

**Self-Employed Debtors Face A Hard Truth When Calculating their Current Monthly  
Income for the Applicable Commitment Periods under Chapter 13 Plans**

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**Introduction**

A bankruptcy court may confirm a debtor's chapter 13 plan of reorganization if the requirements of section 1325(a) of the Bankruptcy Code are satisfied.<sup>1</sup> If the chapter 13 trustee or an unsecured creditor objects to the confirmation of the plan, however, the bankruptcy court may only confirm the plan if it either provides for the repayment in full of claims or that the debtor must devote all of his projected disposable income towards payments of his unsecured creditors during the plan's "applicable commitment period."<sup>2</sup> The debtor's applicable commitment period is five years if the debtor's current monthly income exceeds the state median family income for the debtor's state and household size. Alternatively, a debtor's commitment period will be three years if the debtor's current monthly income is below the state median family income for the debtor's state and household size.<sup>3</sup> Accordingly, all chapter 13 debtors must calculate their current monthly income.

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<sup>1</sup> 11 U.S.C. 1325(b)(4)(A)(ii) (2012) (providing formula using multiplier of 12 to current monthly income of debtor to determine whether three or five year plan is appropriate).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

While such calculation is relatively straight forward for most chapter 13 debtors, self-employed debtors face some uncertainty when calculating their current monthly income because of a conflict between section 101(10A) of the Bankruptcy Code and Official Form 22C. Under section 101(10A),<sup>4</sup> a self-employed debtor is directed to include all sources of income when calculating his current monthly income, including gross business receipts. Section 101(10A), however, does not provide that a self-employed debtor may deduct his ordinary and necessary business expenses when performing such calculation.<sup>5</sup> Like all chapter 13 debtors, self-employed chapter 13 debtors will complete Official Form 22C,<sup>6</sup> which is used to calculate the debtor's current monthly income and the plan's applicable commitment period.

Using the Form 22C, however, may be problematic for a self-employed chapter 13 debtor because, unlike section 101(10A), Line 3b of Form 22C allows for the deduction of ordinary and necessary business expenses from gross business receipts that are listed on Line 3a, which reduces the self-employed debtor's current monthly income which in turn increases the likelihood that the debtor will have a shorter applicable commitment period.<sup>7</sup> Given the inconsistency between section 110(10A) and Form 22C, it is hardly surprising that courts have

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<sup>4</sup> See 11 U.S.C. §101(10A) (2012) (defining current monthly income as “all sources that the debtor receives” . . .).

<sup>5</sup> *Id.*

<sup>6</sup> Official Form of Commitment Period and Disposable Income (Chapter 13) (04/13) Line 3a-3c. Every debtor is required to fill this form out prior to filing their chapter 13 plan. *Id.*

<sup>7</sup> *Id.*

been called upon to resolve this conflict.<sup>8</sup> Currently, courts are split as to whether self-employed debtors should use the Bankruptcy Code's formula of the Form 22C formula.<sup>9</sup>

This Article discusses the conflicting approaches applied by the court and examines the potential impact of each approach on a self-employed debtor. Part I discusses the relevant Bankruptcy Code provisions and conflicting Official Bankruptcy Form 22C. Part II discusses the current court split as to whether a self-employed, chapter 13 debtor may deduct ordinary and necessary business expenses when calculating his current monthly income. Part IV analyzes the implications of each approach.

## **I. The Conflict Between the Bankruptcy Code and the Official Bankruptcy Form**

As noted above, the Bankruptcy Code's formula for calculating a debtor's current monthly income conflicts the formula provided in Form 22C. In particular, section 101(10A)(A) of the Bankruptcy Code defines "currently monthly income"<sup>10</sup> to mean "the average monthly income from all sources that the debtor receives . . . without regard to whether such income is taxable income, derived during a the 6-month period . . . ." Importantly, unlike section 1325(b)(2)(B) (which provides the formula for calculating a debtor's disposable income), section 101(10A) does not provide that a self-employed, chapter 13 debtor may deduct his ordinary and necessary business expenses from his gross business receipts when calculating his current

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<sup>8</sup> See *Drummond v. Wiegand*, (In re *Wiegand*) 386 B.R. 238, 238 (B.A.P. 9th Cir. 2008); see also *In re Arnold*, 376 B.R. 652, 654 (Bankr. M.D. Tenn, 2007); *In re Bembenek*, No.08-22607-svk, 2008 WL 2705289, at 1 (Bankr. E.D. Wisc. July 2, 2008); *In re Harkins*, 491 B.R. 518, 519 (Bankr. S.D. Ohio 2013); *In re Compann*, 459 B.R. 478, 483 (Bankr. N.D. Ga. 2010); but see *In re Romero*, No. 12-20793-BKC-AJC, at \*1 (Bankr. S.D. Fla. 2013); *In re Roman*, No. 11-01415 BKT, 2011 WL 5593143, at \*1. (Bankr. D.P.R. Nov. 16, 2011).

<sup>9</sup> See 11 U.S.C. §1325(4)(B) (requiring three year plan or five year plan when current monthly income of debtor, when multiplied by 12, is greater than similarly situated families median income in State where debtor is filing); *contra* Official Form of Commitment Period and Disposable Income (Chapter 13) (04/13) Line 3a-3c (mirroring Code's formula calculation while additionally providing for deduction of ordinary and necessary business expenses).

<sup>10</sup> 11 U.S.C. 101(10)(A) (2012).

monthly income. Official Form 22C's calculation, on the other hand, allows a self-employed, chapter 13 debtor, who receives his income from operating a business, profession or farm, to deduct such expenses from gross receipts to calculate his current monthly income.<sup>11</sup>

As with all chapter 13 debtors, if a self-employed, chapter 13 debtor does not intend to fully repay his creditor,<sup>12</sup> his plan's applicable commitment period will be determined determined by comparing his current monthly income to that of the median income for a family of the same as the debtor's that resides in the debtor's state.<sup>13</sup> If the debtor's income is above the median, then his plan will have a five-year commitment period. Alternatively, if the debtor's income is below the median, the his plan will have a three-year applicable commitment period.

Therefore, whether a self-employed, chapter 13 can deduct his ordinary and necessary business expenses may be of particular significance because in many cases, the applicability of such deduction will determine whether the debtor's income is above-median. Thus, in order to obtain a discharge, a self-employed, chapter 13 debtor may have make payments under his plan for two years more than he would have had he been able to deduct such expenses. Currently, courts have split as to which formula a self-employed, chapter 13 debtor must apply when calculating his current monthly income.

## II. The Majority View

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<sup>11</sup> Official Form of Commitment Period and Disposable Income (Chapter 13) (04/13) Line 3a-3c.

<sup>12</sup> See 11 U.S.C. §1325(4)(B) (providing that a 100% repayment plan may be less than 3 or five years).

<sup>13</sup> *Id.* (requiring three year plan or five year plan when the current monthly income of debtor, when multiplied by 12, is greater than similarly situated families median income in State where debtor is filing).

As previously mentioned, the majority of courts addressing the conflict between section 101(10A) and Form 22C have adopted a plain meaning approach<sup>14</sup> and held that a self-employed, chapter 13 debtor cannot deduct his ordinary and necessary business expenses when calculating his current monthly income. As a result, under the majority view, a self-employed, chapter 13 debtor's current monthly income will be greater than if would had he used the formula provided in Form 22C, which increases the likelihood that the debtor's plan will limited to a five-year plan.

The leading case adopting the majority vies is *Drummond v. Wiegand (In re Wiegand)*,<sup>15</sup> where the Bankruptcy Appellate Panel for the Nine Circuit held that a self-employed, chapter 13 debtor could not deduct ordinary and necessary business expenses from gross business receipts when calculating his current monthly income. In so holding, the *Wiegand* court noted that unlike section 1325(b)(2)(B), section 101(10A) did not explicitly permit the deduction ordinary and necessary business expenses. The *Wiegand* court reasoned that the fact that one section provided for such a deduction while the other did not indicated Congress did intend to permit a self-employed, chapter 13 debtor to be able to deduct his ordinary and necessary business expenses when calculating his current monthly income.<sup>16</sup> Indeed, the *Wiegand* court noted that had Congress permitted self-employed, chapter 13 debtors when calculating their "current monthly income," to use net profits rather than gross profits it would have done so. Moreover, the *Wiegand* court also opined that permitting a self-employed, chapter 13 debtor to deduct his

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<sup>14</sup> See *Drummond v. Wiegand, (In re Wiegand)* 386 B.R. 238, 238 (B.A.P. 9th Cir. 2008); see also *In re Arnold*, 376 B.R. 652, 654 (Bankr. M.D. Tenn, 2007); *In re Bembenek*, No.08-22607-svk, 2008 WL 2705289, at 1(Bankr. E.D. Wisc. July 2, 2008); *In re Harkins*, 491 B.R. 518, 519 (Bankr. S.D. Ohio 2013); *In re Compann*, 459 B.R. 478, 483 (Bankr. N.D. Ga. 2010); but see *In re Romero*, No. 12-20793-BKC-AJC, at \*1 (Bankr. S.D. Fla. 2013); *In re Roman*, No. 11-01415 BKT, 2011 WL 5593143, at \*1. (Bankr. D.P.R. Nov. 16, 2011).

<sup>15</sup> *In re Wiegand*, 386 B.R. at 239.

<sup>16</sup> See 11 U.S.C. §1325(b)(2)(B).

ordinary and necessary business expenses when expenses when calculating his currently monthly income would lead to the absurd result of the debtor being able to deduct such expenses for a second time when he calculated his disposable income.<sup>17</sup> Additionally, the *Wiegand* court reasoned that section 101(10A)'s language "without regard to whether such income is taxable income" reflected Congress's intent<sup>18</sup> to disregard the concepts found within the Internal Revenue Code for determining taxable income, including deducting ordinary and necessary business expenses.<sup>19</sup>

Thus, under the majority view, a self-employed, chapter 13 debtor cannot rely on Form 22C when calculating his current monthly income. As a result, such a debtor must use his gross business receipts instead of his net business receipts when calculating his current monthly income, thereby increasing the chance that the debtor's plan will need to have a five-year applicable commitment period.

### **III. The Minority View**

Under the minority view, a debtor may use his net business receipts when calculating his "current monthly income."<sup>20</sup> Specifically, courts adopting the minority view have found that it would be inequitable to require a self-employed, chapter debtor to use his gross business receipts when calculating his "current monthly income" because doing so increases the likelihood that such debtors "current monthly income" would be above-median, thereby possibly forcing the

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<sup>17</sup> See *In re Wiegand*, 386 B.R. at 239

<sup>18</sup> *Id.* at 242.

<sup>19</sup> Ordinarily, self-employed individuals are permitted to, on IRS Form 1040, to deduct their ordinary and necessary business expenses from their overall income in order to calculate their taxable income.

<sup>20</sup> See *Romero*, No. 12-20793-BKC-AJC, at \*3; see also *Roman*, 2011 WL 5593143, at \*3.

debtor to propose a five-year plan.<sup>21</sup> In particular, such courts have opined that such a result potentially penalizes self-employed, chapter 13 debtor for being self-employed because such a debtor could be forced to have a plan with a five-year applicable commitment period, while another employed, chapter 13 debtor with the same net income as the self-employed, chapter 13 debtor could confirm a plan with a three-year commitment period.

For example, in *In re Romero*,<sup>22</sup> the court held that the debtor was allowed to deduct his ordinary and necessary business operating expenses when calculating his “current monthly income.”<sup>23</sup> In so holding the *Romero* court reasoned “[accepting] [t]he trustee’s calculation [of current monthly income] would artificially inflate the debtor’s income by including, as part of the debtor’s income, the business revenue that would be consumed by business expenses,” which in turn could force the debtor into a plan with a five-year commitment period.<sup>24</sup>

In *Romero*, the self-employed debtor originally proposed a plan with a three-year applicable commitment period, which reflected the debtor calculating his current monthly income by deducting ordinary and necessary business expenses.<sup>25</sup> The trustee objected to the plan, arguing that this calculation does not conform to Bankruptcy Code section 110(10A)’s calculation method. In overruling the trustee objection, the *Romero* court cited the public policy of equity and fairness.<sup>26</sup> The *Romero* court noted that permitting self-employed, chapter to use his net business receipts was necessary to prevent the “prejudicial result” that occurs when a self-employed, chapter 13 debtor’s income is “artificially inflat[ed]” by the inclusion of gross

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<sup>21</sup> *Id.*

<sup>22</sup> *See* *Romero*, No. 12–20793–BKC–AJC at \*3.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at \*1.

<sup>26</sup> The court held that deducting ordinary and necessary business expenses when calculating current monthly income resulted in “prejudicial treatment to business proprietors” under the Bankruptcy Code. *Id.* at \*2.

business receipts, which includes income that the debtor does not benefit from, in calculating the debtor's current monthly income, which could result in these debtor's having to file a plan with a five-year commitment period, as compared to a chapter 13 debtor, who is employed by another, earning similar take home income pay, that is not "artificially inflated" by ordinary and necessary business expenses.<sup>27</sup>

Thus, under the minority view, since a self-employed, chapter 13 debtor will be permitted to deduct his ordinary and necessary business expenses from his gross business receipts, it is more likely that the debtor will be able to confirm a plan with a three-year commitment period. As result of being able to take such a deduction, self-employed, chapter 13 debtors will be treated similarly to those employed, debtors who are paid a similar amount.

#### **IV. Implications and Possible Issues**

As noted above, whether a self-employed, chapter 13 debtor can deduct his necessary and ordinary business expenses when calculating his current monthly income is often extremely significant because the ultimate determination of that question may dictate whether the debtor must remain in bankruptcy for additional two years in order to obtain a discharge. It is important to remember, however, that while this issue is important to self-employed, debtors filing for chapter 13 bankruptcy, this split will not be relevant to vast majority of debtors, who will either be employed by another person or choose to filed for chapter 7 bankruptcy rather than chapter 13.

In jurisdiction adopting the majority view, self-employed, chapter 13 debtors, are forced to use gross business receipts, resulting in an (arguably unfairly) inflated amount that will be

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<sup>27</sup> Id at \*2-\*3



used to determine their plans' applicable commitment periods.<sup>28</sup> As a result, a self-employed, chapter 13 debtor will be more likely to have an above-medium current monthly income as compared to a debtor who is employed by another person, even if both debtors have the same take-home income at the end of the day. This is particularly, true for self-employed, chapter 13 debtors whose businesses have high revenues but a low profit margin.

Forcing a self-employed, chapter 13 debtor to remain in bankruptcy for an additional two years can have significant consequences for the debtor. The most obvious consequence is that such debtor will be required to remain under the supervision of the court for two more years. As such, in order to obtain a discharge, the debtor will be required to contribute an additional two years of disposable income towards repaying his creditors. As a result, the total cost of the discharge will be significantly higher than it would have been otherwise. This assumes, however, that the debtor will actually receive a discharge at all.

Chapter 13 plans already have a high noncompletion rate, as there are many reasons that a debtor may fail to complete his plan. For example, an unforeseen future event, such as an illness or a divorce, may make it financially impossible for a debtor to complete his plan. Accordingly, it stands to reason, that the longer the debtor remains in bankruptcy, the more likely it will be that he does not complete the plan.

At the end of the day, a self-employed debtor may be better off filing under chapter 7 rather than chapter 13. Doing so would greatly decrease the time required for the debtor to receive a discharge. In addition, the debtor may be able to achieve the same results in chapter 7

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<sup>28</sup> In re Hoffman, 511 B.R. at 137 (“[T]he Court agrees with the rationales employed by *Harkins*, *Wiegand*, *Arnold*, . . . [and] *Compann*” regarding proper calculation of debtors current monthly income for use in determining debtors applicable commitment period).

than he would in chapter 13. For example, while many a debtor will often file under chapter 13 in order to save his home, a debtor may be able to save his home in chapter 7 by obtaining a mortgage modification through a court-sponsored loss-mitigation program.

## **Conclusion**

The Bankruptcy Code and Form 22C conflict as to whether a self-employed, chapter 13 debtor may deduct his ordinary and necessary business operating expenses from his current monthly income. As it stands now, courts are split over this issue, with a majority of the courts have resolved this issue answering in the negative. The issue is of particular significance because if a self-employed, chapter 13 debtor is unable to take such a deduction, his current monthly income will increase, which in turn increases the likelihood that he forced to propose a plan with a five-year applicable commitment period.