No. 07-2503

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

In re MARVIN ROSS-TOUSEY AND DEBORAH TOUSEY,
Debtors.

MARVIN ROSS-TOUSEY and DEBORAH TOUSEY,
Debtors-Appellants

— v. —

WILLIAM T. NEARY,
Trustee-Appellee

ON APPEAL FROM THE DISTRICT COURT FOR THE EASTERN DISTRICT OF WISCONSIN

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF DEBTORS-APPELLANTS AND SEEKING REVERSAL OF THE DISTRICT COURT DECISION

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April 1, 2008

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Ross-Tousey v. Neary, No. 07-2503.

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure *Amicus Curiae* the National Association of Consumer Bankruptcy Attorneys makes the following disclosure:

1) For non-governmental corporate parties please list all parent corporations.
NONE.

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock.
NONE.

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests.
NONE.

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant.
NOT APPLICABLE.

____________________________ Dated: April 1, 2008

Tara Twomey, Esq.
Attorney for the National Association of Consumer Bankruptcy Attorneys

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STATEMENT OF INTEREST OF NACBA

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 2500 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 400,000 bankruptcy cases filed each year.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various courts seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Kawaauhau v. Geiger*, 118 S.Ct. 974 (1998); *In re Suggs*, 377 B.R. 198 (B.A.P. 8th Cir. 2007).

NACBA and its membership have a vital interest in the outcome of this case. NACBA members primarily represent individuals, many of whom own motor vehicles. The proper application of section 707(b)(2)(A)(ii)(I) in both chapter 7 and chapter 13 has been widely debated by creditors, debtors, counsel and commentators. This case affords the court an opportunity to address this debate and provide the first guidance on the issue from a Court of Appeals.

CONSENT

This brief is being filed with the consent of all parties.

SUMMARY OF ARGUMENT

The issue on appeal, whether all debtors who own vehicles may take the ownership expense deduction under the means test, is a question unique to bankruptcy. Bankruptcy is a complex maze of law and procedure that has two main purposes: a fresh start for the debtor and the fair and orderly repayment of creditors. While the Bankruptcy Code gives the honest, but unfortunate debtor the opportunity for a fresh start, the Code has also long permitted courts to dismiss cases for abuse.

Under former section 707(b), the court was permitted to dismiss a chapter 7 case if the court found that the granting of relief would be a "substantial abuse" of the provisions of the chapter. However, Congress did not define "substantial abuse." Consequently, courts were called upon to give meaning to the term and judges were empowered with broad discretion in determining whether "substantial abuse" existed.

In 2005, Congress created an objective, mechanical test that established a threshold beyond which abuse would be presumed. Under the means test, Congress specified how debtors should calculate their "income" and what expenses certain debtors are permitted to deduct from that income.

Congress thereby relieved courts from the duty to answer difficult questions of lifestyle and philosophy that were prevalent under the old law.

At a glance, the means test and the presumption of abuse ensure that debtors' total expenses are reasonable. It does not require an individual inquiry into the debtors' most common expenses such as food, housing and vehicle costs. For these types of expenses the means test looks to the National and Local Standards used by the Internal Revenue Service (IRS). The Bankruptcy Code, however, does not adopt the same methodology or definitions for determining the presumption of abuse as the IRS uses for calculating a taxpayer's ability to pay. Unlike the IRS methodology, the means test prohibits debtors from claiming expenses larger than those provided by the standard even if those higher expenses are necessary and substantiated. Similarly, other parties in interest may not force debtors to claim a smaller allowance than the Standards provide. To limit any individual category, such as food, housing or transportation expenses, to the actual amount of the debtor's expenses in that category defeats the purpose of creating an objective threshold for the presumption of abuse.

ARGUMENT

A. Dismissal for Abuse

Bankruptcy is a complex maze of law and procedure that has two main purposes: a fresh start for the debtor and the fair and orderly repayment of creditors. While the Bankruptcy Code gives the honest, but unfortunate debtor the opportunity for a fresh start, the Code has also long permitted courts to dismiss cases for abuse.

Under former section 707(b), the court was permitted to dismiss a chapter 7 case if the court found that the granting of relief would be a "substantial abuse" of the provisions of the chapter. However, Congress did not define "substantial abuse." Consequently, courts were called upon to give meaning to the term and judges were empowered with broad discretion in determining whether "substantial abuse" existed. Most courts considered "substantial abuse" in light of the "totality of the circumstances." *See, e.g.*, *In re Behlke*, 358 F.3d 429 (6th Cir. 2004); *In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *In re Kornfield*, 164 F.3d 778 (2d Cir. 1999); *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998); *In re Green*, 934 F.2d 568 (4th Cir. 1991).

In determining abuse, courts considered a multitude of factors such as whether the petition was filed as a consequence of illness, disability, unemployment, or some other calamity; whether the schedules suggested the debtor obtained cash advances and consumer goods on credit exceeding his or her ability to repay them; whether the debtor had the ability to repay his debts out of future earnings; whether the debtor's proposed budget was excessive or extravagant; whether the debtor's statement of income and expenses misrepresented the debtor's financial condition; and whether the debtor engaged in eve-of-bankruptcy purchases. *See, e.g., In re Behlke*, 358 F.3d 429, 433-435 (6^{th} Cir. 2004); *In re Stewart*, 175 F.3d 796, 808-809 (10^{th} Cir. 1999). The question of the debtor's ability to pay, in turn, required the courts' subjective inquiries into the necessity and reasonableness of the debtor's expenses.

In the 2005 amendments to the Bankruptcy Code, Congress sought to address the disparate interpretations of "substantial abuse" by creating an objective, bright-line threshold for presuming abuse. In determining whether the presumption of abuse arises, Congress has specified how debtors are to calculate their income (e.g., social security payments are excluded). For debtors whose "current monthly income", a defined term, exceeds the applicable median family income, Congress also specified what expenses debtors are permitted to deduct from that income. Congress thereby relieved courts from the duty to answer difficult questions of lifestyle and philosophy that were prevalent under the old law. *See In re Austin*, 372 B.R. 668 (Bankr. D. Vt. 2007).

The means test ensures that debtors' total expenses are reasonable. The threshold for presuming abuse no longer requires an individual inquiry into the debtors' most common expenses such as food, housing and transportaton costs. For these types of expenses the means test looks to the National and Local Standards used by the Internal Revenue Service (IRS). Specifically, section 707(b)(2)(A)(ii)(I) provides that the debtor's monthly expenses "shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards…issued by the Internal Revenue Service..." By looking at the total of the expenses allowed and comparing it to the debtor's current monthly income, the means test permits debtors' actual expenses in one category of expenses to be greater than the amount of the IRS allowance if that excess if offset by savings from the IRS allowance in other areas.

B. Ownership Costs

Transportation allowances fall under the Local Standards and are divided into two components: operating costs and ownership costs. The Internal Revenue Service ("IRS") specifies amounts to be used for each component.[1] There is no statutory definition of "ownership" in either the Bankruptcy Code or the Internal Revenue Code. Thus the issue of ownership expenses is immediately distinguishable from the standardized tax exemption analogy made by the District Court. In order for a taxpayer to claim a standardized exemption for a dependent he must have actual expenses for that dependent because that is what the statute mandates. Specifically, the statutory definition of "dependent" requires that the taxpayer to have made supporting payments for that dependent during the tax year. *See* 26 U.S.C. § 152(c)(1)(D), (d)(1)(D). By contrast, there is no statutory or regulatory definition that makes the ownership costs unavailable to debtors that own cars simply because they have no loan or lease payment.

Given that there is no statutory definition of "ownership costs" how should debtors determine the "applicable monthly expense amount specified" in the Local Standards? The courts have settled on three different approaches: 1) the IRS approach; 2) the plain language approach; and 3) the split-the-baby approach. The District Court adopted the latter of these three. *Amicus*, and a majority of bankruptcy courts—those with the most practical

[1] The IRS publishes the ownership cost component of the Local Transportation Standard on a national basis, by number of cars. The operating cost component is published by number of cars and by Metropolitan Statistical Area and Census Bureau region. The Local Transportation Expense Standards may be found at http://www.irs.gov/businesses/small/article/0,,id=104623,00.html

experience applying the means test—believe that the plain language approach is correct. *See, e.g., In re Clark*, 2008 WL 444565 (Bankr. E.D. Wis. Feb. 14, 2008); *In re Sawicki*, 2008 WL 410229 (Bankr. D. Ariz. Feb. 12, 2008); *In re Weiderhold*, 2008 WL 353109 (Bankr. M.D. Pa. Feb. 11, 2008); *In re Phillips*, 2008 WL 352396 (Bankr. D. Mass. Feb. 7, 2008); *In re Simms*, 2008 WL 217174 (Bankr. N.D.W. Va. Jan. 23, 2008); *In re Moorman*, 376 B.R. 694 (Bankr. C.D. Ill. 2007); *In re Musselman*, 379 B.R. 583 (Bankr. E.D.N.C. 2007); *In re Fowler*, 349 B.R. 414 (Bankr. D Del. 2006).

C. Applicable Monthly Expense Amounts Specified by the Standards.

i. The Internal Revenue Service's methodology

The IRS Collection Financial Standards defines ownership costs as monthly loan or lease payments. The IRS plainly provides that the amount specified for all the local standards (including housing, utilities and transportation expenses) serve as a cap. *See In re Simms*, 2008 WL 217174, at *17. "The taxpayer is allowed the local standard or the amount actually paid, **whichever is less**."[2] *See* Internal Revenue Manual ("IRM") § 5.19.1.4.3.2 (emphasis in original). *See also* IRM § 5.15.1.1. available at http://www.irs.gov/irm/index.html. Although the IRS treats Local Standard expenses as caps, it also gives agents broad discretion to "deviate from the standard amount when failure to do so will cause the taxpayer economic hardship." *See* IRM § 5.15.1.1 (6). With respect to all the categories covered by the local standards—housing, utilities and transportation expenses—a taxpayer may claim more than the standard allowance if the expenses are substantiated as necessary living expenses. *See* Local Standards: Transportation *available at* http://www.irs.gov/businesses/small/article/0,,id=104623,00.html *and* Local Standards: Housing and Utilities *available at* http://www.irs.gov/businesses/small/article/0,,id=104827,00.html.

While the IRS methodology may be an appropriate measure of a taxpayer's ability to pay it would be inappropriate to conclude that Congress used the same methodology for determining the presumption of abuse in a chapter 7 bankruptcy case. First, the purpose of the IRS financial analysis

[2] The IRM also provides debtors with an additional $200 per month in operating costs for older and high mileage vehicles. The UST does not acknowledge the additional $200 operating expense on its website, see http://www.usdoj.gov/ust/eo/bapcpa/20061001/meanstesting.htm. Instead, USTs only make the availability of such expense public when arguing against the availability of the full ownership expense for unencumbered cars.

and the Bankruptcy Code are fundamentally different. The Bankruptcy Code attempts to balance a fresh start for the debtor with the fair and orderly repayment of creditors. By contrast, providing the taxpayer a fresh start or allowing repayment of creditors, other than the IRS, is not a stated goal or objective of the IRS collection process. *See* Financial Analysis Handbook. Internal Revenue Manual § 5.15.1.1, ¶¶ 1-3 (hereinafter "IRM")(describing purpose of financial analysis and listing alternative case resolutions); *see also In re Clark*, 2008 WL 444565, at *6; *In re Moorman*, 376 B.R. 694, 697 (Bankr. C.D. Ill. 2007). The IRS analysis can be revisited as the debtor's financial circumstances change. The application of the means test is a one-time analysis based solely on the debtor's financial circumstances during the six months leading up to the filing of the petition. In short, the IRS financial analysis and the means test are worlds apart. Consequnetly, "[n]o basis exists for the court to allow the National or Local Standards to be spliced based on what an IRS field agent would do when dealing with a delinquent taxpayer." *In re Simms*, 2008 WL 217174, at *18.

Notably Congress did not use language similar to the IRM, which it could easily have done if it intended the Local Standards to apply as a cap on debtor's actual expenses. *See In re Moorman*, 376 B.R. at 697-98; *In re Fowler*, 349 B.R. at 418. In fact, Congress rejected the IRS methodology that was specifically referenced in an earlier version of the bill. *See In re Fowler*, 349 B.R. at 419 ("The change from the prior version evidences Congress' intent that the Courts not be bound by the financial analysis contained in the IRM and lends credence to the Court's conclusion that it should look only to the amounts set forth in the Local Standards."); *see also* H.R. 3150, § 101(4) (105th Congress 1998)(permitting debtor to deduct "expense allowances… as determined under the Internal Revenue Service financial analysis").

For these reasons, a vast majority of courts have rejected the wholesale importation of the IRS financial analysis into the means test of the Bankruptcy Code. See *In re Hardacre*, 338 B.R. 718, 727 n.6 (Bankr. N.D. Tex. 2006)(Congress created a mathematical protocol that allows debtors "a more generous deduction of mortgage and car ownership expenses than permitted by the Internal Revenue Service"); *but see In re Rezentes*, 368 B.R. 55 (Bankr. D. Hawaii 2007)(amounts for local standard for housing is cap on actual expenses); *In re Ransom*, 380 B.R. 799, 807 (B.A.P. 9th Cir. 2007)("what is important is the payments that the debtors actually make, not how many cars they own, because the payments that debtors make are what actually affect their ability to make payments to their creditors").

ii. The plain language approach.

The Supreme Court has consistently employed a strict plain meaning rule for the Bankruptcy Code. *See Lamie v. U.S. Trustee*, 540 U.S. 526, 534, 124 S.Ct. 1023, 1030 (2004). It has been well established that when the "statute's language is plain, the sole function of the court, at least where the disposition required by the text is not absurd, is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotations omitted). A plain reading of the statutory language in this case results not only in a reasonable outcome, but also one that is consistent with Congress's intent to create a uniform and fair method for determining whether a presumption of abuse arises under section 707(b).

The language of section 707(b)(2)(A)(ii)(I) is clear. It provides that the debtor's monthly expenses "***shall*** be the debtor's applicable monthly expense ***amounts specified*** under the National Standards and Local Standards…issued by the Internal Revenue Service..."(emphasis added). The statutory language of section 707(b)(2)(A)(ii)(I) allows no discretion. *See In re Phillips*, 2008 WL 352396 (Bankr. D. Mass. Feb. 7, 2008). By stating that the debtor "shall" use as his or her expenses the "amounts specified under the National Standards and Local Standards," Congress created a fixed allowance for debtors in the amounts specified, not merely a cap of the debtor's actual expenses. See Eugene R. Wedoff, *Means Testing in the New 707(b),* 79 Am. Bankr. L.J. 231, 257-58 (2005)("because the statute makes no provision for reducing the specified amounts to the debtor's actual expenses—a plain reading of the statute would allow a deduction of the amounts listed in the Local Standards even where the debtor's actual expenses are less"); 6 *Collier on Bankruptcy* ¶ 707.05(2)(c)(i)(A. Resnick and H. Sommer, eds., 15th ed. Rev. 2005)("The better view is that, because the language refers to deducting the 'amount specified' in the standards, and not actual expenses, the ownership allowance specified in the standards is the minimum amount to be deducted"). Additionally, Congress drew a distinction in the statute between "applicable" expenses on the one hand and "actual" expenses on the other. *In re Farrar-Johnson*, 353 B.R. 224, 225 (Bankr. N.D. Ill. 2006)(holding debtor entitled to housing allowance under Local Standards in excess of actual housing costs). "Other Necessary Expenses" must be the debtor's actual expenses. *Id.* In contrast, expenses under the Local Standards need only be "applicable" based on where the debtor lives and the number of vehicles owned. *See id.*

Consequently, under section 707(b)(2)(A)(ii)(I), a creditor may not force debtors to claim a smaller allowance if the debtors' actual expenses are lower, nor may debtors claim a larger expense even if their actual expenses are higher, necessary and substantiated. *Cf.* Local Transportation Expense Standards, *available at* http://www.irs.gov/businesses/small/article/0,,id=104623,00.html (permitting debtors higher expenses if necessary and substantiated).

Applying the plain language rule, a majority of courts have found that if Congress wanted to require an actual expense, it could simply have used the word "actual". However, in the absence of such language, especially since it is used elsewhere in the same provision, the amounts specified in both the National Standard and Local Standards, including expenses for housing, utilities and transportation serve as fixed expenses. *See In re Fowler*, 349 B.R. 414 (Bankr. D Del. 2006); *see also In re Musselman*, 379 B.R. 583, 590-91 (Bankr. E.D.N.C. 2007). Indeed five out of the last seven courts to publish opinions on this issue in 2008 have disagreed with the conclusion reached by the District Court below. *See In re Clark*, 2008 WL 444565 (Bankr. E.D. Wis. Feb. 14, 2008); *In re Sawicki*, 2008 WL 410229 (Bankr. D. Ariz. Feb. 12, 2008); *In re Weiderhold*, 2008 WL 353109 (Bankr. M.D. Pa. Feb. 11, 2008); *In re Phillips*, 2008 WL 352396 (Bankr. D. Mass. Feb. 7, 2008); *In re Simms*, 2008 WL 217174 (Bankr. N.D.W. Va. Jan. 23, 2008).

iii. The split-the-baby approach.

Some courts, including the District Court below, have adopted a "split-the-baby" approach in which the ownership allowance is not a cap as provided in the IRM, but debtors must have a lease or loan payment in order to claim the deduction. *See, e.g.*, *Fokkena v. Hartwick*, 373 B.R. 645, 650 (D. Minn. 2007); *Neary v. Ross-Tousey*, 368 B.R. 762, 765 (E.D. Wis. 2007). As a result, debtors driving a "Mercedes or Mercury" are entitled to the same ownership allowance but only so long as they have some debt payment. *See Ross-Tousey*, 368 B.R. at 765. These decisions are premised on the idea that the terms "actual" and "applicable" are contextually different, but not mutually exclusive. *Id.*

Rather than finding the word "applicable" is a simple directive—picking the correct box based on region and number of cars—these courts adopt a result-driven interpretation that falls back on the IRS methodology and definitions. According to the District Court, and others like it, applicable means that the expense applies. The reasoning continues that the expense only applies if the debtor has a loan or lease payment. Without basis these courts have adopted the IRM definition of "ownership expense"—loan or lease payment—while rejecting the remainder of the IRM methodology.[3] In this way District Court, like the UST's argument, selectively incorporates portions of the IRM that achieve the intended result and have disregarded those parts that would benefit debtors (e.g., flexibility to go beyond the standard amount if the additional expenses are substantiated and necessary).

Furthermore, in adopting the IRM definition of ownership costs, the District Court presumes that there are no other costs to ownership other than loan or lease payments. This is a faulty presumption. For example, nowhere in the IRM definition are major repairs taken into account.[4] Nowhere in the IRM definition is expected depreciation taken into account.

Contrary to bankruptcy policy, the definition adopted by the District Court also favors borrowers over savers. It encourages borrowers to finance the purchase of a new car or take out a title loan just before bankruptcy. It

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[3] Courts have properly rejected the IRS methodology for the reasons stated in Part C.i., *supra.*

[4] The operating costs component under the Local Standards only include insurance, registration fees, ***normal maintenance***, fuel, parking, and tolls. *See* IRM § 5.19.1.4.3.4. Yet, automotive reliability studies show for example that the average 2000 vehicle is 2.5 to 5 times more likely than a 2005 vehicle to have problems with the engine, cooling system, air conditioning and suspension systems. Consumer Reports, Used Car Buying Kit, Reliability History (Average Problem Rates) available at http://www.consumerreports.org/cro/cars/ratings/reliability-histories-406/index.htm. In addition, 10% of 2000 cars will suffer brake problems, 7% electrical problems and 11% fuel system problems. *Id.*

precludes debtors from saving for a replacement vehicle, instead forcing them to borrow money after filing for bankruptcy (at a time the debtor's existing car may have no significant value and the debtor's credit is not good). Regardless of the IRS's methodology and definitions, the "fresh start" foundation of the Bankruptcy Code and Congress's intent to create an objective measure for presuming abuse, should make the means test indifferent between savers and borrowers who own cars. Certainly, neither bankruptcy's core purpose or Congress would condone penalizing savers.

CONCLUSION

For the foregoing reasons, the decision of the District Court should be reversed.

Respectfully submitted:

Date: April 1, 2008

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