

SUMMARY OF CHAPTER 7

of the

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

May 18, 2006

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SECTION 701 Interim Trustee

Summary of Amendment

There was no change to section 701 or to any of the sections to which it refers. However, section 507(a)(1)(C) is new and it refers to section 701. Section 507(a)(1)(C) provides that when a trustee is appointed or elected pursuant to section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under sections 503(a)(1), (a)(2), and (a)(6) must be paid before domestic support obligations accorded priority status by sections 507(a)(1)(A) & (B).

Cross References

New Defined Terms

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

Bankruptcy Code

11 U.S.C. § 507(a)(1)(C) [priorities of expenses and claims]

SECTION 702
Election of Trustee

Summary of Amendment

There is no change to section 702.

However, section 702(b) refers to section 341. Section 341(c) now provides that “a creditor holding a consumer debt or any representative of the creditor” may participate in the meeting of creditors in a chapter 7 or 13 case through a representative that is not an attorney. Given the reference to section 341 in section 702, “participation” apparently includes voting in an election of a trustee. The creditor’s representative may be the representative of more than one creditor.

New section 341(e) permits, after notice and a hearing, the court to waive the meeting of creditors “if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case.” Given the reference to a plan in section 341(e), this provision is not likely applicable in chapter 7 cases.

There are amendments to two sections, sections 507 and 1104, that refer to section 702.

Section 507(a)(1)(C) provides that when a trustee is appointed or elected pursuant to section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under sections 503(a)(1), (a)(2), and (a)(6) must be paid before domestic support obligations accorded priority status by sections 507(a)(1)(A) & (B).

Section 1104(b)(2) provides for the filing of a report by the United States Trustee certifying the election of a chapter 11 trustee at the meeting of creditors and it provides that the court shall resolve any disputes regarding the election.

Cross References

New Defined Terms

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

Bankruptcy Code

11 U.S.C. § 341	[meeting of creditors]
11 U.S.C. § 507(a)(1)(C)	[priorities of expenses and claims]
11 U.S.C. § 1104(b)	[election of trustee at 341 meeting]

SECTION 703 Successor Trustee

Summary of Amendment

There is no change to section 703 or to any of the sections to which it refers and affecting the selection of a successor trustee. There is an amendment section 507(a)(1)(C) which refers to section 703.

Section 507(a)(1)(C) provides that when a trustee is appointed or elected pursuant to section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under sections 503(a)(1), (a)(2), and (a)(6) must be paid before domestic support obligations accorded priority status by sections 507(a)(1)(A) & (B).

Cross References

New Defined Terms

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

Applicable Nonbankruptcy Statutes

11 U.S.C. § 507(a)(1)(C) [priorities of expenses and claims]

SECTION 704 Duties of Trustee

Summary of Amendment

Section 704 has been expanded to impose additional duties on chapter 7 trustees. The duties imposed by former section 704 are now encompassed in subparagraphs (a)(1) through (a)(9). Three new subparagraphs, (a)(10) - (a)(12), have been added. In addition, paragraphs (b) and (c) are new.

Duties Related to Domestic Support Obligations. Section 704(a)(10) is new. It provides that if a creditor holds a claim for a domestic support obligation, the trustee must give the notice required by section 704(c).

“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.

Section 704(c) explains what must be included in the notice required by section 704(a)(10). Practitioners should note that trustees are required by sections 1106(c), 1202(c), 1302(d) to give the same notice.

Actually, section 704(c) requires three different notices. The trustee must provide a written notice both to the holder of a claim of a domestic support obligation and to the state child support enforcement agency. See 11 U.S.C. §§ 704(c)(1)(A) & (B). The state child support enforcement agency is the agency established under sections 464 and 466 of the Social Security Act. See 42 U.S.C. §§ 664 & 666. Section 704(c)(1)(C) requires a third, post-discharge notice to both the claim holder and the state child support enforcement agency.

Notice to Claimant. The notice to the holder of the claim required by section 704(c)(1)(A) must:

- advise the holder that he or she is owed a domestic support obligation;

- advise the holder of the right to use the services of the state child support enforcement agency for assistance in collecting such claim;

- include the address and telephone number of the state child support enforcement agency; and
- include an explanation of the rights a holder of claim based on a domestic support obligation has to payment of such claim under chapter 7.

Notice to State. The notice to the state child support enforcement agency required by section 704(c)(1)(B) must:

- advise the agency of such claim; and
- advise the agency of the name, address and telephone number of the holder of such claim.

Notice re Discharge. Once a discharge is entered, section 704(c)(1)(C) also requires the trustee give written notice to the holder of a domestic support obligation and to the state child support agency of the following:

- the granting of the discharge;
- the last recent known address of the debtor;
- the last recent known name and address of the debtor’s employer;
- the name of each creditor that holds a claim not discharged under sections 523(a)(2), (4) or (14A);
- the name of each creditor that holds a claim that was reaffirmed.

Pursuant to section 704(c)(2), the holder of a claim for a domestic support obligation or the state child support enforcement agency may request the last known address of the debtor from a creditor holding a claim that was not discharged under sections 523(a)(2), (4), or (14A) or that was reaffirmed by the debtor under section 524(c). If the creditor discloses the last known address in response to such inquiry, the creditor cannot be held liable for making the disclosure.

Deadlines. Section 704(c) does not set any firm deadlines for giving the notices required by section 704(c)(1)(A), (B), or (C). The wording of these subparagraphs, however, suggests that the first two notices must be given soon after the case is commenced while the third notice must be given after a discharge is granted.

Section 704(c)(1)(A) refers to “assistance in collecting child support during and after the bankruptcy case.” The second notice to the state child support enforcement agency is required so that it can contact the claim holder and offer its assistance in collecting the claim in connection with the bankruptcy case. To provide effective notice to the claim holder and the state, these

notices would have to be timed such that they were received before deadlines to object to exemptions, file claims, and object to discharge and to the dischargeability of debts.

Section 704(c)(1)(C) clearly contemplates that the third notice be given sometime after entry of the discharge order. Apparently then, the notice is only required if a discharge is granted. How soon after discharge is complicated by the requirement that the notice include information regarding reaffirmation agreements and judgments declaring certain debts nondischargeable. The trustee is required to include in the notice whether the debtor has reaffirmed a debt or the court has declared nondischargeable any debts under sections 523(a)(2), (4), or (14A).

The timing for approving a reaffirmation agreement is made somewhat unclear by the amendments to section 524 [see discussion of section 524]. Existing Rule 4008 sets 30 days following entry of a discharge order as the outer-most date for approving a reaffirmation agreement in a chapter 7 case. See Fed. R. Bankr. P. 4008. However, section 524(m)(1) requires approval of a reaffirmation agreement prior to discharge if a presumption of undue hardship arises because the debtor's statement made in connection with a reaffirmation agreement reveals that the debtor cannot afford to pay the reaffirmed debt. See Interim Rule 4008 [specifying content of debtor's statement under section 524(k)]. Interim Rules 4004(c)(1)(J) and 4008 require that discharge be delayed when the presumption of undue hardship arises under section 524(m)(1). When the presumption arises, then, a reaffirmation agreement will be approved before discharge. See Interim Rule 4004(c)(1)(J) [providing for a delayed entry of discharge order when presumption of undue hardship arises]. When the presumption of undue hardship does not arise, a reaffirmation will be approved after discharge but within 30 days of its entry.

Complaints under sections 523(a)(2) and (a)(4) must be filed no later than 60 days after the first date set for the meeting of creditors under section 341(a). See 11 U.S.C. § 523(c); Fed. R. Bankr. P. 4007(b). However, complaints under section 523(a)(14A) may be filed at any time, including after entry of the discharge, in bankruptcy court or any other court with jurisdiction. See 11 U.S.C. § 523(c).

Thus, if one assumes the third notice must be given only once, the earliest it could be given would be 30 days following the entry of the discharge order. If a complaint is filed under sections 523(a)(2) or (a)(4), the notice would have to await the resolution of the complaint. The possibility of a complaint under section 523(a)(14A) necessarily will make the trustee's notice imprecise. The trustee can verify only that such a complaint was not filed prior to the service of the notice. However, such a complaint could be filed any time after entry of the discharge in any court. If the trustee is aware that such a complaint has been filed, presumably the trustee's notice must await the entry of a judgment.

Section 230 of the 2005 Act requires the Comptroller General of the United States to study the feasibility, effectiveness, and cost of requiring trustees, or the bankruptcy court, to provide to the Office of Child Support Enforcement promptly after commencement of the case, the names and social security numbers of all debtors so that such Office can determine whether

such debtors have outstanding child support obligations. This report to Congress is due 300 days after the date of enactment, April 20, 2005.

Employee Benefit Plans. Section 704(a)(11) is new. It requires a chapter 7 trustee to perform the obligations of an administrator of an employee benefit plan if the debtor (or any entity designated by the debtor) was performing the services of an administrator at the time of commencement of the case. “Administrator” is defined in section 3 of the Employee Retirement Income Security Act of 1974. See 29 U.S.C. § 1002(16)(A).

Section 521(a)(7) was amended to provide that the debtor is to continue to perform the obligations of an administrator of an employee benefit plan if no trustee is appointed. Because a trustee is appointed in all chapter 7 cases, section 521(a)(7) will have no applicability in chapter 7 cases.

Health Care Businesses. Section 704(a)(12) is new. It requires the trustee to use “all reasonable and best efforts” to transfer patients from a health care business that is closing to another health care business. “Health care business” is defined in section 101(27A). This definition encompasses a wide range of public and private facilities, including hospitals and long-term care facilities. “Patient” is defined in section 101(40A).

When selecting an appropriate new facility for a patient, the trustee is directed to consider (1) its proximity to the facility being closed; (2) whether it offers substantially similar services; and (3) its ability to maintain a reasonable quality of care.

Interim Rule 2015.2 requires the trustee to give at least 10 days’ notice of a proposed patient transfer to the patient care ombudsman, if appointed pursuant to section 333, and to the patient and any family member or contact person whose name has been given to the trustee or the debtor for the purpose of providing information regarding the patient’s health care. To the extent notice is given to persons other than the patient, the notice is “subject to applicable nonbankruptcy law relating to patient privacy.”

Several sections are related to section 704(a)(12). Pursuant to section 503(b)(8)(B), any cost or expense incurred by the trustee in connection with transferring patients is an administrative expense. Section 351 deals with the disposal of patient records. The cost of disposal is also entitled to be treated as an administrative expense. See 11 U.S.C. § 503(b)(8)(A). Section 332 provides for the appointment of a consumer privacy ombudsman and section 333 provides for the appointment of a patient care ombudsman.

Duties Imposed by Chapter 15. Although section 704 does not incorporate section 1505, section 103(k)(1) makes section 1505 applicable in all title 11 cases.

Section 1505 permits the court to authorize a trustee appointed under any chapter, or an examiner appointed under section 1104(c), to act in a foreign country on behalf of the bankruptcy estate. When authorized to so act, the trustee or examiner may act as authorized by applicable

foreign law.

Duties Relating to Means Testing Imposed on UST & Court. Section 704(b) is new. It applies only in chapter 7 cases filed by individuals and relates to the means test laid out in section 707(b)(2).

First, the United States Trustee must review all materials filed by the debtor and, not later than 10 days after the first meeting of creditors, the United States Trustee must file a statement indicating whether the debtor's case would be presumed to be an abuse under section 707(b). See 11 U.S.C. § 704(b)(1)(A). That is, it must disclose whether or not the debtor flunked the means test.

Second, the court must "provide" a copy of the United States Trustee's statement to all creditors not later than 5 days after receiving it. See Interim Rule 2002(f)(10).

Third, not later than 30 days after filing the statement, if the United States Trustee determines that the chapter 7 petition "should be presumed to be an abuse under section 707(b)," and if the debtor's current monthly income, multiplied by 12, is not less than the state median family income for a family of like size, the United States Trustee must file either (1) a motion to dismiss or convert the chapter 7 petition, or (2) a second statement explaining why dismissal or conversion will not be sought. There is no requirement that the second statement be served on, or "provided" to, anyone by the court or the United States Trustee. Note that Interim Rule 1017(e)(1) requires that a dismissal/conversion motion under sections 707(b) or (c) be filed within 60 days after the date first set for the meeting of creditors. Thus, it is necessary for the United States Trustee to explain why a dismissal/conversion motion will not be filed before the deadline to file such a motion has passed.

"Current monthly income" is defined by section 101(10A) as average income, whether or not taxable, for the 6-month period prior to the petition date. It is an average of income from all sources, including amounts received on a regular basis for household expenses of the debtor or the debtor's dependents, but excluding social security benefits. It is not a measure of "current" income in the sense that it is the debtor's income on the date of the petition. Nor is it a measure of net or disposable income because no expenses are deducted from the amounts averaged.

"Median family income" is the median family income calculated and reported by the Census Bureau "for the then most recent year" for each state. See 11 U.S.C. § 101(39A). For instance, if a chapter 7 petition were filed in 2005, the relevant year of comparison would be 2004. If the Census Bureau has not yet reported median family income for 2004 [as noted below, this information for 2004 is available, making the adjustment discussed in this paragraph unnecessary for 2004], the amount reported for 2003 would be used for purposes of section 704(b)(2)(A) but with the adjustment required by section 101(39A)(B). The 2003 state median family income would be adjusted to "reflect the percentage change in the Consumer Price Index for All Urban Consumers for 2004." This inflation information is available from the Bureau of Labor Statistics at www.bls.gov/cpi/.

Section 704(b)(2) uses a different method of calculating median family income than is used under section 707(b)(7). Section 707(b)(7) forbids anyone, including the court and the United States Trustee, from bringing a dismissal motion on the basis that the debtor has failed the means test of section 707(b)(2) if the debtor's annualized current monthly income does not exceed the state median family income. In effect, any debtor whose annualized current monthly income is equal to or less than the relevant state median family income is not subject to the means test.

Section 704(b)(2), unlike section 707(b)(7), does not add \$525 per month, or \$6,300 per year, for each individual beyond the fourth household member. Rather, the state median income is determined solely by reference to the data from the Census Bureau. The practical result is that, depending on whether section 704(b)(2) or section 707(b)(7) is being applied, there may be a substantial difference in the state median family income for families with more than 4 persons.

The Census Bureau reports on its Internet site the state median family income in 2004 for households ranging in size from 1 to 7 or more persons. This information, as it pertains to California, and all other states and territories can be found at the Census Bureau's Internet site, www.census.gov/hhes/www/income/medincsizeandstate.html (families of 2 or more, and www.census.gov/hhes/www/income/medincearnersandstate.html (1 person). It is also summarized on the United States Trustee's Internet site, www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm.

Family Size	Section 704(b)(2)	Sections 707(b)(7)
1	\$42,012	\$42,012
2	\$53,506	\$53,506
3	\$59,633	\$59,633
4	\$68,310	\$68,310
5	\$56,591	\$74,610
6	\$56,929	\$80,910
7	\$58,395	\$87,210

As suggested by the table above, if a debtor with annualized current monthly income of \$70,000 and with four dependents (a household of five) files a chapter 7 petition in 2005, the debtor's current monthly income would exceed the relevant state median family income benchmark, \$56,591, under section 704(b)(2). However, section 704(b)(2) requires the United States Trustee to file a second statement explaining the failure to seek dismissal or conversion only if the debtor's current monthly income equals or exceeds \$56,591 and the case is a presumed abuse under section 707(b)(2). To be subject to the means test, however, the debtor's monthly disposable income under section 707(b)(7) would have to exceed \$74,610.

Section 707(b)(7) forbids anyone, including the court and the United States Trustee, from bringing a dismissal motion under section 707(b)(2) unless the debtor's annualized current monthly income exceeds the relevant state median family income. Because state median family income is calculated differently under section 707(b)(7) than under section 704(b)(2), the benchmark figure is \$74,610 for purposes of the means test. The debtor in this example is not subject to the means test. Therefore, the United States Trustee cannot move to dismiss the petition and need not file the second statement required by section 704(b)(2).

There is another difference between sections 704(b)(2) and 707(b)(7).

Section 704(b)(2) directs the United States Trustee to consider only the debtor's current monthly income when making the comparison to state median family income. Presumably, if the petition were a joint petition, the incomes of both spouses and debtors would be considered. However, when only one spouse files a petition, section 704(b)(2) will consider only the income of the filing spouse.

Section 707(b)(7), however, bars a motion to dismiss under section 707(b)(2) only if the debtor's income and the debtor's spouse's income equals or is less than the applicable state median family income. Section 707(b)(7) includes the spouse's income whether or not the petition is a joint petition. A nonfiling spouse's income is excluded only if the spouses are separated and their separation was not contrived to escape the means test.

Therefore, if the debtor's household in the above example included a spouse earning \$40,000 a year, that amount would be included when calculating current monthly income for purposes of the means test. This would put the debtor over the threshold and the debtor would be required to take the means test. [Note should be taken that even though section 707(b)(7) includes a nonfiling spouse's income for purposes of deciding whether the filing spouse must take the means test, the total income of both spouses is not considered current monthly income. There is yet another adjustment to current monthly income under section 707(b)(2). The portion of the income of the nonfiling spouse that is not regularly contributed to the household expenses of the filing spouse and his or her dependents is not included in current monthly income.]

If, with the nonfiling spouse's income [or, rather, the portion of it regularly contributed to the debtor's household] included in the debtor's current monthly income and after deducting those expenses permitted by section 707(b)(2)(A)(ii) - (iv), the debtor's remaining monthly income is sufficient to pay \$166.67 to general unsecured creditors, or if it is between \$100 and \$166.66 and is sufficient to pay 25% of general unsecured claims, the debtor will flunk the means test.

In this example, however, the United States Trustee would not be required to file the second statement and disclose whether or not a dismissal or conversion motion will be filed because, even though the debtor may have flunked the means test, the debtor's current monthly income, calculated in accordance with section 704(b)(2) rather than section 707(b)(7), did not exceed the state median family income.

It would have been simpler had section 704(b)(2) conditioned the filing of the second statement only on the debtor's failure of the means test. It makes no sense to have one definition of median family income for purposes of the means test and yet another definition governing the United States Trustee's disclosure of a decision to not seek dismissal or conversion.

As a practical matter, it is likely that the United States Trustee will file the second statement in any case where the debtor does not pass the means test but the United States Trustee elects not to seek dismissal or conversion. Because the median family income figures report on the United States Trustee's Internet site is calculated exclusively under section 707(b)(7), it appears the calculation of median family income under section 704(b)(2) in fact will be ignored.

Litigation Points

1. Section 704(b)(2)(A) refers to "median family income" for a household of one person, but refers to "the highest median income" when referring to a household of two or more persons. The Census Bureau has three different estimates of median family income for each family size. Do you use different amounts depending on household size? Do you use "upper bound" for a household of 2 or more persons because it represents the highest estimate?

2. May the debtor, chapter 7 trustee, or a creditor object to the initial statement filed by the United States Trustee pursuant to section 704(b)(1)(A)? If that statement indicates that there is no presumed abuse under the means test or that the debtor is not subject to the means test, does the filing of the statement bar a motion to dismiss that argues otherwise?

3. May a party in interest move to dismiss a petition on the ground that the debtor has flunked the means test even though the 30-day time period for the United States Trustee to so move or to file a statement explaining the failure to so move has not yet expired?

4. What if the trustee lacks sufficient information to file a motion to dismiss or convert within the 30-day time period? Can the time be extended? May the United States Trustee move to dismiss after the 30-day period?

5. What is the liability of the trustee if he or she fails to provide notice and/or provides an incorrect notice in a case involving a domestic support obligation?

6. Is a creditor obligated to respond to a request under section 704(c)(2)(A)? Can the court compel a response? Is a nonresponsive creditor subject to being held in contempt of court? May a creditor refuse to respond if a debtor rescinded a reaffirmation agreement after the trustee gave notice under section 704(c)?

7. Because section 704(c)(1)(C) requires the trustee to give notice of debts reaffirmed under section 524(c), it appears that the trustee must review every reaffirmation agreement to determine whether the reaffirmation is valid, i.e., was it enforceable without a court hearing, did the court approve it, or was it rescinded? What reaffirmation agreements does the trustee report

in the notice required by section 704(c)? Does the trustee report only those which are enforceable? That are approved? Must the trustee determine whether a reaffirmation agreement has been rescinded? Must a notice already served be supplemented with information of a rescission?

8. There is no time period set for giving the notices required by sections 704(c)(1)(A) and (B). May those notices be incorporated into the notice of the entry of the discharge order or some other notice?

9. How will the trustee know that there is a claim for a domestic support obligation? Can the trustee rely on the schedules?

10. May the trustee rely on the petition and schedules on file with the court for the “last recent known address of the debtor” and “the last recent known name and address of the debtor’s employer?” Or is some further inquiry necessary?

11. Does the trustee report only final judgments under sections 523(a)(2), (a)(4), and (14A)? What if there is a settlement that does not entail entry of a judgment? What if a settlement provides for entry of a judgment if there is a breach of a settlement agreement?

Cross References

New Defined Terms

current monthly income, 11 U.S.C. § 101(10A)
domestic support obligation, 11 U.S.C. § 101(14A)
health care business, 11 U.S.C. § 101(27A)
median family income, 11 U.S.C. § 101(39A)
patient, 11 U.S.C. § 101(40A)
patient records, 11 U.S.C. § 101(40A)

Bankruptcy Code

11 U.S.C. § 103(k)(1)	[makes section 1514 applicable to all chapters]
11 U.S.C. § 332	[consumer privacy ombudsman]
11 U.S.C. § 333	[appointment of patient care ombudsman]
11 U.S.C. § 351	[disposal of patient records]
11 U.S.C. § 503(b)(8)	[allowance of administrative expenses]
11 U.S.C. § 521(a)(2)(B)	[debtor’s duty re statement of intention]
11 U.S.C. § 521(a)(7)	[debtor’s duty as administrator of employee benefit plan]
11 U.S.C. § 523(a)	[exceptions to discharge]
11 U.S.C. § 524	[effect of discharge and reaffirmation agreement]
11 U.S.C. § 524(m)(1)	[temporary presumption of undue hardship]

11 U.S.C. § 707(b)	[dismissal for abuse]
11 U.S.C. § 727	[discharge of debtor]
11 U.S.C. § 1106	[duties of chapter 11 trustee]
11 U.S.C. § 1202	[duties of chapter 12 trustee]
11 U.S.C. § 1302	[duties of chapter 13 trustee]
11 U.S.C. § 1304(c)	[duties of debtor engaged in business]
11 U.S.C. § 1322	[contents of chapter 13 plan]
11 U.S.C. § 1325	[confirmation of chapter 13 plan]
11 U.S.C. § 1505	[authority of trustee or examiner to act in a foreign country]

Applicable Nonbankruptcy Statutes

29 U.S.C. § 1002(16)(A)	[defines administrator of an employee benefit plan]
42 U.S.C. § 664	[State child support enforcement agency]
42 U.S.C. § 666	[State child support enforcement agency]

Bankruptcy Rules

Rule 4004(c)(1)(J)	[delay of discharge when the presumption of undue hardship arises under § 524(m)(1) in connection with a reaffirmation agreement]
Rule 4007(b)	[deadline for filing dischargeability complaint under § 523(c)]
Rule 4008	[deadline for approving reaffirmation agreements]

Interim Rules

Interim Rule 1017(e)(1)	[deadline for filing motion to dismiss under § 707(b) or (c)]
Interim Rule 2002(f)(10)	[requiring the clerk to give notice of under § 704(b)(1)]
Interim Rule 2015.2	[notice re patient transfers]

Information Necessary to Apply Amended Section

The Census Bureau publishes on its Internet site median family income by family size and state median family income by numbers of earners in a family. The most recent year for these figures is 2004. See www.census.gov/hhes/www/income/medincsizeandstate.html (families of 2 or more), and www.census.gov/hhes/www/income/medincearnersandstate.html (1 person). See also www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm

The Consumer Price Index for All Urban Consumers is available from the Bureau of Labor Statistics and can be obtained by its Internet site. See www.bls.gov/cpi/.

The Internet site of the federal Office of Child Support Enforcement contains a link to the State IV-D program Internet sites for all 50 states. These links may be found at www.acf.hhs.gov/programs/cse/extinf.htm#exta.

The state child support enforcement agency for California is the Department of Child Support Services. See Family Code § 17202. It, in turn, has designated local support agencies to enforce support claims. See Family Code § 17304. The agency for the county of residence of the claim holder can be found by accessing the California Department of Child Support Services at www.childsup.cahwnet.gov, and referencing the section entitled “Contact Local Office.” Consequently, if the trustee serves the notices required by section 704(c) on the California Department of Child Support Services, those notices will not be given to the agency actually handling the collection of the child support claim.

Drafting Issues and Problems

Section 1106(a) requires a chapter 11 trustee to perform certain duties imposed by section 704. Section 1106(a) requires chapter 11 trustees to perform the new duties set out in (2), (5), (7), (9), (10), (11), and (12) of section 704. However, the 2005 Act made these subparagraphs of paragraph (a). The Act failed to include a conforming amendment to section 1106(a). Section 1106(a) merely refers to the just mentioned six subparagraphs without reference to paragraph (a).

Similarly, section 1302(b), delineating the duties of a chapter 13 trustee, makes no reference to section 704(a). Instead, it continues to incorporate by reference “sections 704(2), 704(3), 704(4), 704(5), 704(6), 704(7), and 704(9).” Given the amendment of section 704, the appropriate reference should be to sections 704(a)(2), 704(a)(3), 704(a)(4), 704(a)(5), 704(a)(6), 704(a)(7), and 704(a)(9).

Section 704(a)(3) is unchanged. However, this section requires that the trustee ensure that a debtor performs under section 521(2)(B). Section 521(2)(B) no longer exists. It is now section 521(a)(2)(B).

Section 704(a)(10) requires the trustee to give various notices under section 704(c) if a creditor holds a claim based on a domestic support obligation. However, domestic support obligations include spousal support and alimony. It makes no sense to give persons holding claims for spousal support or alimony the notices required by section 704(c) because the state child support enforcement agency only enforces child support claims.

See the discussion in the Summary of Amendment concerning the inconsistent formulas for calculating median family income under sections 704(b)(2) and 707(b)(7).

Section 704(b)(1)(A) requires the United States Trustee to file a statement disclosing whether the debtor is a presumed abuser of chapter 7 relief not later than 10 days after the date of the first meeting of creditors. It does not specify whether this deadline runs from the date first set for the meeting of creditors or when the meeting of creditors is concluded.

Administrative Burdens Imposed on the Court

The clerk of court is given very little time, five days after receipt, to “provide” to creditors a copy of the United States Trustee’s initial statement as to whether the debtor has failed the means test. If filed on the Friday before a weekend followed by a Monday holiday, this would give the clerk as little as 2 court days to provide the statement.

Also, what if the United States Trustee does not file the initial statement required by section 704(b)(1)(A)? This information will be available from the debtor’s schedules. See 11 U.S.C. §§ 521(a)(1)(B)(ii) & 707(b)(2)(C). Must the clerk still provide the United States Trustee’s notice to creditors?

SECTION 706

Conversion

Summary of Amendment

There is only one change to section 706. Under amended section 706(c) the court may convert a chapter 7 petition to one under chapter 12 or 13 if the debtor requests it **or consents** to the conversion. This is added to permit a chapter 7 debtor, faced with the prospect of dismissal under section 707(b), to consent to conversion in order to avoid dismissal on the motion of the trustee or some other party in interest.

Section 706(a) limits the right of a chapter 7 debtor to convert the petition to one under chapter 11, 12 or 13 if the case was previously converted under section 1112, 1208, or 1307. There are amendments to sections 1112, 1208, and 1307. However, these amendments did not alter or change the limitation on the debtor's right to convert if there has been a prior conversion.

Cross References

Bankruptcy Code

11 U.S.C. § 1112	[conversion or dismissal of a chapter 11 petition]
11 U.S.C. § 1208	[conversion or dismissal of a chapter 12 petition]
11 U.S.C. § 1307	[conversion or dismissal of a chapter 13 petition]

SECTION 707
Dismissal of a Case or Conversion to a Case
Under Chapter 11 or 13

Summary of Amendment

- I. **Dismissal under Sections 707(b) and 707(c).** Section 707 provides three new avenues for the dismissal of a chapter 7 petition.
- A. **Dismissal for Abuse.** A chapter 7 petition filed by an individual whose debts are primarily consumer debts may be dismissed (or converted to chapter 13 if the debtor consents) on the motion of the court, the United States Trustee, the chapter 7 trustee, or any other party in interest, if granting relief under chapter 7 would be “an abuse of the provisions of” chapter 7. See 11 U.S.C. § 707(b)(1). “Substantial” abuse is no longer required.
1. **Presumed Abuse.** Abuse may be presumed. See 11 U.S.C. § 707(b)(2). Section 707(b)(2) imposes a “means test” on some chapter 7 debtors. If a debtor has income above a defined threshold, abuse is presumed if the debtor will have \$10,000 or more in projected disposable income over five years. If the debtor will have less than \$6,000 in projected disposable income over five years, no abuse is presumed. If the debtor will have projected disposable income between \$6,000 and \$10,000 over five years, abuse is presumed only if that income will pay 25% or more of the debtor’s nonpriority, unsecured debt. If the presumption of abuse is not rebutted by the debtor, the petition is subject to dismissal on appropriate motion.
2. **General Abuse Standard.** Even when no presumption of abuse arises, the court may conclude that abuse exists if the petition was filed in bad faith or the totality of the debtor’s financial circumstances suggests abuse is present. See 11 U.S.C. § 707(b)(3). Section 707(b)(3) codifies two lines of cases permitting dismissal because a petition was filed in “bad faith” [see, e.g., Industrial Insurance Services, Inc. v. Zick (In re Zick), 931 F.2d 1124 (6th Cir. 1991)] or because case specific circumstances establish cause for dismissal [see, e.g., Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829 (8th Cir. 1994)].
- B. **Dismissal by a Crime Victim.** A victim of a crime of violence or a drug trafficking crime may move for dismissal if the debtor was convicted of such crime and dismissal is in the best interests of the victim. See 11 U.S.C. § 707(c)(1). However, the court may decline to dismiss the petition if the debtor establishes that a chapter 7 petition is necessary to satisfy a claim for a domestic

support obligation. See 11 U.S.C. § 707(c)(3).

II. **Standing Under Sections 707(b) & (c).**

- A. Any Party in Interest. Any party in interest, including the court, may seek dismissal (or conversion with the debtor’s consent) under section 707(b)(1) on the ground that the petition represents an abuse of chapter 7. However, in some circumstances, standing may be restricted or even eliminated.
1. **Primarily Consumer Debts.** An individual chapter 7 debtor’s petition may not be dismissed on the ground that it is an abuse, whether presumptively or otherwise, of chapter 7, unless the debtor’s debts are primarily consumer debts. See 11 U.S.C. § 707(b)(1). Absent such a determination, no one has standing to bring a motion under section 707(b).
 2. **Current Monthly Income Exclusion from Means Test.** A chapter 7 debtor is not subject to the means test if the debtor and the debtor’s spouse (unless the debtor and the spouse are separated) have annualized current monthly income from all sources, whether or not taxable, equal to or less than the state median family income for a household of comparable size. See 11 U.S.C. § 707(b)(7). In this circumstance, no one has standing to bring a motion under section 707(b)(2).
 3. **Current Monthly Income Limitation on Standing to Bring General Abuse Motion.** Only the bankruptcy judge or the United States Trustee may move for dismissal under the general abuse standard of sections 707(b)(1) and (b)(3) if the debtor or, in a joint case, the debtor and the debtor’s spouse, have annualized current monthly income equal to or less than the state median family income for a household of comparable size. See 11 U.S.C. § 707(b)(6). Median family income is calculated in the same manner as under section 707(a)(7). [See detailed discussion below.] However, current monthly income is defined differently than under section 707(a)(7). Under section 707(b)(7), a nonfiling spouse’s income is included when comparing current monthly income to median family income unless the spouses are separated. For purposes of section 707(b)(6), the spouse’s income is included in current monthly income and compared to median family income only if the petition is a joint petition.
 4. **Disabled Veterans.** A chapter 7 debtor who is a disabled veteran [see 38 U.S.C. § 3741(1)] is not subject to the means test if his or her “indebtedness occurred primarily during a period during which he or she was” on active duty [see 10 U.S.C. § 101(d)(1)] or performing a homeland defense activity [see 32 U.S.C. § 901(1)]. See 11 U.S.C. § 707(b)(2)(D). In this circumstance, no one has standing to bring a motion under section

707(b)(2). See Official Form 22A, Part I.

- B. Motion by Crime Victim. Only a victim of a crime of violence [as defined by 18 U.S.C. § 16] or a drug trafficking crime [as defined by 18 U.S.C. § 924(c)(2)] may move for dismissal on the ground that the debtor was convicted of such a crime and dismissal is in the best interests of the victim. See 11 U.S.C. § 707(c)(1).

III. **Presumed Abuse Under Section 707(b)(2).**

- A. Comparison of “Current Monthly Income” to Median Family Income. See 11 U.S.C. §§ 101(10A), 707(b)(7).

1. **Current Monthly Income**. “Current monthly income” is an average of the debtor’s income for the six months prior to the filing of the petition. This income includes any amount regularly paid by someone other than the debtor (or the debtor’s spouse in a joint case) for the household expenses of the debtor, the debtor’s dependents, and (in a joint case) the debtor’s spouse. For instance, a support payment paid to the debtor (or the debtor’s spouse in a joint case) would be included in current monthly income. Current monthly income does not include Social Security benefits. See 11 U.S.C. §§ 101(10A), 707(b)(7).

Current monthly income is not a measure of “current” income in the sense that it is the debtor’s income on the date of the petition.

2. Is current monthly income net of income, employment, Social Security, Medicare taxes? If the debtor is self-employed, do you deduct the debtor’s business expenses from current monthly income? Or, are these “other necessary expenses” that are part of the means test under section 707(b)(2)(A)(ii)? [See discussion below.] The distinction may make a difference. If these are adjustments to income, they may prevent the means test from applying to the debtor. Otherwise, the debtor is subject to the means test and must seek to deduct these expenses from current monthly income in order to avoid being characterized as a presumed abuser of chapter 7 relief. In the chapter 13 context, if a debtor is subject to the means test, the debtor’s disposable income must be calculated pursuant to the means test rather than through an analysis of the debtor’s actual income and expenses as of the petition date. See 11 U.S.C. § 1325(b)(3).

The Internal Revenue Manual (IRM) available on the Internet site maintained by the IRS [see www.irs.gov/irm/] indicates that current taxes are considered “other necessary expenses.” See <http://www.irs.gov/irm/part5/ch15s01.html#d0e165762>. Hence, under the

means test, current taxes would not be deducted from gross income when determining current monthly income. Rather, current monthly income is gross income and current taxes must be deducted under the means test as an “other necessary expense.”

Is the same true of business expenses incurred by self-employed debtors? On the one hand, the IRM indicates that before deductions are permitted to a debtor’s income, income must first be calculated. Only net income from self-employment is included in income as is net rental income. See On the other hand, the IRM also indicates expenses related to the production of income are “other expenses” that are deducted along with the expenses permitted by the National and Local Standards. See <http://www.irs.gov/irm/part5/ch15s01.html#d0e165762>.

3. **Annualized Current Monthly Income.** Once current monthly income is determined, it is multiplied by 12 in order to obtain the annualized current monthly income. The annual amount is then compared to “median family income” to determine whether the debtor is subject to the means test. See 11 U.S.C. § 707(b)(7). That is, it is compared to determine if anyone has standing to seek dismissal on the ground that the debtor has not passed the means test.
4. **Median Family Income.** “Median family income” is calculated and reported by the Census Bureau “for the then most recent year.” See 11 U.S.C. § 101(39A). For instance, if a chapter 7 petition were filed in 2005, the relevant year of comparison would be 2004. If the Census Bureau has not yet reported the median family income for 2004, the amount reported for 2003 would be used for purposes of section 704(b)(2)(A) but with the adjustment required by section 101(39A)(B). The 2003 median family income would be adjusted to “reflect the percentage change in the Consumer Price Index for All Urban Consumers for 2004.” For 2004, a 3.3% increase in the CPI was reported.
5. Section 707(b)(7) does not use the median family income reported by the Census Bureau for households of more than four persons. Instead, section 707(b)(7) directs that \$525 per month, or \$6,300 per year, be added to the median family income reported by the Census Bureau reports for a household of four for each individual beyond the fourth household member.
6. Below is the Census Bureau Median Family Income by Family Size in 2005 inflation adjusted dollars for cases filed after February 13, 2006 as reported by the United States Trustee at www.usdoj.gov/ust/eo/bapcpa/bci_data/median_income_table.htm. See

also www.census.gov/hhes/www/income/statemedfaminc.html.

Family Size	Median Income Per Section 707(b)(7)
1	\$43,436
2	\$55,320
3	\$61,655
4	\$70,626
5	\$76,926
6	\$83,226
7	\$89,526

7. If the debtor's current monthly income multiplied by 12 is equal to or less than the state median family income for a household of comparable size, with CPI adjustment if appropriate, the debtor is not subject to the means test. If the debtor's annualized current monthly income exceeds this benchmark, the debtor is subject to the means test. See Official Form 22A, Parts II & III.

B. Calculation of "Current Monthly Income" for Means Test. See 11 U.S.C. §§ 101(10A), 707(b)(7). It is important to understand that section 707(b) requires two different calculations of current monthly income.

First, it must be calculated in order to determine whether the debtor is subject to the means test. Stated differently, it is calculated and compared to the state median income to determine a party in interest's standing to request dismissal of the petition under the means test. See Official Form 22A, Part II & III.

If the debtor is subject to the means test, a slightly different calculation is necessary. See Official Form 22A, Part IV. If the debtor is married but the debtor's spouse is not a joint debtor, for purposes of section 707(b)(7) all of the spouse's income is included in the calculation of current monthly income unless the spouses are separated. However, the means test does not charge such a debtor with all of the nonfiling spouse's income. Rather, only the contributions made by the nonfiling spouse to the household expenses of the debtor and the debtor's dependents are included in the debtor's current monthly income. See 11 U.S.C. § 101(10A). Therefore, if a married debtor filing a chapter 7 petition is subject to the means test, the nonfiling spouse's income, to the extent not contributed to the

household, is not considered current monthly income.

C. Deductions from Current Monthly Income. The means test requires that a chapter 7 debtor who is subject to the means test calculate certain actual and presumed monthly expenses then deduct them from current monthly income. See 11 U.S.C. §§ 707(a)(1) & (b)(2)(A)(ii) - (iv). See, also Official Form 22A, Part V.

1. **IRS Collection Financial Standards.** The IRS has developed collection financial standards to guide its revenue agents when evaluating a taxpayer's ability to pay delinquent taxes. These standards fall into three categories. <http://www.irs.gov/irm/part5/ch15s01.html#d0e165762>. All three are applicable to the means test. See 11 U.S.C. § 707(b)(2)(A)(ii)(I).

a. The National Standards are the amounts the IRS considers necessary expenses for food, housekeeping supplies, apparel, personal care products and services, and miscellaneous expenses. www.irs.gov/businesses/small/article/0,,id=104627,00.html; www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm. The IRS allows taxpayers all of the expenses permitted by the National Standards for their family size and income level, without questioning whether the taxpayers' actual expenses are higher or lower. The National Standards, as effective in cases filed after February 13, 2006, are in the table below. Section 707(b) does not indicate whether the same policy is applicable under the means test. However, Official Form 22A, Part V, Subpart A, Line 19 permits the deduction of the entire amount allowed under the National Standards.

Total Gross Monthly Income	Number of Persons in Household				
	One	Two	Three	Four	Over Four*
Less than \$833	367	578	802	856	138
\$833 - \$1,249	409	595	808	890	149
\$1,250 - \$1,666	461	627	812	936	160
\$1,667 - \$2,499	498	679	819	941	171
\$2,500 - \$3,333	556	744	924	1,042	182
\$3,334 - \$4,166	621	825	937	1,063	193
\$4,167 - \$5,833	703	904	1,017	1,203	204
\$5,834 and over	916	1,306	1,368	1,546	216

* For each additional person in household, add to the four-person allowance the applicable amount from this column.

- b. The Local Standards are used for transportation and housing expenses. These standards vary by location, with transportation operational expenses being determined by region and housing expenses being determined by county.

Unlike the National Standards, the IRS permits taxpayers the amount allowed by the Local Standard or their actual expense, whichever is less.

- (1) **The Local Transportation Standards.** The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down regionally. See www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm and www.irs.gov/businesses/small/article/0,,id=104623,00.html

The ownership cost portion of the transportation standard, although it applies nationwide, is nonetheless considered part of the Local Standards. The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles.

Public transportation is included under operating costs. Other operating costs include vehicle insurance, maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license fees and expenses.

If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

The Local Transportation Standards applicable to the Eastern District of California are set out in the table below.

OWNERSHIP COSTS			
National		First Car	Second Car
		\$471	\$332
OPERATING COSTS & PUBLIC TRANSPORTATION			
Region	No Car	One Car	Two Cars
S.F. MSA (Solano County)	\$325	\$401	\$484
Western Census Region*	\$252	\$338	\$420

* Includes all counties in Eastern District of California except Solano County. Solano County is considered part of the San Francisco Metropolitan Statistical Area by the Census Bureau.

- (2) **The Local Housing Standards.** Unlike the transportation standards, the IRS Local Housing Standards do not separate costs and expenses associated with acquiring ownership of a residence and those associated with maintenance of the residence. Housing expenses and utilities are lumped together. However, based on data provided by the IRS, the United States Trustee has split the IRS Local Housing Standard into two components, nonmortgage and mortgage/rent expense. The Local Housing Standards for California, as modified by the U.S. Trustee, is appended. See www.usdoj.gov/ust/co/bapcpa/meanstesting.htm.

According to the IRS, the nonmortgage expenses include gas, electricity, water, fuel, oil, bottled gas, trash and garbage collection, wood and other fuels, septic cleaning, and telephone. Mortgage or rent includes property taxes, interest, parking, necessary maintenance and repair, homeowner's or renter's insurance, homeowner dues, and condominium fees. See Section 5.15.1.9, <http://www.irs.gov/irm/part5/ch15s01.html#d0e165762>.

- (3) As noted above, the IRS permits taxpayers the expense amounts allowed by the Local Standards or the taxpayer's actual expenses, whichever are less.

Section 707(b) does not expressly indicate whether the same policy is applicable under the means test. Arguably,

the language of section 707(b)(2)(A)(ii) [“The debtor’s monthly expenses shall be the debtor’s applicable monthly expense amounts specified under . . . the Local Standards. . . .”] treats the amounts in the Local Standards as deductions every debtor may subtract from current monthly income even though actual expenses may be less. While section 707(b)(2)(A)(ii) does require that the amounts in the standards be “applicable,” this may mean only that, for instance, the debtor must own a car in order to deduct the ownership and maintenance allowances from current monthly income.

This interpretation of section 707(b)(2)(A)(ii) is implicit in Official Form 22A. Official Form 22A, Part V, Subparts A and C, suggest that the Local Standards, both housing and transportation, will be applied differently under the means test than they are applied by the IRS to taxpayers owing delinquent taxes. See Lines 20B, 23, 24, and 42 of Official Form 22A.

In In re Hardacre, 2006 WL 541028 (Bankr. N.D. Tex. 2006), the debtor attempted to argue that section 707(b)(2)(A)(i) permitted the debtor to deduct actual mortgage and car loan expenses as well as the standardized expenses permitted under the Local Standards. The court disagreed, permitting the debtor to deduct only the greater of the actual debt payments or the standard deductions.

- (4) **Adjustment for Payments of Debts.** Section 707(b)(2)(A)(ii)(I) provides that “the monthly expenses of the debtor shall not include payments for debts.” When this language is considered along with section 707(b)(2)(A)(iii) [permitting a debtor to deduct actual payments on secured debt], the debtor’s actual secured debt payments [as well as all other expenses that must be paid to the secured creditor in order to maintain possession of a vehicle and a home] are permitted even if in excess of what is permitted by the Local Standards. These amounts are subtracted from the expense amounts permitted by the Local Standards and are separately deducted from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(iii) and discussion below.

The Local Transportation Standards include two amounts, one for “ownership costs” and another for “operating costs

and public transportation costs.” The amount in the Local Transportation Standards for ownership expense would be reduced to the extent the debtor is making a payment (calculated in accordance with section 707(b)(2)(A)(iii)) to acquire a vehicle. Thus, the debtor may substitute the debtor’s actual car payment in place of the IRS expense allowance and, if it is less than the IRS allowance, take what remains of the allowance as well.

Until recently, for the Local Housing Standards, this could not be done because the housing standards lumped housing acquisition, maintenance, and utility costs together in one amount. Thus, there was no simple way to substitute the debtor’s actual mortgage payment for the housing acquisition expense embedded in the Local Housing Standards. If this was attempted, a portion of the actual mortgage payment might offset all or a portion of the utility expenses and other housing expenses (like insurance, taxes, association fees) that were part of the standard.

However, on October 5, 2005, the Advisory Committee on Bankruptcy Rules indicated that the IRS will amend on or prior to October 17, 2005 the Local Housing Standards to separate mortgage and nonmortgage expenses in the standards. It appears that the IRS did not amend the Local Housing Standards it uses in connection with the collection of overdue taxes. Instead, it provided data to the United States Trustee to permit it to make the adjustment to the Local Housing Standards as they will apply in bankruptcy cases. These modified standards can be found at www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm.

Official Form 22A also permits a debtor to at least attempt to deduct other or additional housing expenses at Line 21 if the debtor contends that “Lines 20(A) and 20(B) do[] not accurately compute the allowance to which [the debtor is] entitled under the IRS Housing and Utilities Standards.”

- c. “Other” Necessary Expenses. When the IRS determines that the expenses permitted by the National and Local Standards are inadequate to provide for a taxpayer’s basic living expenses, the IRS will permit the taxpayer to continue to pay his or her actual expenses. However, the IRS will not generally permit a taxpayer to pay tuition for private schools, public or private college

expenses, charitable contributions, voluntary retirement contributions, payments or unsecured debts such as credit card bills, cable television charges and other similar expenses as necessary living expenses.

- (1) According to the 2005 Act, other necessary expenses under the means test may include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor and the debtor's spouse and dependents. See 11 U.S.C. § 707(b)(2)(A)(ii)(I). See, also Official Form 22A, Part V, Subpart B.
 - (2) Additional other expenses might include state and federal income, self-employment, social security, and Medicare taxes; dental, vision, long-term care, and life insurance; childcare expenses; court ordered payments such as spousal and child support payments; mandatory payroll deductions for such things as uniforms, pension contributions, and union dues; and business expenses [assuming any or all of the foregoing is not an adjustment to current monthly income]. See Official Form 22A, Part V, Subpart B.
 - (3) A self-employed debtor's business expenses are deductible from gross income to determine the debtor's current monthly income (see discussion above). These expenses are not "other expenses" deductible from current monthly income under the means test. See Official Form 22A, Part II, Line 4a, 4b, 4c. But see <http://www.irs.gov/irm/part5/ch15s01.html#d0e165762>.
2. **Expense Related to Safety of Debtor.** Reasonably necessary expenses incurred to maintain the safety of the debtor and the debtor's family from family violence [as defined by 42 U.S.C. § 10421] may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(ii)(I). See, also Official Form 22A, Part V, Subpart B.
 3. **Additional Food & Clothing.** Reasonable and necessary additional expenses for food and clothing of up to 5% of the food and clothing categories specified in the IRS National Standards may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(ii)(I). See, also Official Form 22A, Part V, Subpart B.
 4. **Care of Disabled & Elderly.** Reasonable, necessary, and actual expenses paid by the debtor for care and support of an elderly, chronically ill, or

disabled household member or member of the debtor's immediate family (parents, grandparents, siblings, children, grandchildren, spouse, or dependent) who is unable to pay such expenses may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(ii)(II). See, also Official Form 22A, Part V, Subpart B.

5. **Chapter 13 Administrative Expenses.** If the debtor is eligible for chapter 13 relief, the actual expenses of administering a chapter 13 plan up to 10% of the projected plan payments as determined under schedules issued by the United States Trustee may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(ii)(III). See, also Official Form 22A, Part V, Subpart C.
6. **Education Expenses.** The actual expenses, not to exceed \$1,500 annually, incurred to send a dependent child less than 18 years of age to a private or public elementary or secondary school may be deducted under the means test from current monthly income. However, the debtor must provide documentation of such expenses, explain why they are reasonable and necessary, and demonstrate that the expenses are not already accounted for in the IRS standards. See 11 U.S.C. § 707(b)(2)(A)(ii)(IV). See, also Official Form 22A, Part V, Subpart B.
7. **Additional Home Energy Expenses.** Additional expenses for home energy costs beyond what is permitted by the IRS Local Housing Standards may be deducted under the means test from current monthly income. The debtor must document the expenses and prove they are reasonable and necessary. See 11 U.S.C. § 707(b)(2)(A)(ii)(V). See, also Official Form 22A, Part V, Subpart B.
8. **Secured Debt.** 1/60th of all amounts contractually due on secured debt over the next five years may be deducted from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(iii)(I). See, also Official Form 22A, Part V, Subpart C. As noted above, for debts secured by up to two vehicles and the debtor's home, these amounts must be substituted for the ownership component in the Local Transportation Standards and the mortgage/rent component in the Local Housing Standards.

In addition to deducting 1/60th of the contractual payments due on secured debt, the debtor may also deduct 1/60th of all additional payments to each secured creditor necessary to maintain possession of the debtor's residence, motor vehicle, and other property necessary for the support of the debtor and the debtor's dependents may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(iii)(II). An obvious example of such additional payments would be amounts

necessary to cure arrears owed on a mortgage.

It is not so obvious, however, whether such items as vehicle registration fees, vehicle and home insurance, and property taxes would be included because these items may not be “payments to secured creditors” even though the security documentation may require that they be paid.

The Statement of Current Monthly Income and Means Test Calculation, Official Form 22A, proposed by the Advisory Committee on Bankruptcy Rules directs the debtor to include “payments of taxes and insurance required by the mortgage.” See Official Form 22A, Part V, Subpart C, Line 42.

If not deducted as a payment on a secured debt, real estate taxes might be included as “other necessary expenses” under the IRS collection financial standards as discussed above. However, the Statement of Current Monthly Income and Means Test Calculation, Official Form 22A, directs the debtor to not include real estate taxes as “other necessary expenses.” See Official Form 22A, Part V, Subpart A, Line 25.

Because real estate taxes are secured by a lien on the subject real estate, these taxes may simply be a secured debt. Thus, the debtor may include 1/60th of the taxes to come due over the next five years as well as 1/60th of overdue taxes and deduct these amounts from current monthly income.

Official Form 22A is not so helpful with insurance, taxes and registration fees related to the ownership and operation of a vehicle. These expenses are likely embedded in the IRS Local Transportation Standards. If so, section 707(b)(2) does not contain a provision permitting the debtor to supplant or supplement this element of the standards with the debtor’s actual expenses for insurance, taxes, and registration fees. Section 707(b)(2) permits this only with respect to secured debt payments and home energy costs. See 11 U.S.C. § 707(b)(2)(A)(ii)(V) & (iii).

The second possibility is that insurance, taxes, and registration fees relating to a vehicle might be considered “additional payments to secured creditors” just as Official Form 22A, Line 42 permits comparable expenses to be added to a mortgage payment. Official Form 22A, Part V, Subpart C, Line 42, does not forbid inclusion of these expenses with secured debt payments. While such expenses are not paid directly to a secured creditor, most vehicle installment sale contracts require the debtor to keep the vehicle insured and registered. If not paid by the debtor, a secured creditor may advance the funds for the insurance or registration or purchase its own policy.

9. **Priority Debt.** 1/60th of all priority debts that the debtor is obligated to pay over the next five years may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(2)(A)(iv). See, also Official Form 22A, Part V, Subpart C.
10. **Charitable Contributions.** Continued charitable contributions [as defined by 26 U.S.C. § 170(c)] up to 15% of gross income to a qualified religious or charitable entity or organization [as defined by 26 U.S.C. § 731(c)(2)(C)] may be deducted under the means test from current monthly income. See 11 U.S.C. § 707(b)(1). See, also Official Form 22A, Part V, Subpart B.
- D. **The Means Test.** The next step is to determine whether a debtor is presumptively abusing chapter 7. If, after making the above deductions from current monthly income, the remaining amount is less than \$100 [or less than \$6,000 over 5 years], the debtor is not presumptively abusing chapter 7 relief. If the amount is equal to or greater than \$166.67 [or \$10,000 or more over 5 years], the debtor is presumptively abusing chapter 7 relief. If the debtor has more than \$100 but less than \$166.67, the debtor is presumptively abusing chapter 7 relief if this amount is sufficient over 5 years to pay 25% of nonpriority unsecured claims. See 11 U.S.C. § 707(b)(2)(A)(i). See Official Form 22A, Part VI.
- E. **Disclosure.** The debtor is required by 11 U.S.C. §§ 521(a)(1)(B)(ii) & 707(b)(2)(C) to disclose all of the calculations that comprise the means test in the schedules filed at the beginning of the bankruptcy case. See Official Form 22A, the Statement of Current Monthly Income and Means Test Calculation.
- F. **Clerk's Notice.** Section 342(d) requires the bankruptcy court clerk to give written notice to all creditors not less than 10 days after an individual files a chapter 7 petition if the presumption of abuse arises under section 707(b)(2). See Interim Rule 2002(f)(9), 5008. Official Form 9, the notice of the commencement of the case and the meeting of creditors, is amended to permit the clerk to indicate whether a presumption of abuse has arisen.

However, Interim Rule 1007(c) gives the debtor the option of filing the statement of current income required by Interim Rule 1007(b)(4) [this document will include the section 707(b) calculations] either with the petition or within 15 days of its filing. Obviously, if the debtor files the statement of current income on the 15th day after filing the petition, the clerk will be unable to give the notice required by section 342(d) by the 10th day after the petition is filed. Interim Rule 5008 anticipates this problem. If the debtor has not filed the statement of current income in time for the clerk to notify creditors that presumption of abuse has arisen, the notice will advise creditors only that the debtor's statement has not been filed. Thereafter, once the statement of income is filed, "the clerk shall give

notice to creditors of the presumption of abuse as promptly as practicable.” See Interim Rule 5008.

- G. First UST Statement. The United States Trustee, after reviewing the debtor’s schedules and statements, is required to file a statement indicating whether the debtor is a presumed abuser of chapter 7. See 11 U.S.C. § 704(b)(1)(A). This statement is due no later than 10 days after the date of the first meeting of creditors. Id. Section 704(b) does not indicate whether this time period runs from the first date set for the meeting or the date the meeting is concluded. Not later than 5 days after the United States Trustee’s statement is filed, the clerk of the bankruptcy court is required “to provide” it to all creditors. See 11 U.S.C. § 704(b)(1)(B). Section 704(b) does not require that it be provided to the chapter 7 trustee.
- H. Second UST Statement or Motion. In those cases where the debtor is a presumed abuser of chapter 7, the United States Trustee is required, no later than 30 days after the first statement is filed, to file a second statement explaining why dismissal (or conversion) will not be sought. See 11 U.S.C. § 704(b)(2). Note that Interim Rule 1017(e)(1) requires that a dismissal/conversion motion under sections 707(b) or (c) be filed within 60 days after the date first set for the meeting of creditors. Thus, it is necessary for the United States Trustee to explain why a dismissal/conversion motion will not be filed before the deadline to file such a motion has passed.
- I. Dismissal Motion. Provided the debtor’s income, combined with the debtor’s spouse’s income (unless the two separated), is greater than the state median family income for a household of comparable size, any party in interest may file a motion to dismiss a chapter 7 petition on the ground that the debtor did not pass the means test. See 11 U.S.C. § 707(b)(7).
1. **Conversion as Alternative.** If the debtor consents to conversion, the court may convert the case to one under chapter 11 or 13 rather than dismiss the case. See 11 U.S.C. § 707(b)(1).
 2. **Motion Deadline.** There is no deadline in section 707(b)(2) for bringing a dismissal/conversion motion based on the debtor’s failure to pass the means test. Nor is there a deadline for bringing a motion under sections 707(b)(1) and 707(b)(3) [dismissal/conversion on general abuse grounds], and section 707(c) [dismissal at instance of crime victim]. Under existing Fed. R. Bankr. P. 1017(e), the United States Trustee or the court must bring a motion to dismiss/convert for substantial abuse no later than 60 days after the first date set for the meeting of creditors (the same deadline set by Fed. R. Bankr. P. 4007(c) for filing dischargeability complaints). Interim Rule 1017(e)(1) requires that all of these dismissal motions be

filed no later than this same deadline, 60 days after the first date set for the meeting of creditors.

3. **Debtor's Response.** A chapter 7 debtor faced with a dismissal motion made on the ground that the debtor has not passed the means test, has four possible responses.
 - a. First, if the debtor is a disabled veteran, and if the indebtedness subject to discharge “occurred primarily during a period during which” the debtor was on active duty or performing homeland defense duties, the debtor is not subject to the means test. See 11 U.S.C. § 707(b)(2)(D).
 - b. Second, the debtor may argue that he or she has not flunked the means test. That is, the debtor may take issue with the United States Trustee's (or other movant's) calculation of the debtor's current monthly income or the deductions from current monthly income.
 - c. Third, the debtor could concede that he or she has flunked the means test and request conversion of the petition to one under chapter 11 or 13 rather than suffer a dismissal. See 11 U.S.C. § 707(b)(1).
 - d. Fourth, even though the debtor may have flunked the means test, the debtor may attempt to rebut the presumption of abuse. See 11 U.S.C. § 707(b)(2)(B).
 - (1) This may be done under section 707(b)(2)(B) by showing “special circumstances,” including but not limited to a serious medical condition or active duty in the military.
 - (2) The special circumstances must justify either an adjustment to the debtor's current monthly income or increase the debtor's monthly expenses to beyond what the means test permits.
 - (3) The debtor must show that there is “no reasonable alternative” to the adjustment to current monthly income or expenses.
 - (4) To receive an adjustment of income or be permitted additional expenses, the debtor must document under oath all such expenses and adjustments and provide a detailed

explanation of the special circumstances showing that they are reasonable and necessary. See 11 U.S.C. § 707(b)(2)(B)(ii) & (iii).

- (5) The presumption is rebutted only if the additional expenses or adjustments to income result in the debtor passing the means test. That is, after allowing the additional deductions from current monthly income, a dismissal motion will be denied only if the debtor has less than \$100 in monthly projected disposable income [or less than \$6,000 over 5 years], or, if the debtor has between \$100 and \$166.66 a month in projected disposable income, it will be insufficient to pay at least 25% of the debtor's nonpriority unsecured claims. See 11 U.S.C. § 707(b)(2)(A)(i).
- (6) Note that the means test will be applied in some chapter 13 cases in order to determine the debtor's projected disposable income. See 11 U.S.C. § 1325(b). Section 1322(f) specifies that a chapter 13 plan may not materially alter the terms of a loan to the debtor from a retirement plan. See 11 U.S.C. §§ 362(b)(19) & 1322(f). Further, amounts necessary to repay such loans are not disposable income under section 1325. In other words, money necessary to repay a pension loan may be deducted from current monthly income. While not among the itemized expenses in section 707(b)(2)(A), given the exclusion of this expense from disposable income in chapter 13, the same deduction should be permitted in a chapter 7 case. See related discussion in summary of section 1322.

IV. Liability of Debtor's Attorney. Section 707(b)(4) exposes the debtor's attorney to liability if a chapter 7 petition is dismissed or converted as the result of a motion under section 707(b). Section 707(b)(1) provides for dismissal or conversion (with the debtor's consent) if the petition is an abuse of chapter 7. Abuse may be presumed if the debtor fails the means test of section 707(b)(2), or if the party in interest seeking dismissal establishes under section 707(b)(3) either that the petition was filed in bad faith or that the totality of the debtor's financial circumstances demonstrate that the debtor is abusing chapter 7.

- A. The signature of the debtor's attorney on a petition, pleading, or written motion is a certification that the attorney has performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion, and has determined that the petition is well grounded in fact and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing

law that the petition does not constitute an abuse under section 707(b)(1). See 11 U.S.C. § 707(b)(4)(C). As to the schedules, the signature of the attorney on the petition is a certification that the attorney has no knowledge after inquiry that the information in the schedules is incorrect. See 11 U.S.C. § 707(b)(4)(D).

1. While section 707(b)(4)(D) refers to the schedules, section 707(b)(4) does not provide for sanctions if the schedules are incorrect. It provides for sanctions only if dismissal or conversion is warranted either under the means test of section 707(b)(2)(A), or if the petition was filed in bad faith or the totality of the circumstances warrant dismissal under section 707(b)(3).
 2. The inquiry is directed to “the petition, pleadings, or written motion.” No reference is made by section 707(b)(4)(B) to schedules or statements. However, the phrase in section 707(b)(4)(C) requiring the debtor’s attorney to perform “a reasonable investigation into the circumstances that gave rise to the petition,” indicates that counsel for the debtor is being asked to determine and corroborate the legitimate facts and circumstances impelling the debtor to file chapter 7.
 3. Section 319 of the 2005 Act provides: “It is the sense of Congress that rule 9011 of the Federal Rules of Bankruptcy Procedure . . . should be modified to include a requirement that all documents (including schedules), signed and unsigned, submitted to the court or to a trustee by debtors who represent themselves and debtors who are represented by attorneys be submitted only after the debtors or the debtors’ attorneys have made a reasonable inquiry to verify that the information contained in such documents is – (1) well grounded in fact; and (2) warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law.” If Rule 9011 is amended in light of this Congressional sentiment, sanctions may eventually be meted out via Rule 9011 if the schedules or statements are not accurate.
 4. Note that section 319 of the 2005 Act, section 707(b)(4)(C), and section 527(c) [requiring a debt relief agency to make a “reasonably diligent inquiry” to obtain information for the petition, schedules, and statements] all require the attorney to conduct an “inquiry.”
- B. If the court grants a motion to dismiss or convert filed by the chapter 7 trustee, the court or a party in interest may move to impose sanctions on the attorney for the debtor. See 11 U.S.C. § 707(b)(4)(A).
1. The motion must be in accordance with the procedures required by Fed. R. Bankr. P. 9011. See 11 U.S.C. § 707(b)(4)(A).

2. The court may order the attorney for the debtor to reimburse the trustee for all reasonable costs, including attorney's fees, incurred in prosecuting a motion under section 707(b) if it finds that the action of the attorney in filing the petition violated Fed. R. Bankr. P. 9011. See 11 U.S.C. § 707(b)(4)(A).
3. Also, if the attorney for the debtor violated Fed. R. Bankr. P. 9011 the court may assess an appropriate civil penalty against the attorney and order it paid to the trustee or the United States Trustee. See 11 U.S.C. § 707(b)(4)(B).

V. Liability of Creditor & Creditor's Attorney. Section 707(b)(5) exposes parties in interest other than the chapter 7 trustee, the United States Trustee, and certain small businesses to liability if they file a motion to dismiss or convert under section 707(b)(1) that is not granted. See 11 U.S.C. § 707(b)(5)(A). Unlike section 707(b)(4), which exposes only the debtor's attorney to sanctions, section 707(b)(5) is not limited in its scope to the attorney for the party in interest bringing the motion.

- A. If the court does not grant a motion to dismiss or convert filed by a party in interest (excluding the chapter 7 trustee, the United States Trustee, or a small business), the court or a party in interest may move to impose sanctions on the party in interest bringing the dismissal motion or its attorney. See 11 U.S.C. § 707(b)(5)(A).
 1. The motion for sanctions must be in accordance with the procedures required by Fed. R. Bankr. P. 9011. See 11 U.S.C. § 707(b)(5)(A).
 2. If the party filing the initial dismissal motion is a small business [a business with fewer than 25 full-time employees] with a claim of less than \$1,000, it is not subject to any liability for bringing an unsuccessful dismissal motion. See 11 U.S.C. § 707(b)(5)(B).
 3. The court may order a party in interest to pay the debtor all reasonable costs, including attorney's fees, incurred in contesting the dismissal motion if the position of the party in interest violated Fed. R. Bankr. P. 9011, or the attorney filing the dismissal motion did not perform a reasonable investigation into the circumstances giving rise to the motion, and the motion was not well grounded in fact and was not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law that the petition constituted an abuse under section 707(b)(1), and the motion was made solely for the purpose of coercing a debtor to waive a right guaranteed under the Bankruptcy Code. See 11 U.S.C. § 707(b)(5)(A).

Litigation Points

1. Does the definition of current monthly income include or exclude taxes and other payroll deductions? Current monthly income does not exclude amounts deducted from payroll. These are considered “other necessary expenses. See Official Form 22A, Lines 25 & 26.

2. If the debtor is self-employed, are the debtor’s business expenses an adjustment to current monthly income or are they merely a deduction from current monthly income under the means test? Does it make a difference? In arriving at a debtor’s current monthly income, Official Form 22A, Lines 4(b) and 5(b) permit expenses to be subtracted from business income and rents.

3. Does the 10% administrative expense allowance for a hypothetical chapter 13 case in section 707(b)(2)(A)(III) include a debtor’s attorney’s fees? The October 3, 2005, Comment of the Advisory Committee on Bankruptcy Rules regarding Official Form 22C, for use in chapter 13 cases, indicates that disposable income may be used to pay the debtor’s attorney. From this it can be inferred that the 10% allowance for chapter 13 administrative expenses in the means test includes only the chapter 13 trustee’s compensation and expense.

4. If a debt is secured by a luxury item, such as a recreational vessel, may a chapter 7 debtor deduct the loan payments falling due over the next 60 months as part of the means test? What if the loan secured by the item is in arrears? Note that section 707(b)(2)(A)(iii)(I) does not condition the deduction of future contract payments on the security for the loan being reasonably necessary to the debtor’s maintenance or livelihood. However, section 707(b)(2)(A)(iii)(II), which permits a debtor to deduct “additional payments” due a secured creditor, such as arrearages under the loan, only if the loan is secured by the debtor’s “primary residence, motor vehicle, or other property necessary for the support of the debtor. . . .”

5. Section 707(b)(4) permits any party in interest to seek costs and sanctions against the attorney for the debtor if the petition is dismissed pursuant to section 707(b). However, costs and sanctions may be awarded only if the trustee filed the dismissal motion. Further, the costs, including attorney’s fees, are payable only to the trustee and the sanctions are payable only to the trustee or the United States Trustee. Given these limitations, why would a party in interest other than the trustee or the United States Trustee ever make a motion to recover costs and sanctions? A similar question arises under section 707(b)(5). Any party in interest may move to recover the costs and attorney’s fees incurred by the debtor successfully resisting a dismissal motion under section 707(b) filed by some other party in interest. However, the costs and fees are paid to the debtor.

6. Does the definition of current monthly income under section 101(10A) include the income of a nonfiling spouse if the spouses reside in a community property state?

Cross References

New Defined Terms

assisted person, 11 U.S.C. § 101(3)
bankruptcy assistance, 11 U.S.C. § 101(4)(A)
current monthly income, 11 U.S.C. § 101(10)(A)
debt relief agency, 11 U.S.C. § 101(12A)
domestic support obligation, 11 U.S.C. § 101(14A)
median family income, 11 U.S.C. § 101(39A)

Bankruptcy Code

11 U.S.C. § 342(d)	[notice required by court clerk when presumption of abuse arises]
11 U.S.C. § 362(b)(19)	[exception to automatic stay permitting withholding and collection from debtor's wages to repay loan from a retirement plan]
11 U.S.C. § 521	[requirement that debtor file, among many other things, statements relating to current income and means test]
11 U.S.C. § 548(d)(3) & (4)	[definition of qualified religious or charitable entity or organization and of charitable contribution]
11 U.S.C. § 704(b)	[UST notices regard chapter 7 debtors who are presumed abusers]
11 U.S.C. § 1322(f)	[amounts to repay loan from retirement plan not disposable income under section 1325]
11 U.S.C. § 1325(b)	["disposable income" requirement of chapter 13]

Applicable Nonbankruptcy Statutes

10 U.S.C. § 101(d)(1)	[active military duty]
18 U.S.C. § 16	[definition of crimes of violence]
18 U.S.C. § 924 (c)(2)	[definition of drug trafficking crime]
26 U.S.C. § 170(c)	[definition of qualified religious or charitable entity or organization]
26 U.S.C. § 731(c)(2)(C)	[definition of charitable contribution]
28 U.S.C. § 2075	[authority of Supreme Court to promulgate means test form]
32 U.S.C. § 901(1)	[homeland defense activity]
38 U.S.C. § 101	[definition of veteran]
38 U.S.C. § 3741(1)	[definition of disabled veteran]
42 U.S.C. § 10421	[definition of family violence]

Bankruptcy Rules

Rule 1017(e)	[existing deadline for substantial abuse dismissal motion]
Rule 9011	[sanctions]

Interim Rules

Interim Rule 1007(b)(4)	[requires filing of new statement of current income]
Interim Rule 1007(c)	[sets deadline of not later than 15 days after filing petition to file new statement of current monthly income]
Interim Rule 1017(e)(1)	[deadline for dismissal motions under §§ 707(b) & (c)]
Interim Rule 2002(f)(9)	[requiring clerk to give notice of statement under § 704(b)(1)]
Interim Rule 5008	[notice of presumption of abuse]

Official Forms

Official Form 9	[first meeting notice]
Official Form 22A	[statement of current monthly income and means test calculation]

Information Necessary to Apply to Amended Section

The Census Bureau publishes on its Internet site median family income by family size and state median family income by numbers of earners in a family. The most recent year for these figures is 2004. See www.census.gov/hhes/www/income/medincsizeandstate.html.

The Consumer Price Index for All Urban Consumers is available from the Bureau of Labor Statistics and can be obtained by its Internet site. See www.bls.gov/cpi/.

See <http://www.irs.gov/businesses/small/article/0,,id=109628,00.html> for discussion of the IRS Offer and Compromise program. Links are given for the Collection Financial Standards, the National Standards, Local Housing Standards, Local Transportation Standards, and Necessary Expenses.

See <http://www.irs.gov/businesses/small/article/0,,id=104627,00.html> for National Standards for food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous expenses.

See <http://www.irs.gov/businesses/small/article/0,,id=104701,00.html> for California housing and utilities expense (but not broken into mortgage and nonmortgage components).

See <http://www.irs.gov/businesses/small/article/0,,id=104623,00.html> for California transportation expense.

See <http://www.irs.gov/businesses/small/article/0,,id=104598,00.html> for Necessary Expense explanation.

All of the above data with the exception of that available from the Bureau of Labor Statistics can be obtained from the United States Trustee's Internet site at www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm. The Local Housing Standards from this site are broken down into mortgage and nonmortgage components.

Administrative Burdens Imposed on Court

The primary burden imposed on the clerk relates to the notices required by sections 342(d) and 704(b)(1). These are discussed in connection with sections 342(d) and 704(b)(1).

SECTION 722 Redemption

Summary of Amendment

Section 722 is amended to provide that in order to redeem tangible personal property that is exempt or that has been abandoned to the debtor and is intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, the debtor must pay the holder of the lien “in full at the time of redemption.” This is in accord with existing case law. See, e.g., *In re Avila*, 83 B.R. 6 (B.A.P. 9th Cir. 1987).

The price paid to redeem property will be based on new section 506(a)(2). Section 506(a)(2) applies in chapter 7 and 13 cases filed by individuals. It provides that the value of personal property securing an allowed claim is its replacement value as of the petition date without deduction for costs of sale or marketing. That is, what would it cost the debtor to buy a replacement on the day the petition is filed? If the personal property was acquired for personal, household, or family purposes, the replacement value is the price a retail merchant would charge for property of the same kind, considering its age and condition, as of the time the value is determined.

Thus, for personal property the debtor wishes to redeem, the date of valuation is the date of redemption and value is determined by the price a retail merchant would charge for comparable replacement property without any deduction for costs of sale or marketing.

Litigation Points

1. Section 521(a)(2)(B) requires the debtor to perform a stated intention to redeem property within 30 days of the first meeting. However, the court may grant additional time. Does this discretion permit a debtor to evade the requirement that the redemption price be paid in full at the time of the redemption? Does it permit the grant of additional time to pay the redemption price?

Cross References

Bankruptcy Code

11 U.S.C. § 506(a)(2)	[valuation of personal property held for personal, family or household purposes]
11 U.S.C. § 521(a)(2)	[performance of statement of intention]

SECTION 724

Treatment of Certain Liens

Summary of Amendment

Section 724(b) is amended to prevent a chapter 7 trustee from subordinating tax claims secured by an unavoidable, perfected tax lien securing an ad valorem tax on real or personal property. There is one exception to this rule. Section 727(f) permits the subordination of such tax liens in order to pay wage claims and contributions to an employee benefit plan entitled to priority under sections 507(a)(4) & (a)(5).

As to unavoidable, perfected tax liens securing taxes other than ad valorem taxes, such tax liens may be subordinated to priority claims excluding administrative expense claims arising while the case proceeded under chapter 11.

However, before any tax lien may be subordinated to a priority claim, including claims falling under sections 507(a)(4) & (a)(5), the trustee must exhaust all unencumbered assets of the estate and recover any surcharges permitted by section 506(c) [reasonable and necessary costs incurred by the estate preserving or disposing of a secured creditor's collateral]. See 11 U.S.C. § 724(e).

SECTION 726
Distribution of Property of the Estate

Summary of Amendment

Section 726(a)(1) is amended to permit payment of an untimely priority claim provided that a proof of claim is filed before the earlier of 10 days after the mailing of the summary of the trustee's final report or the date the trustee commences the final distribution to creditors.

SECTION 727 Discharge

Effective Date

Section 727(a)(12) is effective in all cases filed on or after the date of enactment, April 20, 2005. Section 727(d)(4) is effective 18 months following the date of enactment, or October 17, 2006. The remaining amendments to section 727, found in subparagraphs (a)(8) and (a)(11), are effective in all cases filed on or after October 17, 2005.

Summary of Amendment

Denial/Delay of Discharge. There are three new grounds for delaying and perhaps denying an individual debtor a chapter 7 discharge. Also, the period between chapter 7 discharges has been extended from 6 to 8 years.

Uncodified Ground for Denying/Delaying Discharge. The first new basis for denial of a chapter 7 discharge is not an amendment to section 727. It is uncodified and is found in section 1228(a) of the 2005 Act. It provides that in chapter 7 cases, “[t]he court shall not grant a discharge in the case of an individual who is a debtor in a case under chapter 7 of title 11, United States Code, unless requested tax documents have been provided to the court.”

The phrase, “requested tax documents,” is an apparent reference to the tax returns or transcripts that amended section 521 requires the debtor either file with the court and/or serve on various parties in interest. Section 521 requires the following with reference to tax returns:

1. 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). Section 521(e)(2) does not require, however, that this return be filed with the court. 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). If not provided to the trustee or to a requesting creditor, section 521(e)(2)(B) & (C) requires the court to dismiss the petition.

2. If requested by the court, the United States Trustee, or any party in interest in a chapter 7, 11, or 13 case filed by an individual debtor, all federal income tax returns for the 3 years prior to the filing date that had not been filed prior to the filing date of the petition, and any amendments to them, must be filed with the court and made available for inspection and copying by the United States Trustee, trustee, and any party in interest. See 11 U.S.C. § 521(f)(1)-(3) & (g)(2). Section 521, however, does not authorize dismissal when a debtor fails to file with the

court these returns. See 11 U.S.C. § 521(b), (c), (f), & (I).

3. If requested by the court, the 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 must be filed with the court and made available for inspection and copying by the United States Trustee, trustee, and any party in interest. If the debtor fails to file such a tax return with the taxing authority, or to obtain an extension of the due date for filing such a return, the taxing authority may “request” that the court enter an order converting or dismissing the case. See 11 U.S.C. § 521(j). If the debtor then fails to file the return with the taxing authority or to 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. Section 521, however, does not provide for dismissal of the petition if the debtor fails to file these returns with the court after having been requested to do so.

Section 1228(a) of the 2005 Act does not refer to any of these particular requirements of section 521 regarding tax returns and transcripts.

Because section 1228(a) refers to “tax documents provided to the court,” arguably the failure to provide the return required by section 521(e)(2) will not be a ground for denial of discharge. The return for most recent pre-petition tax year for which a return was required is not “provided to the court.” That is, it is not filed with the court. It is given by the debtor to the trustee and any creditor requesting a copy of it. However, the failure to provide this return to the trustee and/or any requesting creditor is a ground for dismissal of the petition under section 521(e)(2)(B) & (C).

As to the second and third group of returns, the debtor has no obligation to file them with the court absent a request by the court, the United States Trustee, or a party in interest. If requested, a chapter 7 debtor’s right to a discharge will be an issue. That is, because section 521 does not provide for dismissal of the petition if those returns are not filed, the issue of the debtor’s entitlement to discharge under section 1228(a) is likely to be presented to the court.

Interim Rule 4004 did not initially address the procedure to be used when challenging a discharge under this uncodified provision. Rule 4004(a), setting the deadline for filing objections to discharge, is limited in its application to objections under section 727(a). However, on October 4, 2005 the Advisory Committee on Bankruptcy Rules proposed a revision to Interim Rule 4004(c) to take care of this problem. Interim Rule 4004(c)(1)(K) has been added to require the entry of a chapter 7 discharge unless a party in interest has filed a motion to delay the discharge because the debtor has not filed “with the court” all tax documents required by section 521(f). As long as that motion “is pending” the discharge may not be entered. If the entry of a discharge is delayed and but the debtor does not file the required returns, presumably, at some point the discharge will be denied or the case will be closed without entry of a discharge. Neither the 2005 Act nor Interim Rule 4004(c)(1)(K) is clear as to the point at which delay ripens into denial or

closure. If the case is closed without a discharge, the possibility of reopening the case in order to file the required return and then to request a belated discharge is also not addressed.

Completion of Instructional Course. Section 727(a)(11) requires an individual chapter 7 debtor to complete a post-petition instructional course concerning personal financial management as a condition to receiving a discharge. If not completed, the court must deny the debtor's discharge. Interim Rule 1007(b)(7) requires the debtor to file a statement on Official Form 23, Debtor's Certification of Completion of Instructional Course Concerning Personal Financial Management, indicating that the instructional course has been completed. Interim Rule 1007(c) requires that this statement 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.

If the statement is not filed, the case will be closed without entry of a discharge. If such occurs, Interim Rule 4006 directs that the clerk serve a notice advising all creditors that the case was closed without entry of a discharge. Note that the possibility of reopening the case in order to enter a discharge because the debtor has belatedly completed the course and/or filed the statement, Official Form 23, is not addressed.

Felonies/Liabilities Described in § 522(q). Section 727(a)(12) is added to the list of grounds for denying, or at least delaying, a chapter 7 discharge. A discharge may not be entered in those cases where section 522(q)(1) is applicable to the debtor and there is a "pending proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B)."

If "as a result of electing . . . to exempt property under State or local law," a debtor could claim a homestead exemption greater than \$125,000, section 522(q)(1) may impose a \$125,000 cap on that homestead exemption. The cap applies if the debtor has been convicted of a felony demonstrating that the petition was an abuse of title 11, or if 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)(A) & (B).

Section 727(a)(12), unlike section 522(q), does not condition its application on the debtor's conviction of a felony for an offense of the type described in section 522(q)(1)(A), or the entry of an adverse judgment on a debt of the types described in section 522(q)(1)(B). Rather, it requires only that section 522(q) "may be applicable to the debtor" and that there is a "pending proceeding" in which the debtor "may be" found guilty of a felony or liable for a debt for an offense or wrong of the type described in section 522(q).

This phrasing means that in those cases where section 727(a)(12) is applicable, the debtor's discharge must be delayed until the pending criminal and/or civil proceeding has been concluded. If the debtor is found not guilty or not liable, a discharge then may be entered. A discharge will be denied only if the criminal or civil proceeding results in conviction of, or a

judgment against, the debtor.

Section 522(p) also imposes a \$125,000 cap on homestead exemptions in circumstances other than those described in section 522(q). But, like section 522(q), section 522(p) is only applicable if the debtor, “as a result of electing . . . to exempt property under State or local law,” could claim a homestead exemption greater than \$125,000. In In re McNabb, 326 B.R. 785 (Bankr. D. Ariz. 2005), the bankruptcy court interpreted this language to mean that section 522(p) was applicable only in “non-opt out states.” That is, only in those states that had not precluded a bankruptcy debtor from electing between exemptions available under state law and those provided in section 522(d). See 11 U.S.C. § 522(b)(2). The court in McNabb noted that there were only two states, Texas and Minnesota, that had both not opted out of the federal exemption scheme, section 522(d), and had state homestead exemptions greater than \$125,000. But see In re Kaplan, 331 B.R. 493 (Bankr. S.D. Fla. 2005).

If McNabb is correct and if the same language in section 522(q) is given the same meaning as in section 522(p), the applicability of section 522(q), as well as section 727(a)(12), will be significantly limited. It may be that Congress did not intend this result and instead intended to bar discharges to those chapter 7 debtors who might be liable for felonies of the type described in section 522(q)(1)(A) or liable for debts of the type described in section 522(q)(1)(B). However, by also requiring that “section 522(q)(1) may be applicable to the debtor,” Congress added yet another element to section 727(a)(12). It appears that in order to trigger section 727(a)(12), the debtor must be able to elect between the state and federal exemptions and claim a homestead exemption greater than \$125,000. If so, a discharge must be delayed if the debtor might be convicted of a felony, or held liable for a debt, of the types described in section 522(q).

Section 727(a)(12) does not contemplate that it will be applied in the context of an adversary proceeding. It requires that the court, “after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge,” determine if there is “reasonable cause to believe” that grounds exist under section 727(a)(12) to delay or deny a discharge. This procedure does not contemplate that a party in interest will seek a denial of discharge. The court may be expected to act *sua sponte*. Interim Rule 4004(c)(1)(I) confirms that a delay of a chapter 7 discharge may be sought by a motion rather than a complaint.

Interim Rule 4004(c)(1)(I), however, does not apply to cases filed by individuals under chapters 11, 12, and 13. For that reason, the Interim Rules were revised on October 4, 2005. Interim Rule 1007(b)(8) requires an individual debtor in a case under chapters 11, 12, or 13 claiming an exemption under section 522(b)(3)(A) [applicable state law or nonbankruptcy federal law] in an amount in excess of the amount set out in section 522(q)(1) [\$125,000, but subject to tri-annual adjustment under section 104] in property of the kind described in section 522(p)(1) [homesteaded residences and burial plots], to file a statement. That statement must disclose whether there is a pending proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) [a felony demonstrating that the petition was an abuse of title 11] or found liable for a debt of the kind described in section 522(q)(1)(B) [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]. The statement must be filed not earlier than the date of the last payment under the plan or the date of the filing of a motion for entry of a discharge under sections 1141(d)(5)(B), 1228(b), or 1328(b). See Interim Rule 1007(c).

The court may not grant a discharge earlier than 30 days after the filing of the statement. See Interim Rule 4004(c)(3). The delay is so the clerk serve notice on parties in interest that the debtor has filed the statement and that they have 30 days to move to delay entry of the discharge under section 1141(d)(5)(B), 1228(b), or 1328(b). See Interim Rule 2002(f)(11).

Eight Year Rule. Section 727(a)(8) increases the time between discharges in chapter 7 cases from 6 years to 8 years. If the debtor was granted a prior discharge in a chapter 7 or 11 case commenced within 8 years before the filing of the current petition, the debtor is not entitled to a chapter 7 discharge.

Revocation of Discharge. Section 727(d)(4) is new. It provides for the revocation of a discharge in those cases where a debtor fails to make available all necessary papers, documents, records, or property requested for an audit authorized by section 603 of the 2005 Act, or where the debtor fails to explain “satisfactorily” any material misstatement found during such an audit. See 28 U.S.C. § 586(f) (permitting the United States Trustee to contract with auditors).

Section 727(e) has not been amended. It sets deadlines for seeking the revocation of a chapter 7 discharge. For instance, a request to revoke discharge under section 727(d)(1) [discharge procured through fraud] must be made within one year after the discharge was granted. See 11 U.S.C. § 727(e)(1). Requests made under sections 727(d)(2) [failure to disclose acquisition of property of the estate] and (d)(3) [failure to obey lawful court order] must be brought before the later of one year after the granting of the discharge and the date the case is closed. See 11 U.S.C. § 727(e)(2).

Because section 727(d)(4) is new, and because section 727(e) has not been amended, there is no deadline set in section 727(e) for seeking revocation of discharge under section 727(d)(4). Consequently, it appears that such a request may be brought at any time. The absence of a deadline in section 727(e) is compounded by the fact that neither 28 U.S.C. § 586(f) nor section 603 of the 2005 Act require that an audit of a particular case take place within any particular time frame. The Act requires only that one in every 250 cases be audited. It does not specify when the audit must take place or be completed.

Litigation Points

1. If a discharge is delayed under section 727(a)(12), and then debtor is convicted of a felony, or is found liable for a debt, of the types described in section 522(q), is a second order denying the discharge entered in connection with the earlier motion to delay discharge, or is a complaint to deny discharge necessary?

2. What is a “satisfactory” explanation for a material misstatement or omission in an audit for purposes of section 727(d)(4)?

Cross References

Bankruptcy Code

11 U.S.C. § 109(h)	[education eligibility requirement imposed on individual debtors]
11 U.S.C. § 111	[Nonprofit budget and credit counseling agencies and providers of financial management instructional courses]
11 U.S.C. § 521	[documents, including tax returns, the debtor must file with the court or provide to parties in interest]
11 U.S.C. § 522(p)	[\$125,000 cap on homestead exemptions]
11 U.S.C. § 522(q)	[\$125,000 cap on homestead exemptions]
11 U.S.C. § 524(b)	[discharge of community property]
11 U.S.C. § 1141(d)(5)(B)	[delay of individual chapter 11 discharge]
11 U.S.C. § 1228(b)	[delay of individual chapter 12 discharge]
11 U.S.C. § 1328(b)	[delay of individual chapter 13 discharge]

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.]
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Bankruptcy Rules

Rule 4004(a)	[deadline for and necessity of complaint to object to discharge under § 727(a)]
Rule 4004(c)(1)(B)	[no discharge may be entered if there is a pending dischargeability complaint]

Interim Rules

Interim Rule 1007(b)(7)	[statement of completion of post-petition instructional financial management course]
Interim Rule 1007(b)(8)	[statement regarding homesteads in excess of \$125,000 and pendency of certain criminal and civil suits]
Interim Rule 1007(c)	[deadline for filing statement of completion of post-petition instructional financial management course and the statement required by Interim Rule 1007(b)(8)]
Interim Rule 2002(f)(11)	[30-day notice of right to seek delay of discharge pursuant to §§ 1141(d)(5)(B), 1228(b), 1328(b)]
Interim Rule 4004(c)(1)(H)	[entry of discharge barred until statement required by Interim Rule 1007(b)(7) filed]
Interim Rule 4004(c)(1)(I)	[permitting motion to delay discharge under § 727(a)(12)]
Interim Rule 4004(c)(1)(J)	[delay of discharge when the presumption of undue hardship arises under § 524(m)(1) in connection with a reaffirmation agreement]
Interim Rule 4004(c)(3)	[delay of discharge when statement required by Interim Rule 1007(b)(8) must be filed]
Interim Rule 4004(c)(1)(K)	[permitting motion to delay discharge is tax returns required by section 521(f) are not filed]
Interim Rule 4006	[notice that case closed without entry of a discharge]

Official Forms

Form 23	[Debtor's Certification of Completion of Instructional Course Concerning Personal Financial Management]
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Drafting Issues and Problems

There is a conflict between section 727(a)(8) and section 524(b)(1)(A). 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). The policy of section 524(b) is to prevent spouses from filing separate, alternating petitions and effectively obtaining chapter 7 discharges more frequently than permitted by section 727(a)(8). Section 524(b)(1), however, continues to refer to 6 years rather than the new 8 year waiting period.

See the discussion above in the Summary of Amendment regarding the applicability of

section 727(a)(12) beyond states that permit a chapter 7 debtor to elect between state and federal exemptions.

Administrative Burdens Imposed on Court

If the court is required to act without a complaint filed by a party in interest under section 1228(a) of the 2005 Act and sections 727(a)(11) and (a)(12), a substantial burden could be imposed on it. That burden could significantly delay entry of discharges.

SECTION 728 (and sections 346, 1146, 1231) Special Tax Provisions

Effective Date

The amendments to section 1231 are effective in all cases filed on or after April 20, 2005. The other amendments to sections 346, 728, 1146, and 1231 are effective in cases filed on or after October 17, 2005.

Summary of Amendment

In 1978, prior to the enactment of the Bankruptcy Code, early drafts of sections 346, 728, and 1146 applied to federal as well as state and local taxes. However, when the Bankruptcy Code ultimately was enacted, these sections dealt only with state and local taxes. A possible reason for the state and local limitation was a jurisdictional conflict over the federal tax provisions between the House Judiciary Committee (which was responsible for the bankruptcy legislation in general) and the House Ways and Means Committee (which had jurisdiction over federal tax matters). Eliminating federal taxes from coverage under section 346, 728, and 1146 essentially meant that the House Ways and Means Committee did not need to weigh in on the tax provisions, easing the way for the enactment of the Bankruptcy Code.

The House Ways and Means Committee eventually did take up these tax issues. In 1980, Congress passed and the President signed the Bankruptcy Tax Act of 1980, enacting 26 U.S.C. §§ 108, 1398, and 1399.

Section 346 as it existed prior to the 2005 Act has been repealed and replaced by an entirely new section 346. Section 346 now consolidates the former special tax provisions in chapter 7 (section 728), chapter 11 (section 1146), and chapter 12 (section 1231). Section 346 also brings state and local bankruptcy tax provisions into line with the bankruptcy tax provisions set out in the Internal Revenue Code, 26 U.S.C. §§ 108, 1398, and 1399. These tax provisions provide certain rules in the following areas:

- (1) Whether the estate of the debtor is treated as a separate taxable entity;
- (2) Who has the responsibility for filing returns for or on behalf of the debtor;
- (3) How should the bankruptcy estate be taxed;
- (4) What tax attributes does the estate succeed to and what tax attributes does the debtor acquire or re-acquire after the bankruptcy is over;
- (5) Under what circumstances is relief of indebtedness treated as income for tax purposes.

Section 728 was repealed in its entirety by the amendment. Now, under section 346, the taxable year of a chapter 7 debtor is not automatically terminated upon the filing of a petition. The taxable year terminates for state and local taxes in the same fashion as provided under the Internal Revenue Code (26 U.S.C. § 1398). In addition, there are conforming provisions of section 346 which deal with the requirements for filing various types of income and informational returns.

Sections 1146 and 1231 were amended to eliminate the duplicate provisions dealing with the termination of taxable years and the requirements that returns be filed. The remainder of section 1146 was unchanged by the 2005 Act. However, section 1231 was further amended to allow for debtor, after obtaining bankruptcy court permission, to seek a determination from any governmental entity concerning the tax treatment of a proposed chapter 12 plan. The bankruptcy court is given the authority to rule upon the tax treatment after the governmental authority has had the opportunity to make a determination. The similar provision contained in section 1146 only allowed for the request to be made to the state or local taxing authority.

These amendments makes the tax rules applicable to bankruptcy uniform around the country. Now, a tax advisor does not need to be concerned about two potentially different sets of rules when advising a debtor.

Cross References

Bankruptcy Code

11 U.S.C. § 346	[special tax provisions relating to the treatment of state and local taxes]
11 U.S.C. § 728	[repealed special tax provision applicable in chapter 7 cases]
11 U.S.C. § 1146	[special tax provisions applicable in chapter 11 cases]
11 U.S.C. § 1231	[special tax provisions applicable in chapter 11 cases]

Applicable Nonbankruptcy Statutes

26 U.S.C. § 108	[see Summary of Amendment above for brief discussion of this section]
26 U.S.C. § 1398	[see Summary of Amendment above for brief discussion of this section]
26 U.S.C. § 1399	[see Summary of Amendment above for brief discussion of this section]

**SUBCHAPTER III (Sections 741 - 752), SUBCHAPTER IV (Sections 761 - 767) &
SUBCHAPTER V (Sections 781 - 784)**

These subchapters of chapter 7 deal with stockbroker liquidations, commodity broker liquidations, and clearing bank liquidations. No discussion of the amendments to the sections in these subchapters is included in this summary.