BAPCPA Implementation Update: New Changes to the Official Means Test Forms and IRS Standards Effective January 1, 2008

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Introduction

The new year brought with it two significant changes to consumer bankruptcy practice. First, the Internal Revenue Service (IRS) revised its Collection Financial Standards that contain standardized allowable living expenses used to calculate disposable income in above-median income chapter 7 and chapter 13 cases. Second, the Judicial Conference of the United States published amended official bankruptcy forms (22A, 22B and 22C), which chapter 7 debtors use to determine whether a statutory presumption of abuse arises, and which chapter 13 debtors use to calculate the applicable plan commitment period and above-median income chapter 13 debtors use to calculate disposable income.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) altered the analysis for determining abuse in chapter 7 cases and for confirming chapter 13 repayment plans. The IRS expense standards, along with Official Form 22, are critical to this post-BAPCPA analysis and changes to these forms and expense standards therefore have a major impact on consumer practice. This article provides an overview of these changes, which became effective as of January 1, 2008.

I. A Little Background: The Means Test Forms and IRS Standards

In chapter 7 cases, the Bankruptcy Code now requires debtors who owe primarily consumer debt to perform a "means test" analysis. Under the means test, above-median income debtors calculate disposable income by reducing their average monthly income in the six months before the bankruptcy filing ("current monthly income") by specific standardized and actual living expenses. Allowable expenses include amounts specified under the National Standards and Local Standards issued by the IRS for the area in which the debtor resides. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I). The IRS Standards are described in more detail in Section II below. Above-median income debtors whose disposable income exceeds statutory thresholds (currently between $109.58 and $182.50, depending on the amount of unsecured debt) are subject to dismissal based on a presumption that granting them chapter 7 relief would be an abuse, unless they establish special circumstances exist.[1]

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[1] Even if a debtor's disposable income does not exceed the statutory threshold, their case may still be subject to dismissal based upon a totality of the circumstances or if the court

In chapter 13 cases, debtors propose debt repayment plans, which take effect upon court confirmation. If a chapter 13 trustee or holder of an allowed unsecured claim objects to plan confirmation, 11 U.S.C. § 1325(b)(1) conditions confirmation upon the debtors committing all of their projected disposable income to payments to unsecured creditors through the plan. The Bankruptcy Code defines "disposable income" as current monthly income less amounts reasonably necessary to be expended. 11 U.S.C. § 1325(b)(2). For above-median income debtors, the amounts reasonably necessary to be expended are determined in accordance with sections 707(b)(2)(A) and (B). *See* 11 U.S.C. § 1325(b)(3).

Means Test Forms

To calculate disposable income in chapter 7 and chapter 13 cases, debtors must complete the appropriate Official Form, prescribed by the United States Judicial Conference. Chapter 7 debtors complete Official Form 22A. *See* 11 U.S.C. §§ 521(a)(1)(B)(v) and 707(b)(2)(C); Fed. R. Bankr. P. 1007(b). Chapter 13 debtors complete Official Form 22C. Fed. R. Bankr. P. 1007(b)(6).

IRS Collection Financial Standards

In 1998, Congress directed the Secretary of the Treasury to prescribe guidelines for calculating repayment of delinquent taxes. *See* Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685, 764); 26 U.S.C. § 7122(d)(1). Congress also directed the Secretary to "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses." *Id.* In response to this directive, the IRS developed and published Collection Financial Standards, which encompass two broad categories of allowable living expense standards: National Standards for general living expenses, and Local Standards for housing, utilities and transportation expenses. As discussed above, Congress incorporated these Standards into BAPCPA to determine allowable living expenses of above-median income chapter 7 and chapter 13 debtors.

On October 1, 2007, the IRS issued revised Collection Financial Standards for purposes of federal tax administration (Revised Standards). The Revised Standards made substantial structural changes to the National and Local Standards.[2] For bankruptcy purposes, the revised standards apply to cases filed on or after January 1, 2008.

II. The New IRS Standards

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determines the debtor's petition was filed in bad faith under 11 U.S.C. §707(b)(3).

[2] Other amounts in the Standards are updated annually with the next update estimated for Spring 2008. The October 1, 2007 revisions, however, went beyond the updating of dollar amounts.

National Standards

Before the IRS published its Revised Standards, the National Standards included expenses for food, clothing, and housekeeping supplies, personal care products and services and miscellaneous items. The amount allowed under the National Standards varied, depending on the size and income of the debtor's family – as income and family size increased, so did the expense allowance. For example, under the old Standards, a single debtor with gross income of less than $833 per month received a $175 allowance for food, while a single debtor with gross income of $5,834 or more per month received $483. In addition, the IRS published separate National Standards expense tables for Alaska, Hawaii, and the Continental United States.

Two structural changes to the National Standards under the Revised Standards make them more uniform. First, the amount allowed under the National Standards is based solely on a debtor's family size, regardless of income level. Second, the IRS has eliminated the separate tables for Alaska and Hawaii, leaving a single table for the entire United States.

The IRS has also added a new expense category to the National Standards for out-of-pocket health care costs. This new National Standards category covers co-payments, prescription drugs, and medical supplies (*e.g.*, eyeglasses, contact lenses, etc . . .).[3] Under the new Standard, debtors are allowed to deduct a minimum monthly amount for each household member on a per person basis without documenting what they actually spend. The allowance is $54 per month for each household member under 65 years old, while the allowance for each household member 65 or older is $144 per month. Debtors who spend more than the Standard amount can still claim the excess as an "Other Necessary Expense,"[4] but must document the expense.

Local Standards

The IRS also publishes "Local Standards" with expenses for housing and utilities (Local Housing Standards), as well as for transportation expenses (Local Transportation Standards).[5] These expenses are based upon the debtor's household size and state and county of residence. For the transportation expenses, the Local Standards are also contingent upon the number of vehicles for which the debtor pays expenses.

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[3] General information about this expense is available on the IRS's website at http://www.irs.gov/businesses/small/article/0,,id=173385,00.html.

[4] Under the means test, a debtor's allowed expenses also include the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses by the IRS, such as taxes, court-ordered payments and health care costs. *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I); *Internal Revenue Manual*, Financial Analysis Handbook § 5.15.1.10, *available at* http://www.irs.gov/irm/part5/ch15s01.html#d0e175114.

[5] General information about the IRS Local Standards is available on the IRS's website at http://www.irs.gov/individuals/article/0,,id=96543,00.html.

Local Housing Standard

The Revised Standards made two significant changes to the Local Housing Standards. First, the IRS added into the allowance expenses for cell phone usage, which was previously not included in the calculation of Local Housing Standards. Second, the IRS now publishes separate expense amounts for households of 1, 2, 3, 4, and "5 or more" individuals. Before issuing the Revised Standards, the IRS published a single expense amount for debtors living in a "1 or 2 person" household, and separate amounts for a 3 and "4 or more" person household. By broadening the range of household sizes in the expense allowance, the Local Housing Standards should more accurately estimate what a like size family spends in this category.

Local Transportation Standard

The Local Transportation Standards break transportation expenses into two components, one related to the costs associated with operating a vehicle, and the other associated with the costs of owning a vehicle.[6] Under the Revised Standards, ownership and operating cost allowances for a first and second vehicle are the same. Previously, the IRS allowed a lower allowance for a second vehicle.[7]

Finally, the IRS also restructured the operating expense portion of the Local Transportation Standard. The options under the operating expense portion address public transportation costs and the costs associated with operating vehicles. The Revised Standards replaced the "no car" allowance, which varied depending on where the debtor lived, with a new nationwide Public Transportation Local Standard allowance of $163. This amount is based on Bureau of Labor Statistics expenditure data for mass transit fares for travel between and within cities. The forms contain a new line item to allow debtors to contend they are entitled to deduct both expenses in the amount of the IRS Standard for the operating and public transportation expense categories.[8]

III. Changes to Forms 22A and 22C

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[6] The United States Trustee Program's position is that only debtors who have a monthly expense pertaining to financing the purchase or lease of a vehicle are eligible to claim the allowance. However, bankruptcy courts are currently split on the issue, and the purpose of this article is not to argue the merits of the legal position.

[7] For example, under the old IRS Standards, married debtors living in Boston who filed jointly and owned one vehicle received operating expenses of $311. If they owned two vehicles, they received $393. Ownership expenses were $471 for the first vehicle, and an additional $332 for the second vehicle ($803 total). Under the Revised Standards, the same couple would receive operating expenses of $209 for one vehicle, and $418 ($209 x 2) if they owned two vehicles. Ownership expenses would be $478 for one vehicle, and $936 ($478 x 2) for two vehicles.

[8] *See* Line 22B on Form 22A and Line 27B on Form 22C.

On November 21, 2007, the United States Judicial Conference approved revisions to Official Forms 22A, 22B and 22C to be effective on January 1, 2008.[9] The revisions to Forms 22A and 22C fall into four broad categories: (1) requests for more information than prior versions of the forms required; (2) requests for different information than the prior versions requested; (3) changes to identify potential legal issues, including those generated by the Revised Standards, and (4) miscellaneous technical amendments to more accurately conform the language of the forms to language in the Bankruptcy Code and in the Internal Revenue Manual. This section summarizes the most significant changes to Forms 22A and 22C.

All Chapter 7 Debtors Must Now File Form 22A

Before the most recent revisions to Form 22A, only chapter 7 debtors who owed primarily consumer debt were required to file the form. *See* Fed. R. Bankr. P. 1007(b)(4). As revised, Form 22A now requires all chapter 7 debtors to file the form. Debtors who claim they do not owe primarily consumer debt must check a new box in Part I. By checking this box, debtors declare that their debts are not primarily consumer, and they are not required to complete any of the income and expense calculations on the form.

More Specificity Regarding Marital Adjustments

Another revision requires debtors to itemize and explain amounts claimed as a "marital adjustment" to a debtor's income that are often necessary when married debtors file for bankruptcy without their spouse.[10] The means test initially requires debtors to include all of their non-filing spouse's current monthly income to determine whether the case is subject to dismissal for abuse based on the presumption of abuse and the applicable commitment period in a chapter 13 case.[11] However, to calculate disposable income, the means test only includes the non-filing spouse's income to the extent the non-filing spouse's income is regularly used to pay the household expenses of the debtor or the debtor's dependents. Accordingly, before performing disposable income calculations, the forms permit debtors to "adjust" income by removing that portion of the non-filing spouse's income *not* regularly used to pay the household expenses of the

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[9] The revised forms are posted at http://www.uscourts.gov/bankform/index.html#means. Revisions to Form 22B, which is only applicable in chapter 11 cases, are beyond the scope of this article.

[10] *See* Form 22A, Line 17; Form 22C, Lines 13 and 19.

[11] In chapter 7 cases, the Bankruptcy Code looks to both the debtor's and the non-filing spouse's income to determine whether the case is subject to dismissal based on the presumption of abuse. 11 U.S.C. § 707(b)(7). In chapter 13 cases, courts consider the non-filing spouse's income to determine the applicable commitment period. 11 U.S.C. § 1325(b)(4)(applicable commitment period is "not less than 5 years" if the current monthly income of the debtor and the debtor's spouse, combined, exceeds the applicable median family income for the debtor's household size)

debtor or the debtor's dependents.

Previously, the forms only required debtors to list a single dollar amount representing the total portion of the non-filing spouse's income that the debtor asserted was not used to pay the debtor's household expenses. As revised, the forms require debtors to itemize each component of the total amount, and specify the basis for excluding the amount from the debtor's current monthly income. The revised forms also now provide examples of items appropriately included as a marital adjustment.

A second set of revisions to the forms addresses requests for different information than requested in earlier versions of the forms. Most revisions in this category incorporate changes to the Revised Standards discussed above, including the new National Standard for out-of-pocket health care expenses.[12] Other changes in this category include revisions to the instructions adjacent to particular lines, and reflect the updated legal consensus of the Rules Committee. For example, the instructions on lines 8 and 10 of Form 22A[13], which help calculate current monthly income, have been revised to clarify when debtors must include child support and spousal support payments (*e.g.*, alimony) in their current monthly income calculation. Previously, the forms directed debtors to include spousal and child support to the extent they were regularly paid for the household expenses of the debtor or the debtor's dependents. As revised, the forms clarify that *all* spousal support payments must be included in the calculation, regardless of the purpose for which those funds were paid.

<u>Special Circumstances on Form 22C</u>

Another significant amendment to Form 22C includes a new line for above-median income debtors to deduct additional expenses not allowed under section 707(b)(2)(A). Debtors may use the new line to assert "special circumstances" that rebut the presumption of abuse in a chapter 7 case under section 707(b)(2)(B).[14] Previously, debtors could include such expenses for informational purposes on a line of the form that followed the disposable income calculation in Part V of the form.

<u>Miscellaneous and Technical Amendments</u>

Finally, the revised Forms 22A and 22C include a number of miscellaneous and technical amendments. Several revisions amend the language on the forms to more closely track language used by the IRS or the Bankruptcy Code. For example, line 26 of Form 22A and Line 31 of Form 22C, which previously allowed deductions for "mandatory payroll deductions" under the IRS's categories of Other Necessary Expenses, are now titled "involuntary deductions for employment,"

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[12] These changes are reflected on Form 22A, Lines 19 and 22, and Form 22C, Lines 24 and 27.

[13] Lines 7 and 9 of Form 22C.

[14] *See* Form 22C, Line 57.

which is the phrase the Internal Revenue Manual uses. Similarly, Line 55 of Form 22C, which excludes qualified retirement deductions from a chapter 13 debtor's disposable income, was amended to track the language of section 541(b)(7) of the Bankruptcy Code.

Other revisions made the forms more technically accurate. For example, the headings in Part V of Form 22A and Part IV of Form 22C were changed from "Calculation of Deductions Allowed Under § 707(b)(2)" to "Calculations of Deductions From Income." The reference to section 707(b)(2) in the earlier forms was technically incorrect because one of the deductions contained in this part of the forms, for charitable contributions, is not a deduction found in section 707(b)(2).

IV. Conclusion

It is essential that bankruptcy practitioners be aware of these changes to the IRS National and Local Standards and the Official Forms. Debtors are better served and the bankruptcy system made more efficient by the appropriate use of the IRS Standards and Official Forms, which comprise core elements of the means test that affects chapter 7 eligibility and chapter 13 repayment plans.