agreement before or at the hearing conducted pursuant to section 524(d).

Section 524(d) permits, but does not require, the court to hold a hearing at which the debtor “shall appear in person.” At the hearing, the court must inform the debtor that a discharge “has been entered” or the reason why a discharge has not been granted. That is, at least in those cases where the debtor is eligible for a discharge, the hearing under section 524(d) follows the entry of the discharge. Fed. R. Bankr. P. 4008 requires this hearing take place not more than 30 days after entry of the discharge order. Rule 4008 and section 524(d), then, permit the motion to approve the reaffirmation agreement to be filed after the discharge, and they require the court to consider approving a reaffirmation agreement only after entry of the discharge.

However, in cases where an individual debtor is not represented by counsel and the debtor’s statement raises the temporary presumption of undue hardship, the 60-day deadline imposed by section 524(m)(1) seemingly requires that the motion be filed in time to permit a hearing before the entry of a discharge order. This conflicts with the requirement in section 524(d) that the court hold a hearing after discharge.

Perhaps the conflict between section 524(d) and section 524(m)(1) can be resolved by interpreting the former as requiring court approval of reaffirmation agreements filed by unrepresented debtors and the latter as permitting court disapproval of an agreement, whether or not the debtor is represented by counsel, if the presumption of undue hardship arises.

Under this interpretation, if a debtor is represented and the presumption does not arise, no hearing is necessary. Section 524(d) does not require one because the debtor had the assistance of counsel, and section 524(m)(1) does not require one because the presumption did not arise. If the same debtor is unrepresented by counsel, a hearing to approve the reaffirmation agreement would be necessary after the debtor were discharged. One would not be necessary prior to

discharge because the presumption of undue hardship did not arise.

In those cases where the presumption of undue hardship arises, so do the problems.

If the debtor is represented, the court must hold a hearing that concludes prior to discharge in order to disapprove the agreement. However, because no motion to approve such agreements is required, the court will be put to the task of reviewing every reaffirmation agreement and the accompanying debtor’s statement in order to identify those cases where the presumption arises. If that review indicates to the court that the agreement should not be disapproved, conceivably it need do nothing further because the presumption is temporary and section 524(m)(1) requires notice and a hearing only to disapprove the agreement.

If the debtor is unrepresented and if the presumption of undue hardship arises, the court must hold a pre-discharge hearing to disapprove the agreement. Again, no hearing is necessary unless the court wishes to disapprove the agreement.

The conflict between paragraphs (d) and (m) is highlighted in the table below.

	<b>Debtor represented by counsel</b>	<b>Debtor not represented by counsel</b>
<b>No Presumption of Undue Hardship</b>	No hearing required. <u>See</u> § 524(d).	Hearing to approve agreement required after discharge. Must conclude no later than 30 days after discharge. <u>See</u> § 524(d), Rule 4008.
<b>Presumption of Undue Hardship</b>	Hearing to disapprove the agreement must be held within 60 days of filing agreement and conclude prior to discharge. <u>See</u> § 524(m)(1), Rule 4004(c)(1)(J).	Hearing to disapprove the agreement must be held within 60 days of filing agreement and conclude prior to discharge. <u>See</u> § 524(m)(1), Rule 4004(c)(1)(J). Post-discharge hearing to approve the agreement must conclude no later than 30 days after discharge. <u>See</u> § 524(d), Rule 4008.

Interim Rules 4004 and 4008 attempt to deal with some of these issues. Interim Rule 4004(c)(1)(J) provides that if the debtor’s statement required by section 524(k) reveals that the debtor will not have the income to repay the obligation to be reaffirmed, thereby raising the presumption of undue hardship, the debtor’s discharge will be delayed to permit a hearing on the reaffirmation agreement prior to a discharge as required by section 524(m). However, Rule 4008 does not change the deadline for filing a motion to approve a reaffirmation [it may be filed before or at a post-discharge hearing permitted by section 524(d)] nor has any deadline been set for filing the reaffirmation agreement. Consequently, when the presumption of undue hardship arises, the ability of the court to disapprove the reaffirmation agreement may be frustrated.

Credit Union Exemption. Section 524(m)(2) prevents the temporary presumption of undue hardship from applying to reaffirmation agreements between credit unions and debtors.

Section 524(m)(2) refers to section 19(b)(1)(A)(iv) of the Federal Reserve Act, 12 U.S.C. § 461(b)(1)(A)(iv). Section 461 in turn refers to any insured credit union under 12 U.S.C. § 1752, any federally insured credit union, or any credit union that is eligible to be insured under 12 U.S.C. § 1781. Those credit unions that are eligible to be federally insured are credit unions organized and existing under the laws of any state, the District of Columbia, the several territories, including the trust territories, and possessions of the United States, the Panama Canal Zone, or the commonwealth of Puerto Rico, and certain credit unions organized and operating under the Department of Defense. Basically, section 524(m)(2) covers all credit unions except foreign credit unions.

Essentially, all provisions in section 524 regarding the temporary presumption of undue hardship do not apply to reaffirmation agreements between credit unions and debtors. The debtor's statement need not include anything about the debtor's income and expenses, 11 U.S.C. § 524(k)(6)(B), the debtor's attorney's certification need not give an opinion as to whether the debtor is able to make the payments required by the reaffirmation agreement, 11 U.S.C. § 524(k)(5)(B) & (C), and a reaffirmation agreement by a debtor represented by counsel will be effective upon its filing without any exception for instances where the presumption arises. See 11 U.S.C. § 524(k)(3)(J)(i)(6), (k) (3)(J)(ii), (k)(5)(B) & (C), & (k)(6)(B).

Safe Harbor. Section 524(l)(1) provides that a creditor "may accept" payments before and after the filing of a reaffirmation agreement provided the creditor in good faith believes the agreement is "effective."

### Litigation Points

1. For purposes of section 524(i), if the payments under the plan are paid untimely to the creditor, is this a plan default or a payment not made in the manner required by the plan? If it is a plan default, doesn't the payment by the debtor, even though paid late, cure the default? Section 524(i) uses the words, "is in default." Arguably, if the plan was in default, but no longer is in default, the debtor will be able to pursue a remedy under section 524(i). What will constitute a material injury?

2. Section 524(i), given its placement in the section dealing with the discharge injunction, appears to limit relief for misapplication of plan payments to the post-discharge period. What if the misapplication of funds becomes apparent in connection with a motion for relief from the automatic stay, or an objection to a post-confirmation modification? May the claim be pursued during the case?

3. Section 524(I) provides a remedy for "material injury" caused to the debtor by the creditor's willful failure to credit payments in accordance with a confirmed plan. Is emotional distress a material injury even in the absence of economic loss? Cf. In re Dawson, 390 F.3d 1139 (9<sup>th</sup> Cir. 2004).

4. Is the mere filing of a reaffirmation agreement sufficient to continue the automatic stay under sections 362(h)(1)(B) and 521(a)(6)? Or, in those instances where the debtor is

unrepresented by counsel, must the motion to approve the reaffirmation be granted within the 30-day or 45-day periods of sections 362(h)(1)(B) and 521(a)(6), whichever is applicable? Given that section 524(d) provides for approval of reaffirmation agreements only after a discharge is entered, if the reaffirmation (or redemption) must be approved and completed, very few debtors, at least those without attorneys, will be able to avoid the automatic termination of the automatic stay under sections 362(h)(1)(B) and 521(a)(6).

5. What is the relationship between section 524(f), permitting voluntary payments, and new section 524(l)(2), allowing a creditor to accept payments whenever the creditor in good faith believes there is an effective reaffirmation agreement? Can't the creditor accept payments even without such a good faith belief on the theory that the debtor could still make voluntary payments?

6. How can sections 521(a)(6) and 524(f) be reconciled? Section 524(f) prohibits the debtor from retaining possession of personal property subject to a purchase money security interest. If the debtor may make voluntary payments without reaffirming the debt, and if the creditor can accept those payments, may the debtor nonetheless retain the personal property? Has the creditor waived the right to recover its collateral if it accepts voluntary payments from the debtor? May the creditor refuse to take the debtor's voluntary payments? Does the result depend on whether there is a contract provision placing the debtor in default because of the debtor's insolvency or the filing of a bankruptcy petition?

7. Section 524(l)(3) provides that the requirements of sections 524(c)(2) and 524(k) are met if the creditor gives the disclosures in good faith. Does this mean that substantial compliance with the disclosure requirements is sufficient? Or, does it mean the disclosure requirements are satisfied whether or not the disclosure substantially complies with section 524(k) as long as the creditor believes (or reasonably believes) they satisfy section 524(k)?

8. Is the calculation of the debtor's available income in the debtor's statement required by section 524(k)(6) the same calculation required by the means test of section 707(b)(2)? Apparently not. Interim Rule 4008 provides that available income must be calculated by subtracting the total expense amounts reported on Schedule J from the total income reported on Schedule I.

9. At the time a discharge order is granted, if a claim for a domestic support obligation has been filed, sections 704(c)(1)(C)(iv)(II), 1106(c)(1)(C)(iv)(II), 1202(c)(1)(C)(iv)(II), and 1302(d)(1)(C)(iv)(II) require the trustee to notify the holder of such claim, as well as the state child support enforcement agency, of the name of each creditor whose claim was reaffirmed by the debtor. How can this be done in a case where the debtor does not have an attorney given that section 524(d) requires that the court approve the reaffirmation after a discharge has been granted? What if the agreement is rescinded? Must the trustee verify that the agreement has not been rescinded?

10. Section 524(k)(8) proscribes the form of the order approving the reaffirmation agreement. No form disapproving the reaffirmation agreement is provided. Must the form of the

order provided in section 524(k)(8) be used even when the court disapproves the reaffirmation agreement?

11. Section 524 makes distinctions based on whether or not an attorney represented the debtor “during the negotiation” of a reaffirmation agreement. See 11 U.S.C. § 524(d), (k)(3)(J)(3)-(7). Does this mean that an attorney representing the debtor when the petition was filed may decline to advise the debtor during the negotiation of the reaffirmation agreement? If not, why not just refer to the debtor’s attorney?

### Cross References

#### Bankruptcy Code

11 U.S.C. § 362(d)(4)	[in rem relief from automatic stay]
11 U.S.C. § 362(h)(1)(B)	[automatic termination of the automatic stay]
11 U.S.C. § 365(p)(2)(C)	[rejected personal property leases]
11 U.S.C. § 704(c)(1)(C)	[chapter 7 trustee reports to domestic support claim holder]
11 U.S.C. § 727(a)(7)	[length of time between chapter 7 discharges]
11 U.S.C. § 1106(c)(1)(C)	[chapter 11 trustee reports to domestic support claim holder]
11 U.S.C. § 1202(c)(1)(C)	[chapter 12 trustee reports to domestic support claim holder]
11 U.S.C. § 1302(d)(1)(C)	[chapter 13 trustee reports to domestic support claim holder]

#### Applicable Nonbankruptcy Statutes

12 U.S.C. § 461(b)(1)(A)(iv)	[definition of credit union]
12 U.S.C. § 1752	[definition of credit union]
12 U.S.C. § 1781	[definition of credit union]
15 U.S.C. § 1602(c)	[definition of credit in the Truth-in-Lending Act]
15 U.S.C. § 1602(i)	[definition of open end credit plan in the Truth-in-Lending Act]
18 U.S.C. § 158	[criminalization of abusive reaffirmation practices]
28 U.S.C. § 159	[clerk’s statistical reports]

#### Bankruptcy Rules

Fed. R. Bankr. P. 4008	[discharge and reaffirmation hearing]
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#### Interim Rules

Interim Rule 1007(b)(7)	[statement re completion of course in personal financial management]
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Interim Rule 4004(c)(1)(H)	[denying discharge if debtor fails to file statement re completion of course in personal financial management]
Interim Rule 4004(c)(1)(J)	[delaying entry of a discharge when the presumption of undue hardship arises under § 524(m)]
Interim Rule 4008	[adds requirement to Rule 4008 that the debtor's statement required by § 524(k)(6) be accompanied a statement of the total income and total expenses reported on Schedules I and J]

### Official Forms

Official Form 6	[Schedules I and J amended to “total monthly income,” “total monthly expenses,” and “monthly net income”]
Official Form 23	[statement regarding completion of course in personal financial management]

### Information Necessary to Apply Amended Section

All federally insured credit unions are listed on the National Credit Union Administration's Internet site at [www.ncua.gov](http://www.ncua.gov).

### Drafting Issues and Problems

Section 524(b) limits the discharge on community property given by section 524(a)(3). With the exceptions laid out in section 524(b), when one spouse files a petition, section 524(a)(3) extends the discharge to both spouses' interests in post-petition community property. However, if the spouse has been a debtor in a case commenced within 6 years of the debtor's petition, and if the spouse did not receive a discharge in that case, the discharge granted in the debtor's case will not extend to after acquired community property.

The policy of section 524(b) is to prevent spouses from filing separate, alternating petitions and obtaining chapter 7 discharges more frequently than permitted by section 727(a)(8). Section 727(a)(8) formerly barred an individual debtor from receiving a chapter 7 discharge more frequently than every 6 years. Section 727(a)(8) has been amended to lengthen the wait between discharges from 6 to every 8 years. However, the corresponding amendment was not made to section 524(b)(1).

In those cases where a debtor is represented by an attorney and a reaffirmation agreement will presumptively cause the debtor undue hardship, section 524(m)(1) requires the court to hold a hearing within 60 days of the date the agreement is filed and to conclude it prior to entry of a discharge. However, nothing in section 524 requires the represented debtor to file a motion to approve the reaffirmation agreement.

Section 524(c)(1) permits a debtor and a creditor to enter into a reaffirmation agreement any time prior to discharge. However, no deadline is set for filing the reaffirmation agreement even though the court must conclude a hearing in those instances when a presumption of undue hardship arises prior to granting a discharge. A deadline to file a reaffirmation agreement is needed.

For debtors who do not have legal counsel, section 524(d) requires a hearing after entry of discharge to consider approving the agreement while section 524(m)(1) requires, at least in cases where performance of the agreement will presumptively cause the debtor undue hardship, that a hearing be concluded prior to discharge. If these two hearings are the same hearing, compliance with both section 524(d) and 524(m)(1) is not possible. If they are different hearings, the procedure is cumbersome and duplicative.

Federal Bankruptcy Rule 4008 provides for reaffirmation hearings not more than 30 days following the entry of an order granting or denying a discharge. The timing required by this Rule is inconsistent with section 524(m)(1).

For cases in which the debtor does not have an attorney, section 524(c)(6) discusses the conclusions the court must make in order to approve a reaffirmation agreement after the post-discharge hearing. See 11 U.S.C. § 524(d)(2). One of these is a conclusion that the agreement will not impose an undue hardship on the debtor. What if the presumption of undue hardship already has arisen under section 524(m) but has expired because the court did not disapprove the agreement before the discharge was entered? Is the court precluded from concluding, apart from the expired presumption, that the agreement is an undue hardship?

#### Administrative Burdens Imposed on Court

Section 524(m)(1) provides the court shall review any reaffirmation agreement in which there is an undue hardship presumption. At the very least, this will require that every reaffirmation agreement be reviewed and, in those cases where the presumption arises, a hearing set no later than 60 days after the agreement is filed with the court. Further, the hearing must conclude prior to the discharge.

Because undue hardship hearings must be concluded before discharge, the clerk may be required to delay entry of the discharge order until all reaffirmation agreements have been reviewed and any hearings needed under section 524(m)(1), as well as section 524(d), have been concluded. See Interim Rule 4004(c)(1)(J).

In all chapters, a case trustee must report any reaffirmed debts to the holder of a domestic support obligation. This will require the trustee to monitor the docket and note all reaffirmation agreements either approved by the court or executed and filed by debtors represented by attorneys.

28 U.S.C. § 159 has been added to require the bankruptcy court clerk to collect certain statistics for cases under chapters 7, 11, and 13 and to submit a report to Congress not later than

July 1, 2008, and annually thereafter. Section 159(c)(3)(E) requires that this report include the number of cases in which a reaffirmation agreement was filed, the total number of agreements filed, the number of cases with agreements in which the debtor was not represented by counsel, and the number of cases in which the court approved the reaffirmation agreement.

The 2005 Act includes a new criminal statute, 18 U.S.C. § 158, which requires the United States Attorney and Federal Bureau of Investigation to address abusive practices relative to the reaffirmation of debt. However, section 158(d) does not require the bankruptcy court to refer abusive reaffirmation practices to law enforcement personnel. It is directed to refer only cases in which a debtor makes a materially fraudulent statement in a bankruptcy schedule.

**SECTIONS 526, 527, & 528**  
**Restrictions on Debt Relief Agencies, Disclosures, and**  
**Requirements for Debt Relief Agencies**

Summary of Amendments

Sections 526, 527, and 528 are new to the Bankruptcy Code. They regulate the provision of “bankruptcy assistance” to “assisted persons” by “debt relief agencies.”

**Debt Relief Agency**

A “debt relief agency” refers to a bankruptcy petition preparer and any person paid to provide bankruptcy assistance to an assisted person but excluding the following: (1) an officer, director, employee, or agent of a bankruptcy petition preparer or a debt relief agency; (2) a nonprofit organization (e.g., credit counseling organizations); (3) a creditor of the assisted person who is attempting to restructure debt owed by the assisted person to that creditor; (4) a depository institution or a credit union; and (5) an author, publisher, distributor, or seller of works subject to copyright protection (e.g. Nolo, do-it-yourself legal publications). See 11 U.S.C. § 101(12A).

This definition is broad enough to include attorneys. However, in In re Attorneys at Law, 332 B.R. 66 (Bankr. S.D. Ga. 2005), the court held, without the issue being raised by any party in a case, that sections 526, 527, and 528 did not apply to licensed attorneys. In In re McCartney, 336 B.R. 588 (Bankr. M.D. Ga. 2006), the court declined to rule on the same issue because there was no case or controversy that permitted the exercise its judicial power under U.S. Const. Art. III, § 2.

**Assisted Person**

The term “assisted person” refers to any person whose debts are primarily consumer debts and whose nonexempt property is less than \$150,000. See 11 U.S.C. § 101(3).

**Bankruptcy Assistance**

Goods or services sold to an assisted person for the “express or implied” purpose of providing legal representation, information, advice, counsel, document preparation or filing, or for appearing at a meeting or hearing with respect to a bankruptcy case qualifies as “bankruptcy assistance.” See 11 U.S.C. § 101(4A).

**Prohibited Practices**

A debt relief agency is prohibited by section 526(a) from:

1. Failing to perform any service promised to an assisted person in connection with a bankruptcy case;

2. Making, or advising the assisted person to make, statements that are known to be untrue or misleading, or that upon the exercise of reasonable care should have been known to be untrue or misleading, in any document filed in a bankruptcy case;
3. Misrepresent, either affirmatively or by omission, to the assisted person the services the debt relief agency will provide or the benefits and risks of filing a bankruptcy case; or
4. Advise an assisted person to incur more debt in contemplation of filing a petition or to pay an attorney or bankruptcy petition preparer for services related to a petition.

### **Disclosures and Notices**

Section 527(a) requires a debt relief agency to give written notice to the assisted person of the following:

1. Section 342(b)(1) Notice. The same information the clerk of the bankruptcy court is required by section 342(b)(1) to give to an individual debtor, section 527(a)(1) requires the debt relief agency to give to the assisted person. This information includes a brief description of the general purpose, benefits, and costs of proceeding under chapters 7, 11, 12, and 13 of the Bankruptcy Code, as well as the types of services available from credit counseling agencies;
2. Section 527(a)(2) Notice. Not later than 3 business days after the first date the debt relief agency first offers to provide bankruptcy assistance to an assisted person, section 527(a)(2) requires the debt relief agency to give the assisted person a “clear and conspicuous” notice that –
  - a. all information provided by the assisted person with a petition must be complete, accurate, and truthful;
  - b. all assets and liabilities must be completely and accurately disclosed in the schedules;
  - c. the replacement value set by section 506 for each asset, determined after reasonable inquiry, must be disclosed in the schedules;
  - d. the current monthly income, the amounts specified in section 707(b)(2) [the means test], and disposable income in a chapter 13 case, must be stated after reasonable inquiry; and
  - e. all information provided by an assisted person may be audited and that the failure to provide it may result in the dismissal of the case or other

sanctions, including criminal sanctions.

Note that no deadline is set by section 527(a)(1) for the debt relief agency to give the written notice required by section 342(a)(1). Whenever it is given, it must be accompanied by two other written notices required by section 527(b) & (c).

Section 527(b) Notice. The first of these remaining two notices is a clear and conspicuous separate written notice in a form substantially similar to that laid out in section 527(b). This notice must advise the assisted person that:

1. The debtor may hire a lawyer or a bankruptcy petition preparer or the debtor may represent himself or herself in any bankruptcy case;
2. If a lawyer or a bankruptcy petition preparer is hired, the debtor must be given a written contract explaining the services provided and their cost;
3. Before a petition is filed, the debtor should determine the debtor's eligibility for bankruptcy relief;
4. The petition must be accompanied by many documents that must contain accurate information;
5. The debtor is required to attend the creditor's meeting;
6. In a chapter 7 case, the debtor may be asked to enter into a reaffirmation agreement;
7. In a chapter 13 case, the debtor must repay some or all debts over a 3 to 5 year period;
8. A bankruptcy case may involve litigation and the debtor may represent himself or herself in that litigation, but only an attorney can give the debtor legal advice.

Section 527(c) Notice. Accompanying the notices required by sections 527(a)(2) and 527(b) must be a further written notice required by section 527(c). Unless the debt relief agency provides the information, ascertained with reasonably diligent inquiry of the assisted person or others, for inclusion in the petition, schedules, and statements, the debt relief agency must explain in writing how the debtor can ascertain and provide the information necessary to documents required by section 521, including:

1. How to determine an asset's replacement value;
2. How to calculate current monthly income, the amounts specified in section 707(b)(2), and disposable income in a chapter 13 case;

3. How to complete the list of creditors including determining the amount owed and the address of each creditor;
4. How to determine what property is exempt and its value.

A copy of the notices required under section 527(a) [the notice required by section 342(b)(1) plus the “3-day” notice] must be maintained by the debt relief agency for 2 years after the date it is given to the assisted person. There is no such requirement for the notices required by section 547(b) and (c).

### **Contracts Between Assisted Persons and Debt Relief Agencies**

Not later than 5 business days after the first date on which a debt relief agency provides bankruptcy assistance to an assisted person, but prior to the petition being filed, a written contract must be executed by the debt relief agency. That contract must clearly and conspicuously explain the services the agency will provide, together with the fee and charges for those services and the terms of payment. See 11 U.S.C. § 528(a)(1). An executed completed copy of the contract must be given to the assisted person. See 11 U.S.C. § 528(a)(2).

If the contract for bankruptcy assistance does not comply with the material requirements of section 526, 527, or 528, the contract is void and cannot be enforced in any forum against anyone other than the debt relief agency. See 11 U.S.C. § 526(c)(1). For instance, this provision might be triggered if the contract attempted to waive any protection or right given by these sections or if the contract called for a nonattorney debt relief agency to provide legal advice. See 11 U.S.C. § 526(b) & (d)(2).

### **Remedies Against Debt Relief Agencies**

If a debt relief agency intentionally or negligently fails to comply with sections 526, 527, or 528 with respect to a case or proceeding under title 11, if it provides bankruptcy assistance in a case or proceeding that is dismissed or converted to a case under another chapter because of the agency’s intentional or negligent failure to file any required document, or if it intentionally or negligently disregards the “material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency, the agency is liable to the assisted person for the fees and charges paid for the bankruptcy assistance as well as any actual damages, attorneys’ fees, and costs. See 11 U.S.C. § 526(c)(2).

If the chief law enforcement or other designated officer of a state has reason to believe a debt relief agency has or is violating section 526, the state may bring an action in state court or in federal district court to enjoin the violation, to recover actual damages, the other damages permitted by section 526(c)(2) on behalf of assisted persons who are residents of the state, and its attorneys’ fees and costs if the action is successful. See 11 U.S.C. § 526(c)(3) & (c)(4).

Finally, if the bankruptcy court, on its own motion or that of the debtor or the United States Trustee, finds that a person has intentionally violated section 526 or has engaged in a

“clear and consistent pattern or practice of violating section 526, the court may enjoin the violation of section 526 or impose “an appropriate civil penalty against such person.” See 11 U.S.C. § 526(c)(5).

### **Business Practices of Debt Relief Agencies**

Section 528(a)(3) regulates advertising directed to the general public regarding bankruptcy assistance services or the benefits of bankruptcy. Such advertising includes descriptions of bankruptcy assistance in connection with a chapter 13 plan even if chapter 13 is not mentioned, as well as statements such as “federally supervised repayment plan” or “Federal debt restructuring help,” or similar statements. See 11 U.S.C. § 528(b)(1).

Any advertisement directed to the general public regarding bankruptcy assistance services or the benefits of bankruptcy, whether in the “general media,” seminars, “specific mailings,” telephonic or electronic messages, or otherwise, must clearly and conspicuously disclose that services or benefits relate to bankruptcy relief. Also, the following statement, or one substantially similar to it, must appear in the advertisement: “We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.”

Any advertisement directed to the general public and indicating that assistance is provided with respect to credit default, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay consumer debt must disclose that the assistance provided may involve bankruptcy relief and must include the same statement quoted immediately above.

### **No Waiver**

Any waiver by an assisted person of any protection or right provided by section 526 is unenforceable against the assisted person. See 11 U.S.C. § 526(b).

### **Nonbankruptcy Laws & Regulations**

Sections 526, 527, and 528 do not annul, alter, affect, or exempt any person subject to them from complying with applicable nonbankruptcy law unless that law is “inconsistent with those sections, and then only to the extent of the inconsistency.” See 11 U.S.C. § 526(d)(1). Nor do these sections limit or curtail the authority or ability of any state or federal court to determine and enforce qualifications for the practice of law under the laws of that state and before such federal court. See 11 U.S.C. § 526(d)(2).

### Litigation Points

1. Section 527(a)(2)(D) requires that a debt relief agency advise an assisted person that “information” provided by the assisted person “during the case may be audited. . . .” Does this refer to information contained in documents filed with the court? Or does it include information given by the assisted person to the debt relief agency but not filed? If the debt relief agency is an

attorney, and section 527(a)(2)(D) is given the latter interpretation, what if the information is protected by the attorney-client privilege?

2. Section 526(c)(3) permits the chief law enforcement officer of a state to seek redress for violations or threatened violations of section 526. Is the chief law enforcement officer precluded from seeking redress for violations of sections 527 and 528?

3. Section 526(c) permits suits by the chief law enforcement officer of a state to be brought in federal district court. May these suits be referred to the bankruptcy court by the district court under 28 U.S.C. § 157(a)?

4. Section 526(c)(5) permits the court or the United States Trustee to move to enjoin violations of section 526 and for appropriate civil penalties for its violation. While the section refers to proceeding by motion, considering the type of relief authorized, will an adversary proceeding be necessary? Is the motion or proceeding limited to seeking redress for violations of section 526, or may it also be based on violations of section 527 and 528?

5. Do sections 526, 527, and 528 apply to attorneys representing creditors? The definitions of “bankruptcy assistance” and “debt relief agency” in sections 101(4A) and 101(12A) do not seem to be limited to the assistance of debtors and prospective debtors. However, the definition of “assisted person” in section 101(3) requires that the person have primarily consumer debts. If these sections were meant to apply to the representation of creditors, why would a creditor be defined with reference to his or her debts? Also, if these sections do apply to agencies representing creditors in bankruptcy cases, the disclosures required by section 527 and the regulation of advertising required by section 528 will be misleading.

6. Section 526 is phrased somewhat awkwardly. Can it be interpreted to say that an attorney may not advise an assisted person to pay the attorney for services related to filing a bankruptcy case? Or, does it prohibit only advising the assisted person to incur more debt in order to pay the attorney for such services?

## Cross References

### New Defined Terms

**assisted person**, 11 U.S.C. § 101(3)

**bankruptcy assistance**, 11 U.S.C. § 101(4A)

**debt relief agency**, 11 U.S.C. § 101(12A)

### Bankruptcy Code

11 U.S.C. § 110

11 U.S.C. § 342(b)(1)

11 U.S.C. § 521

[bankruptcy petition preparers]

[notice of bankruptcy/nonbankruptcy alternatives  
the clerk must give an individual debtor]

[statements, schedules, and other documents a

11 U.S.C. § 707(b)(2)	debtor must file in connection with a petition]
11 U.S.C. § 506	[chapter 7 means test]
	[valuation of collateral securing a claim]

### Local Rules

See General Order 03-03, ¶ 4(c), Guidelines for Payment of Attorneys' Fees in Chapter 13 Cases, and Rights and Responsibilities of Chapter 13 Debtors and Their Attorneys. In the chapter 13 context, the latter document might be amended to satisfy the requirement of section 528(a)(1) for a written contract.

### Drafting Issues and Problems

No deadline is set in 527(a)(1) for the debt relief agency to give the assisted person the information required by section 342(b)(1).

See Litigation Point #6 above.

## **SECTION 541**

### **Property of the Estate**

#### Effective Date

Section 541(f) is effective upon enactment and applies to all cases, including those already pending. The date of enactment was April 20, 2005. All other paragraphs in section 541 are effective 180 days after enactment, October 17, 2005.

#### Summary of Amendment

##### **Transfers by Nonprofit Debtors**

Section 541(f) is added to make clear that property of a debtor that is a nonprofit corporation as defined in Internal Revenue Code section 501(c)(3) [corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals] may be transferred to an entity that is not a nonprofit corporation to the extent such a transfer could take place outside of a bankruptcy proceeding.

##### **Exclusion from the Estate**

Four exclusions from property to the estate were added by subparagraphs (b)(5) through (b)(8) of section 541.

Education Individual Retirement Accounts. Funds held in an education individual retirement account [see Internal Revenue Code section 530(b)(1)] are excluded from property of the estate by section 541(b)(5) if the funds:

- were placed in the account at least 365 days before the petition was filed;
- are for the benefit of a child [including, by virtue of section 541(e), adopted and foster children who are members of the debtor's household], stepchild, or step grandchild;
- are not pledged or promised as collateral for an extension of credit; and
- do not exceed \$5,000 if placed in the account for a designated beneficiary within 365 to 720 days before the filing of the petition.

Schedule B, part of Official Form 6, is amended to require the debtor to list any interests in an education individual retirement account.

State Tuition Credits and Certificates. Funds used to purchase a tuition credit or certificate pursuant to Internal Revenue Code section 529(b)(1)(A) under a qualified state

program are excluded from property of the estate by section 541(b)(6) if the purchase was:

- at least 365 days before the petition was filed;
- was for the benefit of a child [including, by virtue of section 541(e), adopted and foster children who are members of the debtor's household], stepchild, or step grandchild;
- does not represent an excess contribution under Internal Revenue Code section 529(b)(7); and
- does not exceed \$5,000 if placed in the account for a designated beneficiary within 365 to 720 days before the filing of the petition.

The debtor's interest in an education individual retirement account and in a qualified state tuition program must be disclosed in the statements and schedules filed pursuant to Bankruptcy Code section 521(a). See 11 U.S.C. § 521(c).

Employer Withholding. Amounts withheld by an employer from the wages of employees or received from employees are excluded from property of the estate by section 541(b)(7) if the amounts are contributions to:

- an employee benefit subject to title I of the Employee Retirement Income Security Act (ERISA);
- a government employee benefit plan under Internal Revenue Code section 414(d);
- a deferred compensation plan under Internal Revenue Code section 457;
- a tax-deferred annuity under Internal Revenue Code section 403(b); or
- a health plan regulated by state law.

Further, amounts withheld for or contributed toward such plans (excluding health plans) and annuities, are excluded from a debtor's disposable income under section 1325(b)(2).

Pawned Property. Finally, if the debtor has "pledged or sold tangible personal property . . . as collateral for a loan or advance of money" given by a person licensed to make such loans or advances, section 541(b)(8) excludes that property from the estate if:

- the property is in the possession of pledgee or transferee;
- the debtor does not have an obligation to repay the loan or redeem the property, or buy it back at a stipulated price; and
- neither the debtor nor the trustee has exercised any right to redeem provided by contract or state law with the time provided under state law as it may be extended by Bankruptcy Code section 108(b).

Section 541(b)(8) excepts from the property excluded from the estate securities or written or printed evidences of indebtedness or title. Section 541(b)(8) appears to be aimed at excluding pawned personal property from the estate.

CPI Adjustment. The dollar amounts in section 541(b) are subject to adjustment at 3-year intervals to reflect the change in the Consumer Price Index for All Urban Consumers rounded to the nearest \$25. When adjusted, the Judicial Conference of the United States publishes the revised amounts in the Federal Register. See 11 U.S.C. § 104(b)(1) & (b)(2).

### Case Authority Impacted by the Amendment

Most courts have held that a chapter 13 debtor may not continue to make contributions to a pension or deferred compensation plan consistent with section 1325(b)'s directive that all disposable income be paid into a chapter 13 plan, at least when the plan does not provide for payment in full of all unsecured claims and the trustee or an unsecured creditor has raised the objection. With the addition of section 541(b)(7)(i), this will change. Contributions to qualified employee benefit plans, government employee benefit plans, deferred compensation plans, and tax deferred annuities are excluded from the chapter 13 debtor's disposable income.

The additional exclusions from property of the estate compliment Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed.2d 519 (1992), which held that the reference in section 541(c)(2) to "applicable nonbankruptcy law" includes federal law, such as ERISA, and state law. Under section 541(c)(2) and Patterson, a pension plan could be excluded from the property of the bankruptcy estate, if it could be shown that (1) the pension plan is a valid trust; (2) the debtor's interest in the trust is subject to a transfer restriction/restriction on alienation; and (3) the transfer restriction must be enforceable under "applicable nonbankruptcy law" such as ERISA. Section 541(b)(5)-(b)(7) now makes the issue of exclusion from the estate a simpler inquiry at least for the enumerated accounts and plans.

### Litigation Points

See discussion immediately above regarding Patterson.

### Cross References

#### New Defined Terms

**transfer**, 11 U.S.C. § 101(54)

#### Bankruptcy Code

11 U.S.C. § 104	[CPI adjustments to dollar amounts]
11 U.S.C. § 108(b)	[extensions of time]
11 U.S.C. § 521(c)	[filing record of interest in education IRA or tuition program]
11 U.S.C. § 1325(b)(2)	[disposable income in chapter 13]

### Applicable Nonbankruptcy Statutes

26 U.S.C. § 403(b)	[tax deferred annuities]
26 U.S.C. § 414(d)	[government employee benefit plans]
26 U.S.C. § 457	[deferred compensation plans]
26 U.S.C. § 501(c)(3)	[nonprofit corporations]
26 U.S.C. § 529(b)	[state tuition programs]
26 U.S.C. § 530(b)(1)	[education IRAs]
26 U.S.C. § 4873(e)	[excess contributions to education IRA]
29 U.S.C. § 1001 et seq.	[ERISA employee benefit plans]

### Official Forms

Official Form 6	[Schedule B now requires disclosure of education IRA]
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### Information Necessary to Apply Amended Section

While section 541, as amended, requires reference to many other statutes, including portions of the Internal Revenue Code and ERISA, it does not require that data be gathered from some source before the amendments can be applied to a case.

## SECTION 545 Statutory Liens

### Summary of Amendment

Current section 545 permits the trustee to avoid a statutory lien if it became effective upon the debtor's financial distress (as indicated by the debtor's insolvency, failure to meet some financial standard, appointment of a custodian, execution against property of the debtor, filing of a petition or some other insolvency proceeding), or the statutory lien is not perfected or enforceable against a hypothetical bona fide purchaser on the petition date, or the statutory lien is for rent or is a "lien of distress for rent." The amended section 545(2) now reads:

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien –

. . .

is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists, **except in any case in which the purchaser is a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any similar provision of State or local law. . . .**

Under current law, in order for a statutory lien to be enforceable against a trustee it must be perfected and enforceable against a hypothetical bona fide purchaser as of the date the petition is filed.

A federal tax lien arises and attaches to all property of a taxpayer once a tax is assessed and is unpaid. See 26 U.S.C. §§ 6321, 6322. The tax lien, however, is not enforceable against "any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor" until a notice complying with section 6323(f) is recorded (as to real property) or is filed with the appropriate state or county office (as to personal property). See 26 U.S.C. § 6323(a).

Even when a notice of tax lien has been properly filed and/or recorded, the resulting perfected tax lien may not be enforceable against certain purchasers of securities, motor vehicles retail inventory, and household goods. See 26 U.S.C. § 6323(b)(1)-(9). Because the Internal Revenue Code gives superpriority status over its perfected tax liens to these purchasers, and because former section 545(2) permitted avoidance of "unenforceable," not just unperfected, statutory liens, a split developed in the case law.

The Ninth Circuit held that a trustee's status as a hypothetical bona fide purchaser did not include rights of a superpriority purchaser under section 6323(b). See In re Berg, 121 F.3d 535 (9th Cir. 1997). See also In re Walter, 45 F.3d 1023 (6<sup>th</sup> Cir. 1995). The trustee could not avoid a perfected tax lien even if it was not enforceable against the superpriority purchasers described in section 6323(b).

Another court, In re Sierer, 121 B.R. 884 (Bankr. N.D. Fla. 1990), *aff'd in part and rev'd in part*, 139 B.R. 752 (N.D. Fla. 1991), came to the opposite conclusion. It held that because former section 545(2) permitted avoidance of “unenforceable” albeit perfected statutory liens, because superpriority purchasers under section 6323(b) took free of perfected tax liens, and because nothing in former section 545(2) prevented a bankruptcy trustee’s status as a hypothetical purchaser from including the rights of such superpriority purchasers, a trustee could avoid a perfected tax lien encumbering the property (securities, motor vehicles, inventory, household goods) described in section 6323(b).

The purpose of amended section 545(2) is to overrule Sierer. A trustee will no longer be able to avoid a perfected statutory tax lien, whether arising under federal law or similar state or local law, even though it may be unenforceable against a superpriority purchaser described in section 6323(b) or a similar tax statute.

#### Case Authority Impacted by the Amendment

See discussion immediately above regarding Sierer.

#### Litigation Points

The amendment will restrict the trustee’s ability to avoid perfected tax liens that are unenforceable outside of bankruptcy against categories of purchasers described in various tax statutes. There may be disputes as to whether a state or local law is “similar to” section 6323.

#### Cross References

##### Applicable Nonbankruptcy Statutes

26 U.S.C. § 6323 [federal tax lien priorities]

#### Information Necessary to Apply Amended Section

While section 545, as amended, requires reference to the Internal Revenue Code, it does not require that data be gathered from some source before the amendments can be applied to a case.

## **SECTION 546**

### **Limitations on Avoiding Powers**

#### Effective Date

While section 546 is effective on October 17, 2005, UCC § 7-209, referred to in section 546(i)(1), is as in effect on the date of enactment, April 20, 2005.

#### Summary of Amendment

Section 546 specifies limitations on the avoiding powers granted to trustees under sections 544, 545, 547, 548, or 553. Two significant changes are made in amended section 546.

**Warehouseman's Liens.** First, a statutory warehouseman's lien for storage or transportation, or for incidental charges for storage and handling of goods may not be avoided pursuant to section 545(2) or (3). This prohibition shall be applied in a manner consistent with UCC § 7-209, as in effect on the date of enactment, April 20, 2005.

**Reclamation Claims.** Second, amended section 546(c) prevents reclamation claims from being avoided under sections 544(a), 545, 547, and 549. A seller of goods that has sold goods to the debtor, in the ordinary course of the seller's business, is entitled to reclaim such goods if the debtor received the goods while insolvent and within 45 days before the commencement of the case. However, in order to reclaim, the seller must make a written reclamation demand not later than 45 days after the debtor's receipt of the goods or not later than 20 days after the date of commencement of the bankruptcy case if the 45-day period expires after the commencement of the case.

The right of reclamation, however, is subject to the prior rights of a holder of a security interest in such goods or their proceeds.

Under current law, if a seller has a right to reclaim, reclamation can be prevented if the court grants the seller an administrative claim or it secures the reclamation claim with a lien. See 11 U.S.C. § 546(c)(2). This provision has been stricken from amended section 546(c).

Section 503(b)(9) has been added to the Bankruptcy Code and it also affects the rights of a seller of goods to the debtor. Section 503(b)(9) gives a seller an administrative claim for the value of goods received by the debtor within 20 days before the commencement of the case provided the sale to the debtor was in the ordinary course of the debtor's business. Note that the administrative claim is not dependent on giving any notice to the debtor and it may be the best recourse for a seller whose rights are subject to the rights of a holder of a security interest in the goods.

There are additional amendments to section 546(e), (f), (g), and (j) affecting securities and securities transactions and their avoidance. These amendments are not addressed because

they have minimal impact on practice in the Eastern District of California.

Cross References

New Defined Terms

**transfer**, 11 U.S.C. § 101(54)

Bankruptcy Code

11 U.S.C. § 503(b)(9) [priority claim for goods delivered pre-petition]

Applicable Nonbankruptcy Statutes

UCC § 7-209 [warehouseman's liens]  
Cal. Comm. Code § 7209 [warehouseman's liens]

## SECTION 547 Preferences

### Effective Date

Section 547(i), overruling the holding in Deprizio, takes effect upon the date of enactment, April 20, 2005, and applies to all cases whether filed before or after that date. All other amendments to section 547 are effective in cases filed on or after October 17, 2005.

### Summary of Amendment

**Effective Date of Transfer.** For purposes of section 547 a transfer is made: (1) when it is effective between the transferor and the transferee provided the transfer is perfected within 30 days after such time; (2) when it is perfected if perfected more than 30 days after the transfer; or (3) immediately before the petition is filed if the transfer is not perfected by the later of the date the bankruptcy case is commenced or 30 days after the transfer is effective between the transferor and the transferee. See 11 U.S.C. § 547(e)(2). Section 547(e)(2) formerly gave a 10-day window of time rather than the new 30-day window.

Section 547(c) enumerates the defenses to the avoidance of a preferential transfer. There are four amendments to these defenses.

**Ordinary Course Transfers.** First, section 547(c)(2) bars the trustee from avoiding a transfer if it was in payment of a debt incurred by the debtor and extended by the creditor in the ordinary course of business, and if the transfer was made in the ordinary course of business of the debtor and the creditor or [rather than “and”] the transfer was made according to ordinary business terms.

**Perfection of Purchase Money Security Interests.** Second, section 547(c)(3) now gives a creditor 30 days, rather than 20 days, from the date the debtor acquires an interest in the property, to perfect a purchase money security interest in that property. If the security interest is perfected within this window, it cannot be avoided as a preference.

**Payment of Domestic Support Obligations.** Third, section 547(c)(7) is amended to incorporate the new definition of domestic support obligation in section 101(14A). A transfer that is a bona fide payment of a domestic support obligation may not be avoided.

**De Minimis Transfers.** Finally, if the debtor’s debts are not primarily consumer debts, that is, in a business case, the trustee may not recover a transfer when “the aggregate value of all property that constitutes or is affected by such transfer” is less than \$5,000. See 11 U.S.C. § 547(c)(9). Existing law prevents the trustee in a consumer case from recovering preferences aggregating less than \$600. See 11 U.S.C. § 547(c)(8). However, unlike section 547(c)(8), the amount made de minimis by section 547(c)(9) is subject to tri-annual adjustment under section 104(b)(1).

In a related amendment to 28 U.S.C. § 1409(b), the venue statute for proceedings arising under title 11, or arising in or related to a case under title 11, a proceeding must be filed in the defendant's district or residence if it seeks to recover less than \$1,000 from an insider, less than \$15,000 for a consumer debt, or less than \$10,000 on a business debt from a noninsider.

While not contained in paragraph (c), new sections 547(i) and 547(h) provide additional defenses to the avoidance of preferential transfers. See 11 U.S.C. § 547(b).

**Deprizio.** In Levit v. Ingersoll Rand Financial Corp. (In re V.N. Deprizio Construction Co.), 874 F.2d 1186 (7<sup>th</sup> Cir. 1989), the court held that the preference recovery period for a creditor who is not an insider is one year when the payment also produces a benefit for an insider. This can occur, for example, when a loan owed to a bank and guaranteed by an insider is paid by a future debtor more than 90 days before, but within one year of the filing of, a bankruptcy petition. The satisfaction of the loan owed the bank is obviously a transfer. The insider is also a creditor of the debtor because the guarantee gives the insider a contingent claim. If called upon by the bank to honor the guarantee, the insider has recourse against the debtor. The debtor's payment to the bank, then, not only satisfies the loan but also satisfies the insider's contingent claim. Therefore, the payment is a transfer to both the bank and the insider. See 11 U.S.C. § 547(b)(1).

Even though the transfer to the bank in this example is outside the 90-day preference period of section 547(b)(4)(A), the transfer to the insider is within the 1-year preference period of section 547(b)(4)(B) applicable to insiders. Because the latter transfer is recoverable, section 550(a) gives the trustee the option of recovering it either from the insider (the "initial transferee") or the bank (the "immediate or mediate" transferee).

With the addition of section 547(i), a transfer by the debtor "made between 90 days and 1 year before the date of the filing of the petition," benefitting both a creditor that is not an insider and a creditor that is an insider "shall be considered to be avoided . . . only with respect to the creditor that is an insider."

**Payments Under an Alternative Repayment Schedule.** Section 547(h) prohibits a trustee from recovering payments made to creditors as part of an "alternative repayment schedule" created for the debtor by an "approved nonprofit budgeting and credit counseling agency."

The term "alternative repayment schedule" is not defined in section 101. The same term appears in section 502(k), permitting the partial disallowance of a creditor's claim if the creditor has unreasonably refused to negotiate an alternative repayment schedule. The term "approved nonprofit budgeting and credit counseling agency" is also undefined in section 101 but is referred to in sections 109(h) and 111. A nonprofit budgeting and credit counseling agency, after being approved by the United States Trustee as satisfying the requirements of section 111, is charged by section 109(h) with providing an individual contemplating bankruptcy under any chapter with a briefing, whether in a group setting, in person, by telephone, or over the Internet, outlining the credit counseling services that are available and providing the individual with a budget analysis.

Given the reference to alternative repayment schedules in sections 547(h) and 502(k), an approved nonprofit budgeting and credit counseling agency may also negotiate a work-out agreement, i.e., alternative repayment schedule, for the individual in the hope of avoiding bankruptcy and repaying something to creditors.

### Case Authority Impacted by the Amendment

As indicated in the discussion above, the holding of Levit v. Ingersoll Rand Financial Corp. (In re V.N. Deprizio Construction Co.), 874 F.2d 1186 (7<sup>th</sup> Cir. 1989), is overruled by section 547(I). Bankruptcy Judge Wedoff held in ABC-NACO, Inc. v. Bank of America (In re ABC-Naco), 331 B.R. 773 (Bankr. N.D. Ill. 2005), that the retroactive application of section 547(i) to pending cases is constitutional and does not deprive the bankruptcy estate of a property interest nor does it violate its substantive due process rights.

### Litigation Points

1. Section 547(c)(9) makes reference to “the aggregate value of all property that constitutes or is affected by” a transfer. This suggests that transfers may not be discrete transfers of property. Rather, property that is the subject of several transfers might be aggregated if they are part of a single transaction or course of conduct.

### Cross References

#### New Defined Terms

**domestic support obligation**, 11 U.S.C. § 101(14A)  
**transfer**, 11 U.S.C. § 101(54)

#### Bankruptcy Code

11 U.S.C. § 109	[nonprofit budgeting and credit counseling agency and alternative repayment schedule]
11 U.S.C. § 111(c)(2)(E)	[nonprofit budgeting and credit counseling agency and alternative repayment schedule]
11 U.S.C. § 502(k)	[failure to negotiate alternative repayment schedule]
11 U.S.C. § 550	[recovery of avoidable transfers]

#### Applicable Nonbankruptcy Statutes

28 U.S.C. § 1409(b)	[venue of proceedings]
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## SECTION 548 Fraudulent Transfers and Obligations

### Effective Date

The amendments to section 548 (a)(1) [avoidance of transfers to or on account of insiders under employment contracts] and to section 548(e) [avoidance of transfers to self-settled trusts] are effective upon enactment, April 20, 2005, but do not apply to pending cases. The extension of the “look back” period for recovery of fraudulent conveyances from one year to two years applies only to cases filed one year after the date of enactment, April 20, 2006.

### Summary of Amendment

**Two-Year Look-Back.** Section 548(a)(1) makes fraudulent transfers recoverable if they are made within 2 years before the filing of the petition. The look back period was formerly 1 year.

**Insider Compensation.** Transfers eligible for avoidance now expressly include transfers made under an employment contract to or for the benefit of an insider and not made in the ordinary course of business. See 11 U.S.C. § 548(a)(1)(B)(ii)(IV).

**Self-Settled Trusts.** If the debtor transfers an interest in property within 10 years of a bankruptcy petition, the transfer is avoidable by the trustee if it was made to a “self-settled trust or similar device,” the debtor is a beneficiary of the trust or device, and the transfer is made with the actual intent to hinder, delay, or defraud a present or future creditor. See 11 U.S.C. § 548(e)(1). Transfers eligible for avoidance under section 548(e)(1) include transfers made in anticipation of a money judgment, settlement, civil penalty, equitable order, or criminal fine “incurred by, or which the debtor believed would be incurred by” a violation of state or federal securities laws, or for fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of registered securities. See 11 U.S.C. § 548(e)(2).

### Litigation Points

When a trustee seeks to avoid a transfer to a self-settled trust, must the trustee prove that the transfer was made to hinder, delay or defraud a particular creditor, or is it enough to prove that the transfer was part of some general asset protection strategy? The fact that an actual intent to defraud a creditor is required suggests the former, but the inclusion of “an entity to which the debtor . . . because, on or after . . . such transfer was made, indebted” suggests the latter.

### Cross References

#### New Defined Terms

**financial participant**, 11 U.S.C. § 101(22A)

**master netting agreement**, 11 U.S.C. § 101(38A)  
**transfer**, 11 U.S.C. § 101(54)

Applicable Nonbankruptcy Statutes

15 U.S.C. § 77f	[federal securities law relevant to § 548(e)(2)]
15 U.S.C. § 78c(a)(47)	[federal securities law relevant to § 548(e)(2)]
15 U.S.C. § 78o(d)	[federal securities law relevant to § 548(e)(2)]
15 U.S.C. § 781	[federal securities law relevant to § 548(e)(2)]

**SECTION 552**  
**Postpetition Effect of Security Interest**

Summary of Amendment

Section 552(b)(1) is amended to change the word “product” to “products.” This change from the singular to the plural conforms the word “products” to other items described in section 522(b)(1) [if a security interest extends “to proceeds, products, offspring, or profits” before the petition was filed, it extends “to such proceeds, products, offspring, or profits” after the petition is filed].

## SECTION 553 Setoff

### Summary of Amendment

A creditor has the right to setoff a mutual debt except under circumstances listed in this section. The section as amended limits the exceptions to setoff in certain transactions involving securities contracts, commodities or futures contracts, swap agreements, repurchase agreements, and master netting agreements and described in 11 U.S.C. §§ 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, and 561. This is part of other amendments to, not only the Bankruptcy Code, but federal securities and banking laws as well, that are designed to permit the unwinding of derivative contracts despite the filing of a bankruptcy petition.

### Cross References

#### Bankruptcy Code

11 U.S.C. § 362(b)(6)	[exception to automatic stay for setoff for margin payment, etc.]
11 U.S.C. § 362(b)(7)	[exception to automatic stay for setoff for margin payment]
11 U.S.C. § 362(b)(17)	[exception to automatic stay for setoff for payment due in connection with a swap agreement]
11 U.S.C. § 362(b)(27)	[exception to automatic stay for setoff for payment due in connection with a master netting agreement]
11 U.S.C. § 555	[contractual right to liquidate, terminate, or accelerate a securities contract]
11 U.S.C. § 556	[contractual right to liquidate, terminate, or accelerate a commodities contract or forward contract]
11 U.S.C. § 559	[contractual right to liquidate, terminate, or accelerate a repurchase contract]
11 U.S.C. § 560	[contractual right to liquidate, terminate, or accelerate a swap agreement]
11 U.S.C. § 561	[contractual right to liquidate, terminate, accelerate, or offset under a master netting agreement]

## **SECTIONS 555, 556, 559, 560, 561, 562**

No discussion of the amendments to these sections is included in this summary. Generally, these sections and the amendments to them deal with securities contracts, commodities or futures contracts, swap agreements, repurchase agreements, and master netting agreements. These sections of the Bankruptcy Code, together with federal securities and banking laws as well, are designed to permit the unwinding of derivative contracts despite the filing of a bankruptcy petition.