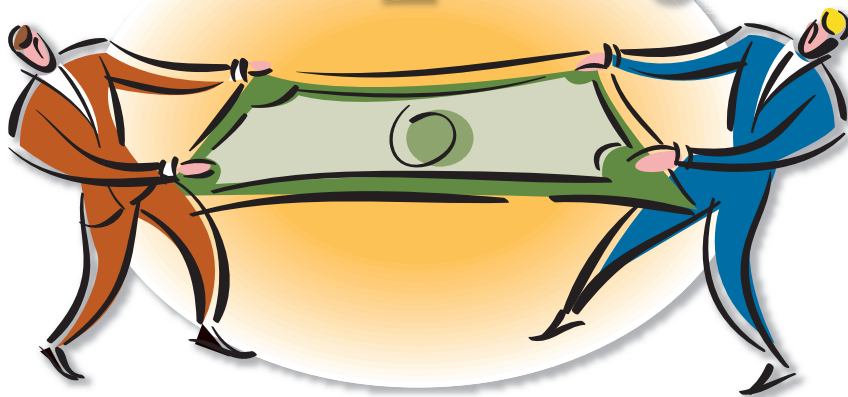


What the New Changes in Bankruptcy Law



Mean for Consumers

By Jennifer Mitchell*

On April 20, 2005, President Bush signed into effect the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The Act, which has been described as the “most substantial revision of bankruptcy law since the 1978 Bankruptcy Code,” will generally affect cases filed on or after October 17, 2005.¹ This article will explore how this Act substantially changes certain sections of the bankruptcy code affecting consumers. Initially, restrictions on filing for Chapter 7 bankruptcy will be examined. The second section of this article reviews the impact of the act on family support obligations. Finally, it reviews changes to discharge rules which potentially impact all types of bankruptcies. The goal of this article is to alert the reader to some of the areas of major impact, and is by no means a complete list and analysis of the bill’s consumer provisions.

Consumer Issues

Means Test for Chapter 7 Eligibility

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“2005 Act”) provides for a “means test” to determine if a debtor qualifies to file for Chapter 7. This new test is incorporated into section 707 of the Act.

Prior to the amendments, section 707(b) provided that After notice and a hearing, the court, on its own motion or on a motion by the United States Trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter.²

Under this version of section 707(b), only the court or the US Trustee could bring a motion to dismiss due to abuse. In response

to such motion, the court’s only option was to dismiss the case. The court did not have the discretion to convert the case to a chapter 11 or 13 case.

The 2005 Act, however, allows “the Trustee or any creditor to bring a motion to dismiss under §707(b) if the debtors income is greater than the state median income.”³ The text of new section 707(b) is (in part) as follows:

(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor’s consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter...

(2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor’s current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of –

- (I) 25 percent of the debtor’s nonpriority unsecured claims in the case, or \$6,000, whichever is greater; or
- (II) \$10,000.⁴

Presumption of Abuse

The means test creates a presumption of abuse if the debtor fails to meet the test. Essentially, “[a]buse is presumed if the amount of debtor’s current monthly income less secured [debts] divided by 60, less priority debts divided by 60, less the allowed expenses permitted by the IRS, less certain other allowed expenses, is greater than \$100 per month.”⁵ This presumption “may be rebutted only by establishing exceptional circumstances such as serious medical [conditions] or call to active duty in

[the] armed forces.”⁶ Further, any additional expenses “must be itemized, documented, and necessary and reasonable.”⁷

The 2005 Act sets out definitions and methods of calculating each variable of the means test formula. Current monthly income is defined in the Act as:

...the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor’s spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on—

- (i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii); or
- (ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii)...⁸

Monthly income also includes “amounts regularly paid by others for household expenses [but] excludes social security payments and payments received by victims of war crimes, crimes against humanity, or terrorism.”⁹ Allowable expenses under §707(b)(2)(A)(ii)-(iv) are determined “under the National and Local Standards and actual Other Necessary Expenses as provided in the Collection Financial Standards issued by the Internal Revenue Service without regard for debt payments.”¹⁰

Additional allowable expenses include:

- Necessary health insurance, disability insurance, and health savings plans;
- [Necessary expenses to m]aintain safety under the Family Violence Prevention and Services Act;
- Continuation of expenses paid for the care of an elderly, chronically ill, or disabled member of the household;
- If eligible for chapter 13, the actual administrative expenses not to exceed 10% of projected plan payments;
- Up to \$1,500/year for expenses of dependent minor child to attend a private or public elementary or secondary school (documented and explained);
- Actual expenses for utilities in excess of allowance specified in Collection Financial Standards;
- An additional 5% of the National Standards for food and clothing if reasonable and necessary.¹¹

Standing to file a Motion to Dismiss

Previously, only the court or the U.S. Trustee had standing to file a motion to dismiss based on abuse. Under the 2005 Act, if the current monthly income of the debtor multiplied by 12 exceeds the state median family income of an equal or smaller size family, a Motion to Dismiss may be brought by any party in interest, the U.S. Trustee, or on the court’s own motion.¹²

However, if the current monthly income of the debtor (and spouse in a joint case) multiplied by twelve, is equal to or less than the state median family income of an

equal or smaller size family, only the court or a U.S. Trustee may bring the motion.¹³

The 2005 Act provides:

The term “median family income” means for any year--

- (A) the median family income both calculated and reported by the Bureau of the Census in the then most recent year; and
- (B) if not so calculated and reported in the then current year, adjusted annually after such most recent year until the next year in which median family income is both calculated and reported by the Bureau of the Census, to reflect the percentage change in the Consumer Price Index for All Urban Consumers during the period of years occurring after such most recent year and before such current year.¹⁴

State Exemptions and the Homestead Exemption

The state or local law governing the debtors’ property exemptions is now specified as “the law of the place where the debtor’s domicile was located for 730 days before filing, and if the debtor did not maintain a domicile in a single state for that period, the governing exemption law is that of the place of the debtor’s domicile for the majority of the 180-day period preceding the 730 days before filing (that is, between 2 and 2 ½ years before the filing).”¹⁵ If this new domiciliary requirement would render the debtor ineligible for any exemption, “then the debtor is allowed to choose the federal exemptions.”¹⁶

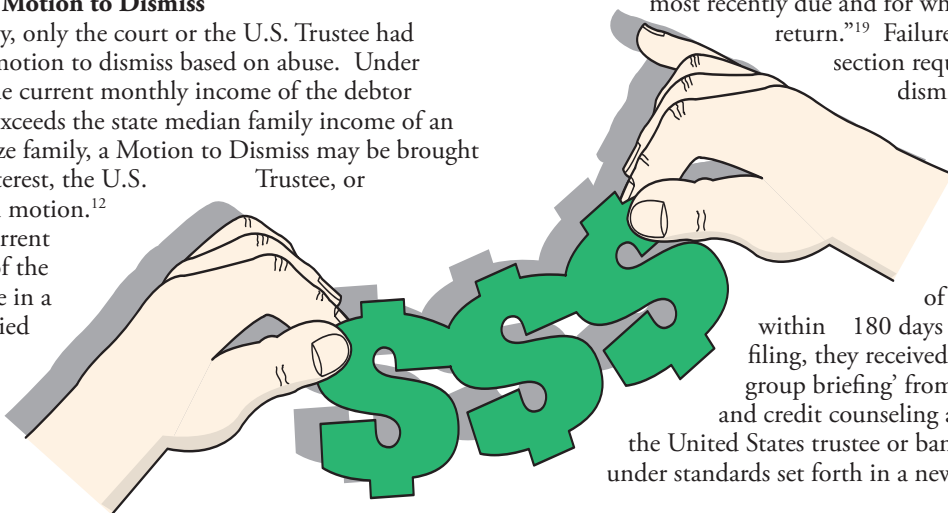
A debtor may not exempt any homestead value in excess of \$125,000 – without regard to the debtor’s intent – that is added to a homestead during the 1215 days (about 3 years, 4 months) preceding the bankruptcy filing “unless it was transferred from another homestead in the same state or the homestead is the principal residence of a family farmer.”¹⁷ Moreover, the value of a debtor’s homestead, for purposes of a state homestead exemption, is reduced “to the extent of any addition to the value of the homestead on account of a disposition of nonexempt property made by the debtor with intent to hinder, delay, or defraud creditors during the 10 years prior to the bankruptcy filing.”¹⁸

Filing of Tax Returns Mandatory

Section 521(e)(2)(A) now “requires that each debtor, at least seven days prior to the 341 [(creditors)] meeting, provide both to the trustee and to any creditor making a timely request a copy of the federal income tax return or transcript of the return (at the debtor’s option) for the period for which the return was most recently due and for which the debtor filed a return.”¹⁹ Failure to comply with this section requires that the case be dismissed.²⁰

Mandatory Credit Counseling

Individuals are now ineligible for relief under any chapter of the Code “unless, within 180 days of their bankruptcy filing, they received ‘an individual or group briefing’ from a nonprofit budget and credit counseling agency approved by the United States trustee or bankruptcy administrator under standards set forth in a new § 111 and published



by the clerk of [the] court.”²¹ “The required briefing may take place by telephone or on the Internet and “must ‘outline’ the opportunities for credit counseling and ‘assist...in performing a related budget analysis.”²² Then, “[t]he debtor is required to file a certificate from the credit counseling agency describing the services provided, and file any debt repayment plan developed with the agency.”²³

Mandatory Debtor Education

In addition to mandatory pre-bankruptcy credit counseling, the 2005 Act provides for pre-discharge debtor education. Under the Act, the Executive Director of the Office for United States Trustees is now required “to develop a financial management training curriculum and materials to educate individual debtors ‘on how to better manage their finances.’”²⁴ This program will be tested in 6 judicial districts over an 18 month period, and requires:

While the U.S. Trustees’ test program is being evaluated, debtors in both Chapters 7 and 13 will be required to complete “an instructional course concerning personal financial management” in order to assure their discharge, as long as the United States trustee or bankruptcy administrator determines that there are adequate approved educational programs available and the debtor is not disabled or incapacitated (as defined in § 109(h)), or on active military duty in a combat zone.²⁵

Unless one of these exceptions applies, Failure to complete the instructional course is now a ground for a denial of discharge.²⁶

Duration of Chapter 13 Plans

For debtors whose income is equal to or greater than the applicable state median family income, “the ‘best efforts’ test of § 1325(b) is amended by the addition of a new paragraph (4) requiring that, in the absence of earlier full payment of all claims, the plan must have a five-year term.”²⁷

Dischargeability of Student Loans

In the absence of undue hardship, all student loans are now nondischargeable, regardless of the nature of the lender, thus including loans from non-governmental and profit-making organizations.²⁸ Previously, only government-backed or nonprofit-funded student loans were nondischargeable.²⁹

Family Law Issues

Domestic Support Obligations

Under the new provisions of the Act, support obligations have first priority, but the administrative expenses of a trustee “are paid ahead of the support costs to the extent that the trustee is administering assets that can be used to pay support costs.”³⁰ Within this new first priority of the debtor’s domestic support obligations, support “owed to or recoverable by a spouse[,] former spouse[,] or child is given priority over support obligations that have been assigned or owed directly to a governmental unit.”³¹ Furthermore, as a result of the removal of affirmative defenses previously included, “all property settlements arising from divorce or separation proceedings that are not domestic support obligations are now nondischargeable under (a)(15).”³²

Nonsubordination of Property Tax Liens to Family Support Claims

The Act limits the authorization of a Chapter 7 trustee “to pay priority claims from funds that would otherwise be used to satisfy a property tax lien (and subordinate the tax lien to other liens on the affected property).”³³ Therefore, in contrast

to the prior law, if a debtor owes “both ad valorem property taxes secured by a lien on the debtor’s property and support obligations, the proceeds of any sale of the property will now be used to pay the taxes before the support obligations.”³⁴

Payments Required for Confirmation and Discharge Under Chapter 13

Chapter 13 now provides that “a plan will not be confirmed unless the debtor is current in payments of any postpetition domestic support obligations.”³⁵ In addition, a discharge under Chapter 13 “will not be granted until a debtor who owes such obligations certifies that they are current.”³⁶ Further, failure to make postpetition support payments is now a ground for dismissal or conversion to Chapter 7.³⁷

Exceptions to Automatic Stay

Several new exceptions to the automatic stay have been added “for purposes of enforcing a debtor’s obligation to make support payments.”³⁸ Exceptions have been made for income withholding for support obligations, suspension of professional, recreational and driver’s licenses on account of nonpayment of support, and the interception of tax refunds for payment of support obligations.³⁹ Each of these exceptions is intended to prevent other use of the funds under the Chapter 13 plan.⁴⁰

Discharge Issues

Serial Filings

The 2005 Act establishes new rules regarding the amount of time between bankruptcy discharges. Under the Act, a discharge will not be granted under Chapter 13 if the debtor “obtained a discharge in Chapter 7, 11 or 12 within the 4 years prior to the date of filing of the pending case, or in a Chapter 13 case filed within 2 years of the pending case.”⁴¹ This provision, however, does not “prevent the debtor from filing a Chapter 13 case, and receiving the benefits of the stay, including the ability to cure arrearages on secured claims over a period of time.”⁴²

The Act also establishes new rules with respect to Chapter 7. Chapter 7 is amended to subject a Chapter 7 debtor to denial of discharge “if the debtor received a Chapter 7 or 11 discharge in a case filed within 8 years of the filing of the pending case.”⁴³ Previously, the minimum amount of time between discharge and a new petition had been six years.⁴⁴

Conclusion

As demonstrated by the significant changes discussed above, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 will have a substantial impact on consumers, especially in the areas of choice of the type of bankruptcy, family support obligations, and bankruptcy discharge. Because these changes have only recently become effective and are yet to be tested in the courts, it remains to be seen what the actual ramifications of the Act will be to our bankruptcy system. It is clear, however, that the overwhelming majority of these changes place additional hurdles in the path of debtors faced with the necessity of filing for bankruptcy.

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1. Eugene R. Wedoff, Major Consumer Bankruptcy Effects of the 2005 Reform Legislation 1, available at <http://www.abiworld.org/pdfs/s256/mainpoints11.pdf>, last visited December 10, 2005.
2. 11 U.S.C. § 707(b) (1998) (emphasis added).

3. Samuel Gerdano, 25 Changes to Personal Bankruptcy Law §1, available at <http://abiworld.net/bankbill/changes.html>, last visited December 10, 2005 (emphasis added).
4. 11 U.S.C. § 707(b) (2005) (emphasis added).
5. Gerdano at §1.
6. Thomas J. Yerbich, Synopsis of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 2, available at <http://www.abiworld.org/pdfs.s256/yerbich.pdf>, last visited December 10, 2005; 11 U.S.C. §707(b)(3) (2005).
7. *Id.*
8. 11 U.S.C. §101(10A) (2005).
9. Yerbich at 1; 11 U.S.C. §707(b)(2)(A)(ii)-(iv) (2005).
10. Yerbich; 11 U.S.C. §707(b)(2)(A)(ii)-(iv) (2005).
11. *Id.*
12. Yerbich at 3.
13. *Id.*
14. 11 U.S.C. §101(39A) (2005).
15. Wedoff at 10; 11 U.S.C. §522(b)(3) (2005).
16. Wedoff at 10; 11 U.S.C. §522(b)(3) (2005).
17. Wedoff at 11; 11 U.S.C. §522(p) (2005).
18. Wedoff at 11; 11 U.S.C. §522(o) (2005).
19. Wedoff at 3; 11 U.S.C. §521(e)(2)(A) (2005).
20. *Id.*
21. Wedoff at 6; 11 U.S.C. §109(h) (2005).
22. *Id.*
23. Wedoff at 30-31; 11 U.S.C. §1325(b) (2005).
24. Wedoff at 6.
25. Wedoff at 6-7.
26. Wedoff at 7; 11 U.S.C. § 727(a)(11) (2005); 11 U.S.C. §1328(g).
27. Wedoff at 30-31; 11 U.S.C. §1325(b) (2005).
28. Wedoff at 10; 11 U.S.C. §523(a)(8) (2005).
29. 11 U.S.C. §523(a)(8) (2004).
30. Gerdano at §17; 11 U.S.C. §507(a)(1) (2005).
31. Wedoff at 23; 11 U.S.C. §507(a)(1)(B) (2005).
32. Wedoff at 23; 11 U.S.C. §523(a)(15) (2005). Domestic support obligations are nondischargeable per §523(a)(5).
33. Wedoff at 28; 11 U.S.C. 724(b) (2005).
34. Wedoff at 28.
35. Wedoff at 33; 11 U.S.C. 1325(a) (2005).
36. Wedoff at 33; 11 U.S.C. 1328(a) (2005).
37. Wedoff at 33; 11 U.S.C. 1307(c)(11) (2005).
38. Wedoff at 33; 11 U.S.C. 362(b)(2) (2005).
39. Wedoff at 33-34; 11 U.S.C. 362(b)(2)(2005).
40. Wedoff at 33-34.
41. Gerdano at §6; 11 U.S.C. 1328(f) (2005).
42. Gerdano. at §6.
43. Wedoff; 11 U.S.C. 727(a)(8) (2005).
44. 11 U.S.C. 727(a)(8) (1998).