

## CONSUMER BANKRUPTCY

# The Business Debt Exception to the Means Test

By Craig D. Robins

The means test that turned six-years old last month, was intended by Congress to create an objective standard for permitting only those consumers who are not "abusing" the privileges of bankruptcy to get Chapter 7 relief.

In general terms, if a consumer debtor has an income that is relatively high in relation to his or her expenses, the consumer will not pass the means test and will not be eligible to file Chapter 7.

### The business debt exception

The means test only applies to individuals whose debts are "primarily" "consumer debts," as opposed to business debts, as set forth in Bankruptcy Code §707(b). A debtor can check a box on the first page of the means test to declare that his or her debts are primarily non-consumer debts, and then avoid the rest of the means test, also known as Form B22A.

Congress could have told us what exactly "primarily" means, but they didn't bother to, so we have to analyze this word. *Webster's* dictionary defines "primarily" as "for the most part." Most courts have focused on this definition to mean more than half. Thus, if more than 50 percent of the debtor's debts are non-consumer debts, the debtor is automatically eligible for filing a Chapter 7 case without having to bother with the means test. There is no presumption of abuse for such cases.

### Consumer debts

So what exactly is a consumer debt? The Bankruptcy Code defines "consumer debt" as "debt incurred by an individual primarily for a personal, family, or household purpose."

In analyzing whether a debt is a consumer debt or not, bankruptcy courts have developed a "profit motive" test: if the debt was incurred with an eye towards making a profit, then the debt should be classified as a business debt. Thus, the mortgage on an individual's home would clearly be a consumer debt, and the mortgage on a vacation home would also be a consumer debt. However, if that vacation home was also purchased as an investment and rented out, then the mortgage would qualify as a business debt.

One bankruptcy court permitted a debtor to deem one of the three mortgages on his home to be a non-consumer debt because the proceeds were used to fund a business venture.

Most credit card debts are obviously consumer debts. However, if an individual used a credit card for business purposes, then it could be reasonably argued that the resulting liability is a business debt.

Other examples of business debts include personal guaranties on business obligations, investment losses, and motor vehicle accident liabilities. Domestic support obligations such as child support and maintenance are generally considered consumer debts. There are some varieties of debt that courts have held to be neither a business debt nor a consumer debt.

Although some courts have held that student loans are not consumer debts, the Second Circuit has held that they are.

Any liability as a responsible person for taxes on a business is clearly business debt. However, there is no clear-cut answer in this jurisdiction as to whether personal income tax obligations are consumer debts or not. Courts outside of New York and the Second Circuit have reached different conclusions on income tax debt.

In one case in the Sixth Circuit, the court rejected the application of the prof-



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it motive test concluding that income taxes can be distinguished from consumer debts for several reasons. Tax debts are not incurred like consumer debts as they are not incurred voluntarily. Tax debt is assessed for the benefit of the general public whereas consumer debt is incurred for personal and household purposes. Finally, tax debt arises from income and earning money

whereas consumer debt results from consumption and spending money. *In re Westberry*, 215 F.3d 589 (6th Cir. 2000).

Most of the debtors that I have represented who were able to make a means test business debt declaration were victims of a failed business who owed substantial sums, either directly, or through personal guaranties, to various trade creditors, taxing authorities or business partners.

Most individuals with a failed mom and pop business will not be able to take this shortcut as their mortgage debt alone will likely exceed their business debt.

### Business debt exception has limitations

Just because a debtor can by-pass the means test does not mean that a debtor can use it as a loophole to escape other good faith requirements.

In a Michigan decision from earlier this year, the bankruptcy court addressed a situation involving husband and wife debtors whose debts were genuinely primarily business debts. They had over six million dollars of unsecured debts from failed real estate investments. However, both debtors were doctors whose budget showed that they were living on \$42,000 of monthly expenses – what the court described as a very lavish and extravagant lifestyle. They each drove a Mercedes Benz and had a BMW in the garage.

The court commented that even though the debtors did not fail the means test, they nevertheless lacked good faith because they could have easily adjusted their budget while still maintaining a nice lifestyle, and paid their creditors a significant dividend through a Chapter 11 plan. *In re Rahim and Abdulhussain*, No.1 10-57557 (Bankr.E.D.Mich 12/16/10).

### Practical tips

If the characterization of a particular debt that is not clear-cut in this jurisdiction, such as tax debt, enables your client to pass the means test, how should you tackle the situation?

That really depends on how aggressive you want to be. My recommendation is to take an aggressive position as long as it is reasonable and you have a good basis for taking your position. You should be prepared for presenting your arguments to the U.S. Trustee as they have the initial burden of proof to support a dismissal motion under § 707(b).

You would also want to review the matter with your client before filing the petition and prepare a letter that the client signs, acknowledging the aggressive position and the potential risk of defending a dreaded §707(b) motion that the U.S. Trustee brings. Defending §707(b) motions will certainly be a topic for a future column.

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