

# **Rattet Pasternak & Gordon Oliver, LLP**

## **2005 Bankruptcy Reform Act Bulletin**

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act"). The Act significantly impacts consumer bankruptcy cases. The majority of changes under the Act relating to consumer filings become effective on October 17, 2005. Individuals who may have been eligible under Chapter 7 of the old Bankruptcy Code may no longer be eligible to file for Chapter 7 relief. The following is a synopsis of some of the highlights of the changes affecting consumer bankruptcy filings.

### **Being a Debtor after October 17<sup>th</sup>: The Effect of the 2005 Bankruptcy Reform Act on Consumer Debtors**

The stated purpose of the Act is to resolve perceived abuses under the current Bankruptcy Code. The Act makes it more difficult for Debtors to obtain relief under Chapter 7 of the Bankruptcy Code. The most notorious of the changes is the addition of the "Means Test", which compares, among other things, the Debtor's current monthly income against the state's median income, and determines whether the Debtor has the capacity to repay its debts under a Chapter 13 Bankruptcy plan. In addition, the Act tries to resolve perceived abuses under the current code by becoming more stringent of the Debtor and expanding the Debtor's and the Debtor's Attorney's duties in filing a Chapter 7 Bankruptcy.

#### **Mandatory Credit Counseling Under §109(h)**

The Act adds §109(h) to the Bankruptcy Code, which requires an individual Debtor to first seek credit counseling prior to filing a bankruptcy petition within 180 days before filing for bankruptcy. Individual Debtors must receive, as a condition to filing for bankruptcy, a counseling session from a nonprofit budget and credit counseling agency approved by the Office of the U.S. Trustee. The counseling may take place either by telephone or Internet and is to analyze and assist the Debtor with his or her budget and then guide the Debtor to alternatives to filing for bankruptcy. Included in the Debtor's filings, the Debtor must now file a certificate from the credit counseling agency describing the services provided and any debt repayment plan developed by the agency. Exceptions are made only where: (1) there are no approved adequate counseling services in the Debtor's area, (2) exigent circumstances require immediate bankruptcy filing and the Debtor sought counseling within five (5) days prior to the filing, without being able to obtain it; or (3) the Debtor is either incapacitated, disabled, or on active military duty in a combat zone.

#### **The Means Test and Presumptions of Abuse Under §707(b)**

Upon the filing for a Chapter 7, the Debtor must pass the "Means Test" to rebut a presumption of abuse. Under the means test, codified in §707(b), a Debtor whose income was below the median state income would remain eligible for Chapter 7, while the Debtors with incomes above the state median income would be presumed to be an abuse and the Debtor might have to resort to Chapter 13 for bankruptcy relief. The Means Test begins by analyzing the Debtor's current monthly income against the state's median income, which can be found at the website for the IRS: <http://www.census.gov/hhes/www/income/statemedfaminc.html>. The Debtor's current monthly income is the Debtor's average monthly incomes from all sources, including the Debtor's salary, the income of a non-filing spouse, and third-party contributions to household expenses, with certain limited exceptions, for a defined six (6) month period before filing. If the Debtor's current monthly income is at or below the state's median income, then no party has standing to challenge the Debtor's Chapter 7 filing under the means test. Even though a bankruptcy judge or trustee (not creditors) cannot challenge the filing under the means test, they still may challenge the filings on grounds of abuse. If the Debtor's current monthly income is at or above the state's median, then all parties, including creditors, have standing to challenge the means tests and abuse of the Code. The Trustee shall have 10 days from §341(a) meeting of creditors to file a statement pursuant to §704(b) on grounds of presumed abuse, and, under §707(b)(2) within 30 days of the §704(b) Statement must either (1) file a motion to dismiss, or (2) file a statement why dismissal is not appropriate.

After the Debtor's current monthly income is compared to the state median, then, the Debtor's disposable income must be analyzed. The Debtor's current monthly income less his or her expenses (see below) is the disposable income of the Debtor. If the Debtor's disposable income is less than \$100 per month, the Debtor is eligible for a Chapter 7 bankruptcy and no presumption of abuse arises. When the Debtor's disposable income exceeds \$100 per month, before an abuse is presumed, a calculation must first be performed to determine whether the Debtor has sufficient funds to pay its creditors. If a Debtor's disposable income is between \$100-\$166.66, then the disposable income is multiplied by 60. If that calculation is between \$6,000 and \$10,000, a Debtor may file for Chapter 7 bankruptcy if the debtor has sufficient income to pay 25% of nonpriority unsecured claims. Otherwise, the Debtor is presumed to be in violation of §707(b) for abuse of the Bankruptcy Code, and conversion to a Chapter 13 or dismissal is required. However, if the Debtor's disposable income is equal to or exceeds \$166.67 per month, the presumption of abuse always arises and the Debtor is no longer eligible for Chapter 7 relief and must either convert the case to Chapter 13 or have their Chapter 7 case dismissed. The presumption of abuse may only be rebutted by a showing of special circumstances requiring additional monthly expense, to which there is no reasonable alternative.

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### **Regulation of Debtor's Expenses Under § 707(b)(2)(A)**

Under §707(b)(2)(A), the Debtor's allowed expenses, which are deducted from the Debtor's current monthly income in determining whether abuse exists, are now regulated under Internal Revenue Service standards, which were previously only applicable to Debtors seeking an offer in compromise from taxing authorities. Although it is anticipated that the allowances for expenses will be posted on the website for the Office of the U.S. Trustee, the allowances are currently accessible at: <http://www.irs.gov/businesses/small/article/0,,id=104627,00.html>. Prior to the Act, each individual Debtor's schedule of expenses was reviewed on an ad hoc basis, with an attorney from the U.S. Trustee's Office using their own judgment and making a determination as to whether the expenses were excessive. Now, uniform, nationwide standards establish allowances for food, clothing, personal care, and entertainment depending on the Debtor's family size. The expenses depend upon the monthly gross income of the individual. Local standards govern the reasonableness for transportation and housing; transportation is compared on a regional basis and housing on a county-by-county basis. Under the means test, if reasonable and necessary, Debtors are allowed an increase up to 5% on the food and clothing allowance.

### **Debtor's Duties Under §521**

The Act also significantly expands a Debtor's duties. In addition to current filing duties, under §521 the Debtor must now also provide or file the following:

1. Participate in mandatory credit counseling within 180 days preceding the filing and file with the Court the certificate of credit counseling and the repayment plan created by the approved agency. The credit counseling requirement may only be waived if the Debtor certifies exigent circumstances or was denied services, or for Debtors who are incapacitated, disabled or on active duty in a military zone;
2. Statement demonstrating the Debtor has received and read §342(b) notice;
3. Pay stubs or some other evidence of employer payments within 60 days preceding the filing;
4. Statement of any anticipated postpetition income or expenditure increases over the 12 month period following the date of filing;
5. Itemized monthly net income;
6. Debtor's most recent federal income tax return;
7. A continuing duty to provide tax returns during the case from commencement to termination;
8. In a Chapter 13, an annual statement of income and expenses required for each tax year;
9. Disclosure of qualified education savings accounts and tuition programs; and
10. A photo ID, if requested by the Office of the U.S. Trustee.

In addition to the above duties, §521(a)(2)(B) of the Act provides that Debtors must perform on its statement of intention to surrender, reaffirm or redeem debt secured by property of the estate within 30 days after the first date set for the meeting of creditors. In the case of a personal property secured by a purchase money security interest, under §521(a)(6), debtors must reaffirm, redeem, or surrender such property within 45 days after the first meeting of creditors. Failure to do so will result in an automatic lifting of the stay without creditor motion.

### **Changes to Chapter 13 Filings**

The Act also changes the mechanics of a Chapter 13 filing, though not as drastically as the reform to Chapter 7. Most importantly, if an objection to a Chapter 13 plan is filed by the Office of the U.S. Trustee or an unsecured creditor, then the plan must be amended to either pay unsecured claims in full or contribute all of the Debtor's disposable income to the plan for its minimum term under §1325. Also, whereas the Debtor's plan was generally 3 years under the Old Code, absent a motion to extend the plan to up to 5 years, now, under §1325(b)(4), the duration of a plan may only be less than 5 years if the plan provides for full payment of unsecured claims in a shorter period. The Act also added §521(f)(4) and §521(g)(1) to the Code, which requires the Debtor to file a personal financial statement showing the income and expenditures, how they are calculated, and to disclose any contributions from any third persons, in what amounts and how the contributions were applied to the expenses. New §1308(a) requires the Debtor to file with the appropriate taxing authority all tax returns for a four (4) year period prior to the §341(a) meeting of creditors. If §1308(a) is complied with, the §341(a) meeting may then be adjourned up to 120 days unless the taxing authority grants a further extension of time. New §1307(e) provides that the Debtor's case may be converted or dismissed on motion of the U.S. Trustee or a party in interest for failure to file tax returns required under §1308(a). The Debtor must also be current in all support obligation payments, if any, prior to confirmation.

### **Audits to Consumer Cases**

The Office of the U.S. Trustee will now randomly select 1 out of every 250 consumer cases where the income and expenses exceed the district's average to conduct an audit. The Trustee will audit the Debtor's petition, schedules, statement of financial affairs, list of creditors, and Chapter 13 plan (if applicable) for accuracy, veracity and completeness. The audit will be filed with the Court. Any mistakes or mis-statements are reported to the clerk of the Court, who must then notify all creditors. If the Debtor fails to explain or substantiate the mistake or mis-statement, the Trustee may then either (a) file a complaint seeking revocation of the discharge, or (2) refer the matter for criminal prosecution. Failure to cooperate with the audit may result in a revocation of the discharge.

*Rattet, Pasternak & Gordon Oliver, LLP ("RPGO") is an "AV rated" boutique bankruptcy firm located in Harrison, New York. RPGO focuses its practice on corporate reorganization proceedings, workouts, and the debtor-creditor relationship. This Bulletin was written by Arlene Gordon Oliver, Joseph Corneau and Julie Cvek. Ms. Gordon Oliver is partner with RPGO, concentrating in consumer and business bankruptcy and reorganization. Mr. Corneau, a third year associate with RPGO, concentrates on Chapter 11 Bankruptcy and debtor and creditor rights. Ms. Cvek, a first year associate with RPGO, concentrates on Chapter 7, 11 and 13 Bankruptcies, reorganization and workouts. **Disclaimer:** This Bulletin is not comprehensive nor is it intended to constitute legal advice. Use of this Bulletin is with the express understanding that it is provided as a courtesy only. Users are strongly urged to retain and/or consult bankruptcy counsel for a full explanation of the Bankruptcy Code and all amendments created by the Act before advising clients with respect to bankruptcy law. Users of this Bulletin agree to hold Rattet, Pasternak & Gordon Oliver, LLP harmless from any reliance on this Bulletin without prior consultation with counsel.*