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2009

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**Applying the “Applicable” Standard or the Actual Amount:
Monthly Rent in a Debtor’s Chapter 13 Plan**

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Overview

Under The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) (S. 256, Pub. L. No. 109–8, 119 Stat. 23), debtors are subjected to a test in order to ensure their creditors are repaid as much as possible. Chapter 13 requires debtors in bankruptcy to file a plan indicating a monthly amount they will repay to creditors over a given set of years. The amount to be repaid is a debtor’s entire “disposable income,” which is income minus expenses. See 11 U.S.C. § 1325 (2007). Deductible expenses are to be calculated the same as a chapter 7 filing. See 11 U.S.C. §§1325, 707. When subtracting expenses, Chapter 7 directs filers to use the “applicable” standard amounts, which are averages issued by the Internal Revenue Service. However, there is currently a split among circuits as to whether these standard averages are intended to be used in all circumstances or as a cap when debtor’s actual expenses are above average. As a cap, debtors who do not meet the “maximum” would use their actual amounts and creditors would be entitled to higher repayments.

The Second Circuit recently evaluated this issue when a debtor subtracted the applicable standard amount using the IRS’s data. A creditor wanted the court to direct the debtor to only subtract the lower, actual expense, thereby increasing the debtor’s disposable income allowing the creditor a larger return. At the time of that case, and still today, there is far from a clear

majority on either side and courts continue to base their holdings on various rationale, such as the existence of other standards, statutory construction, legislative intent and policy concerns.

BAPCPA

BAPCPA was passed in an effort to safeguard creditors from overzealous consumers. As protection, a “best interest of creditors” test is applied to a debtor’s plan; plans not submitted in good faith will not be confirmed. 6 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* § 1325 (15th ed. 2007). For example, if a debtor’s disposable income is too high, their plan will not be confirmed and they will be required to repay their debt on their own. Additionally, BAPCPA created a “bright line test” to ensure debtors repay creditors as much as possible. *Colliers, supra* § 1325.08.

The Means Test

The bright line test created under BAPCPA, commonly called the “means test,” is applied to chapter 13 debtors with above average incomes to ensure that a repays creditors as much as the debtor can afford. See *In re Kibbe*, 361 B.R. 302, 314 (1st Cir. B.A.P. 2007) (citing H.R. Rep. No. 109–31, pt. 1, at 2 (2005)). The objective means test subtracts specified expenses from the debtor’s “current monthly income;” the difference is defined as “disposable income.” 11 U.S.C. § 1325(b)(1)–(3); 4 Hon. William L. Norton, Jr. & William L. Norton III, *Norton Bankruptcy Law and Practice* § 151.20, 151.22 (3d ed. 2008). Current monthly income is defined under the Code as the “average monthly income from all sources” to the debtor. 11 U.S.C. § 101(10A). If a debtor’s income is above the median for their state, they are entitled to deduct expenses. See *Norton, supra*, § 151.22; U.S. TRUSTEE PROGRAM, CENSUS BUREAU MEDIAN FAMILY INCOME BY FAMILY SIZE (2009), <http://www.usdoj.gov/ust/eo/bapcpa/20090315>

/bci_data/median_income_table.htm (providing requisite data to compare to the debtor's income). The expenses to be deducted are identified as the "applicable monthly expense specified under . . . [s]tandards [issued by the Internal Revenue Service], and the debtor's actual monthly expenses for . . . Other Necessary Expenses [as categorized by the Internal Revenue Service]." 11 U.S.C. § 707(b)(2)(A)(ii)(I). The difference, the disposable income, is the amount expected to be paid out to creditors. *Norton, supra*, § 151.20.

IRS Standards

The IRS, for their own department's purposes, collects national and local figures regarding individuals' expenses. See INTERNAL REVENUE SERVICE, COLLECTION FINANCIAL STANDARDS (2009), <http://www.irs.gov/individuals/article/0,,id=96543,00.html>. Depending on the expense's category, the data is either computed and averaged nationally or locally. After BAPCPA, the IRS has created a separate set of data, which is more frequently updated, for bankruptcy filing purposes. See U.S. TRUSTEE PROGRAM, MEANS TESTING (2009), <http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm>. The IRS compiles one national figure for each of the common expenses, such as food, clothing and out-of-pocket health expenses. See U.S. TRUSTEE PROGRAM, IRS NATIONAL STANDARDS FOR ALLOWABLE LIVING EXPENSES (2009), http://www.usdoj.gov/ust/eo/bapcpa/20090315/bci_data/national_expense_standards.htm. The IRS also compiles local data, broken down by county, for housing expenses as well as transportation expenses based on census information. See MEANS TESTING, *supra*. Under BAPCPA, the Code § 707(b)(2)(A)(ii) directs filers to this information to calculate expenses.

Additionally, a debtor may deduct actual amounts for "[o]ther [n]ecessary [e]xpenses," if necessary, as defined by the IRS, which includes accounting and legal fees, charitable contributions, child care, court-ordered payments, and taxes. See *Norton, supra* § 151.22;

INTERNAL REVENUE SERVICE MANUEL, 5.15.1 FINANCIAL ANALYSIS HANDBOOK § 5.15.1.10 (2009), <http://www.irs.gov/irm/part5/ch15s01.html#d0e214358>.

Financial Analysis Handbook

Like the means test, revenue agents use the IRS Standards to negotiate tax repayment plans. See *Norton, supra* § 151.22; INTERNAL REVENUE SERVICE MANUEL, INTRODUCTION TO THE IRM § 1.11.2.1(5) (2009), <http://www.irs.gov/irm/part1/ch08s02.html>. The applicability of the IRS Standards is detailed within the Internal Revenue Service Manuel's Financial Analysis Handbook. See FINANCIAL ANALYSIS HANDBOOK, *supra*. For example, reviewing the average income and expenses, an agent can assess whether the taxpayer is using "best efforts" to repay all past due, unpaid taxes the IRS. See *Norton, supra* § 151.22.

The Issue

BAPCPA's reference to the IRS Standards has created much confusion over when, or if always, the standards are to apply. The overall purpose of BAPCPA was to ensure creditors are repaid as much as possible, however, the process was meant to be more formulaic. *In re Morgan*, 374 B.R. 353, 362 (Bankr. S.D. Fla. 2007); *In re Quigley*, 391 B.R. 294, 303 (Bankr. N.D.W. Va. 2008) (quoting *In re Sorrell*, 359 B.R. 167, 184 (Bankr. S.D. Ohio 2007)). The applicability of the standards under the Code can be read either as a "fill-in," or merely a cap when actual expenses are above average. 11 U.S.C. § 707(b)(2)(A), 1325(b)(3). This issue is frequently contended because the less a debtor deducts the higher the disposable income, which is assumed under BAPCPA to be the amount a debtor can afford to pay to a creditor. This issue was recently addressed by the U.S. Bankruptcy Court for the Southern District of New York in *In re Osei* where a creditor, seeking to ensure a debtor would be repaying as much as possible, questioned

whether debtors are allowed to hide behind the IRS Standard housing expense when their actual expenses were lower. 389 B.R. 339, 340 (Bankr. S.D.N.Y. 2008).

The Facts

The debtor in *Osei* had an actual rent expense of \$1,150 per month, yet in calculating the disposable income, the debtor claimed \$1,494, the IRS Standard for Bronx County. *Osei*, 389 at 341. A creditor asserted that IRS Standards used in repayment plan calculations were intended only to be used as caps limiting the deducted expenses of debtors, as opposed to fill-ins. The creditor urged that when a debtor's actual expenses are lower, the actual is meant to be applied. The creditor sought this application because the seemingly small \$344 per month difference between the standard and actual rent would amount to an additional \$20,640 payout to the creditor over the life of the plan.

While the court in *Osei* determined the use of the standards applied regardless of actual amounts under plain meaning, it reviewed four other methods of analysis: IRS's use of their standards, interpretation of the statutory language, legislative intent, analogous transportation cases, as well as policy concerns. In reviewing these, the court found there was "no clear consensus" as to whether the standard or a lower actual amount applied. *Id.* at 344.

Is the IRS's Use of the Standards Persuasive?

The creditor in *Osei* sought to establish the IRS's use of its standards was persuasive to the bankruptcy court's use of the same standards. *Osei*, 389 at 345 (quoting *Weiland v. Thomas (In re Thomas)*, 382 B.R. 793, 798 (D. Kan. 2008)). For the purpose of collecting unpaid taxes, the IRS does not use standards as fill-ins. Taxpayers will normally be allowed the local standard or their actual expenses, whichever is less, to calculate what can affordably be repaid.

FINANCIAL ANALYSIS HANDBOOK, *supra*, § 5.15.1.7. Under the premise that the reference to the IRS Standards in the Code implicitly carries the IRS's use of the standards, creditors claim when debtors calculate disposable income, the standard can be used, unless actual expenses are less. *Id.*

The *Osei* court found two problems with the creditor's IRS argument. First, the creditor misinterprets and deceptively portrays the Handbook's language. The IRS allows a flexible approach and does not mandate the lower amount be used, as urged by the creditors. FINANCIAL ANALYSIS HANDBOOK, *supra*, § 5.15.1.7(4)–(5). The IRS allows the national standards to be used without questioning the actual amount of a taxpayer's expenses. *Id.* at § 5.15.1.8. Second, the Handbook's purpose is to guide tax collection, not bankruptcy and the Handbook is never mentioned in the Code. *Osei*, 389 at 345. Moreover, the IRS disclaims their standards and directs those seeking information on bankruptcy to the U.S. Trustee website. *Osei*, 389 at 355.

Interpreting the Statutory Language

The court in *Osei* found no ambiguity in the plain meaning of sections 1325 or 707. *Osei*, 389 at 346. However, courts which held debtors must apply their actual, lower expenses have found two ambiguities in the Code's direction to calculate disposable income. Section 1325(b)(2) states:

“[i]f the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless... (B) the plan provides that all of the debtor's projected disposable income... will be applied... under the plan. . . “[D]isposable income” means current monthly income . . . less amounts reasonably necessary to be expended[, which] shall be determined in accordance with. . . section 707(b)(2)(A).” 11 U.S.C. § 1325(b)(2).

Section 707(b)(2) states: “monthly expenses shall be the debtors applicable monthly expense specified under . . . [s]tandards [issued by the Internal Revenue Service], and the debtor's actual

monthly expenses for . . . Other Necessary Expenses [as categorized by the Internal Revenue Service].” 11 U.S.C. § 707(b)(2)(A)(ii)(I).

First, courts have found the word “applicable” in section 707 may mean “as applied by’ the IRS through the [Financial Analysis] Handbook.” *Osei*, 389 at 346 (quoting *In re Slusher*, 359 B.R. 290, 307–08 (Bankr. D. Nev. 2007) (finding that if Congress intended the Standard, regardless of the actual expense amount, the word applicable would be “superfluous”). The court in *Osei* claims courts finding ambiguity are taking an inexplicable leap, a “tortured reading,” that would require one to look beyond plain meaning. *Osei*, 389 at 348–49. The word “applicable” is used for expenses listed in the National and Local Standards contrasted to the word “actual” used for Other Necessary Expenses. *Id.* See *In re Fowler*, 349 B.R. 414, 418 (Bankr. D. Del. 2006) (stating use of two different words, applicable and actual, shows a legislative intent for different standards to apply); *In re Demonica*, 345 B.R. 895, 902 (Bankr. N.D. Ill. 2006) (stating the use of two different terms, applicable and actual, is intent of two different calculation methods).

Second, courts have found ambiguity with the phrase “in accordance with.” For example, in *In re McGillis*, the court found the phrase “in accordance with,” as opposed to more forceful language, gave courts discretion to ensure expenses comply with the reasonableness requirement of section 1325(b)(3)). 370 B.R. 720, 729 (Bankr. W.D. Mich. 2007). Creditors urge that this discretion means the standards are not fill-ins; the standards use may be reviewed by a court regarding their applicability. The court in *Osei* disagrees with the idea of judicial discretion *McGillis* attempts to create. *Osei*, 389 at 350–51. The court in *Osei* assumes if Congress intended this discretion regarding the reasonableness of expenses, Congress would have used deliberate language to convey such an intent. *Id.* at 351.

Congress' Construction of BAPCPA

House of Representative reports, like other canons of statutory construction, are places of reference for assessing legislative intent once ambiguity is found in a statute. While the report on BAPCPA is useless to interpret disposable income, the *Osei* court focused on the report's general statement of purpose of BAPCPA. See *In re Nance*, 371 B.R. 358, 365 n.7, 366 (Bankr. S.D. Ill. 2007); *In re McNabb*, 326 B.R. 785, 789 (Bankr. D. Ariz. 2005). The report states BAPCPA was created to "ensure that debtors repay creditors the maximum they can afford." *Osei*, 389 at 352. The court held the only interpretation that would further the BAPCPA objective was to use the data in a "raw" form as a fill-in, requiring no analysis or comparison. *Osei*, 389 at 352 (quoting *In re Briscoe*, 374 B.R. 1,9 (Bankr. D.D.C. 2007)). This process allows calculating expenses to be more "formulaic" or "mechanical" as the bright-line as was intended for the means test. *Osei*, 389 at 352 (quoting *In re Farrar-Johnson*, 353 B.R. 224, 228 (Bankr. N.D. Ill. 2006)). To support this, the court refers to House members who opposed the BAPCPA amendments. Opponents found the expense formula "inflexible" and "divorced from the debtor's actual circumstances," so the court reasoned the majority must have intended a rigid fill-in formula. *Osei*, 389 at 353 (quoting *In re Grunert*, 353 B.R. 591, 594 (Bankr. E.D. Wis. 2006)).

Additionally, language removed or rejected can be interpreted as intent to mean the legislature specifically did not want those words to be included. *Osei*, 389 at 353. The language removed in this case was "as determined under"; replaced with "applicable monthly expense amounts." *Id.* (citing *In re Fowler*, 349 B.R. 414, 419 (Bankr. D. Del. 2006)). The court held the removal indicated "determinations" are now unnecessary; the amount is merely what is "applicable." *Osei*, 389 at 353.

Local Transportation Expense

Due to the lack of decided cases regarding the application of standard housing costs, the court looked to cases dealing with the other local averaged expense, transportation. See *Osei*, 389 at 342 n.1. Because there is a split in case law, the court looked to other circuit courts and within the second circuit for direction as to whether the IRS Standard or a lower actual amount should be applied. *Id.* at 344.

At the time *Osei* was decided, the only circuit decision held standard transportation costs should apply despite actual costs being lower or non-existent. *Hildebrand v. Kimbro (In re Kimbro)*, 389 B.R. 518, 522–24 (6th Cir. B.A.P. 2008). Similarly, within the Second Circuit there were three district court cases that addressed transportation costs and each held in support of the use of the standard regardless of a debtor’s actual expenses. See *In re Schneider*, No. 07-32487, 2008 WL 1885768, at *2–3 (Bankr. N.D.N.Y. Apr. 28, 2008); *In re Roberts*, No. 07-210247, 2008 WL 542503, at *1, *4 (Bankr. D. Conn. Feb. 28, 2008); *In re Austin*, 372 B.R. 668, 678 (Bankr. D. Vt. 2007) (holding disposable income is to be calculated based on standards without regard to actual expenses). The court chose to keep in line with the second circuit and the sixth circuit while acknowledging that district courts elsewhere are of the opposing view.

Policy Concerns

If the IRS Standards are not fill-ins but merely caps, one policy concern is the perverse incentive for debtors to spend as much as they can on housing and transportation in order to claim the maximum local standard deduction. *Osei*, 389 at 355. This punishes a debtor’s frugality instead of rewarding it. *Id.* at 355–56. Courts that require the use of actual expenses when below standard also recognize this unexpected result. For example, one court noted the debtor probably moved into a significantly smaller and less expensive home as a temporary

measure in order to pay off debt. *Id.* at 356 (discussing *In re Rezendes*, 368 B.R. 55, 62 (Bankr. D. Haw. 2007)). However, due to the large size of the family it would be unlikely the debtor would remain in the new residence for the entire length of the payment plan. *Osei*, 389 at 356. Had the debtor remained in the prior home, the entire standard deduction would have applied. *Id.* Unfortunately, the debtor, having moved to save money, was only allowed to deduct the actual housing expense. *Id.* The *Osei* court included the facts of *Rezendes* to emphasize an erroneous and unfair result.

Another policy concern is the uncertain nature of expenses. *Osei*, 389 at 356. For example, rents often increase at renewal, property taxes may be increased yearly, and people may need to move. Increases are bound to occur throughout the life of a repayment plan. *Id.* Similarly, a debtor may have a below average vehicle payment because their car is old, however, that vehicle may incur greater expenses from required repairs due to normal wear and tear. *Id.* Increases in expenses lower a debtor's expendable income and may allow or require debtors to request changes to their plans, taking up courts' and debtors' time and resources. *Id.*

Conclusion

BAPCPA was intended to ensure debtors repay as much as possible, courts have held it was also intended to make bankruptcy filings easier by removing judicial discretion causing contradictory results with regard to IRS Standards. There has been a clear affirmative step to keep the IRS Standards to apply to housing costs as applied to transportation costs. See *In re Morgan*, 374 B.R. 353, 362 (Bankr. S.D. Fla. 2007). However, there is such a clear split of authority regarding transportation expenses that to even assess the statute solely under plain meaning is pointless (the court in *Osei* found plain meaning was enough but still chose to shoot down all the other areas on contention). In the nine months since the *Osei* decision was issued

only one court has cited it, and even then it was merely listed in a long string of other cases on the issue. *In re Coffin*, 396 B.R. 804,807–08 (Bankr. D. Me. 2008). The only way this issue will be able to be resolved is through Congressional revision to the statute or a Supreme Court decision because it does not appear a consensus will be able to be reached without instruction.

