

Should a Bankruptcy Court Consider a Debtor's Social Security Income When Determining Whether His Chapter 13 Plan is Feasible?

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Introduction

Chapter 13 of the Bankruptcy Code provides individuals the opportunity to reorganize their debt obligations.¹ This adjustment chapter permits an individual debtor to keep his nonexempt assets but requires that he make payments for three to five years through a repayment plan.² During this repayment period, the individual debtor uses his disposable income to fulfill his debts.³ After all of the payments are made to creditors, the debtor receives a discharge.⁴

If the trustee or an unsecured creditor objects to the plan, a court must determine if the plan can fulfill the unsecured claim and allow the debtor's "projected disposable income" during the commitment period to make payments toward those claims.⁵ Calculation of "projected disposable income" is also involved in the "means test" - a new threshold test determining if an

¹ See DOUGLAS G. BAIRD, THOMAS H. JACKSON & BARRY E. ADLER, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 25 (4th ed. 2007) (highlighting chapter 13's objectives).

² See *id.* at 25-26.

³ See *id.*

⁴ See 11 U.S.C. § 1328 (2012) (explaining, notwithstanding certain exceptions, courts "shall grant the debtor a discharge of all debts provided for by the plan . . ." upon completion of the commitment repayment period).

⁵ See § 1325(b)(1) (listing requirements to overcome an objection to confirmation of a plan).

individual consumer debtor can file for chapter 7.⁶ Additionally, a court must confirm a repayment plan. One of the elements required for court confirmation is that a plan is “feasible.” In order to be considered feasible, “a debtor's plan must have a reasonable likelihood of success, i.e., that it is likely that the debtor will have the necessary resources to make all payments as directed by the plan.”⁷ Therefore, a debtor’s personal income and expenses are important factors in chapter 13 petitions.

There are many issues that arise in the context of plan confirmation but there are two that are particularly important and usually highly contested. First, plans must determine what income should be included within “projected disposable income” - this value is necessary to calculate the repayment plan. Second, if Social Security funds are excluded, may a bankruptcy court consider this excluded income when determining whether the chapter 13 plan is feasible. Both issues must be considered in light of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005’s (“BAPCPA”)⁸ purposes to “to correct perceived abuses of the bankruptcy system” of underreporting disposable income while allowing debtors to repay creditors to their utmost abilities.⁹

⁶ The 2005 Code reforms also created a “means test” which places limitations on individual consumer debtors who seek bankruptcy chapter 7 relief and pushes able debtors toward chapter 13. *See* BAIRD, JACKSON & ADLER, *supra* note 1 at 79. This test focuses on the debtor’s ability to repay debt. *See id.* The “means test” takes the current monthly income, multiplied by twelve to get the annual income. *See* §§ 1325(b)(3), 707(b)(2) (explaining confirmation plan calculations and exclusions). If a consumer makes more than the state’s median income and has enough disposable income to make substantial repayments to creditors he is precluded from chapter 7 bankruptcy absent extraordinary circumstances. *See* §§ 1325(b)(3), 707(b)(2).

⁷ *In re Fantasia*, 211 B.R. 420, 423 (B.A.P. 1st Cir. 1997) (explaining judicial discretion in confirming chapter 13 repayment plans)

⁸ *See* Pub.L. No. 109-8, 119 Stat. 23 (2005).

⁹ *Ransom v. FIA Card Servs., N.A.*, 131 S. Ct. 716, 721 (2011) (quoting *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010) (illustrating purposes surrounding 2005 Bankruptcy Code reforms)).

This Article discusses the relevant case law regarding both issues.¹⁰ Part I explains why Social Security income is excluded from “projected disposable income.” Part II examines the circuit split as to why a court should confirm a chapter 13 plan that provides for a debtor to use funds that are excluded the projected disposable income test to fund the payments under the plan. Finally, Part III summarizes the implications of allowing excluded Social Security income to fund such plans.

I. Social Security Income is Excluded from “Projected Disposable Income”

In a chapter 13 bankruptcy case, a debtor’s entire “projected disposable income” for three or five-years (depending on numerous factors)¹¹ must be paid out under the plan.¹² As explained in the Bankruptcy Code, this repayment plan must meet certain requirements and must be approved by a bankruptcy court.¹³ If the trustee or an unsecured creditor objects to the plan, a court must determine if the plan provides for the full repayment of the unsecured claims or provides for all of the debtor’s “projected disposable income” during the commitment period to be used make payments toward those claims.¹⁴

Prior to BAPCPA, “disposable income” was defined as the excess of “income which is received by the debtor,” excluding money needed for support and maintenance of the debtor and his dependents, certain business expenses, and certain charitable contributions.¹⁵ Section 1325(b) of the pre-BAPCPA Bankruptcy Code had a “disposable income test.”¹⁶ Under this test,

¹⁰ 721 F.3d 241, 243 (4th Cir. 2013) (holding although Social Security monies are excluded from “projected disposable income, courts must consider those monies when evaluating plan feasibility).

¹¹ *Chapter 13 Bankruptcy Plan Length*, THEBANKRUPTCYSITE.ORG, <http://www.thebankruptcysite.org/resources/bankruptcy/chapter-13/how-long-will-my-chapter-13-bankrup> (listing the factors).

¹² *See* 11 U.S.C. §§1301-1330 (2012) (outlining chapter 13’s repayment method).

¹³ *See id.* § 1325(a) (explaining confirmation of a plan).

¹⁴ *See id.* § 1325(b)(1) (listing requirements to overcome an objection to confirmation of a plan).

¹⁵ 11 U.S.C. § 1325(b)(2) (2000) (explaining pre-BAPCPA classification of “disposable income”).

¹⁶ *Id.* § 1325(b) (describing the previous “disposable income test”).

“projected disposable income” included all of the debtor’s “disposable income” for a month, multiplied by the length of the commitment period.¹⁷

In 2005, BAPCPA redefined “disposable income” as “current monthly income received by the debtor,” excluding money reasonably necessary for support and maintenance of the debtor, certain business expenses, and certain charitable contributions.¹⁸ Section 101(10A) defines “current monthly income” as “the average monthly income from all sources that the debtors receives” for the last six months before commencement of the proceeding, excluding “benefits received under the Social Security Act.”¹⁹ Therefore, the “disposable income” test was altered by the BAPCPA reforms. Now, “disposable income” is not based on an individual debtor’s “current disposable income,” but rather on his average income over the last six months.²⁰

It is well settled that Social Security income is not included in determining the debtor’s “disposable income” for two main reasons. First, courts have opined that since the Bankruptcy Code excludes Social Security income from definition of “current monthly income,” Congress also intended it to be excluded from “projected disposable income.”²¹ For example, in *Hamilton v. Lanning*,²² the Supreme Court explained that “projected disposable income” is calculated by multiplying “disposable income” after the deductions by the three- or five-year commitment

¹⁷ For example, if the disposable income, less the exemptions as provided in section 1325(b)(2), amounted to \$300 dollars and there was a 5 year (60 months) commitment period, then the total paid into the plan by the debtor would be \$18,000.

¹⁸ 11 U.S.C. § 1325(b)(2) (2012).

¹⁹ *Id.* §101(10A) (defining “current monthly income”).

²⁰ *See id.*

²¹ *See id.*; *see also In re Ranta*, 721 F.3d 241, 251 (4th Cir. 2013) (citing *In re Welsh*, 711 F.3d 1120, 1127 n. 28, 1130–31 (9th Cir.2013) (explaining the Code clearly excludes Social Security income); *In re Ragos*, 700 F.3d 220, 223 (5th Cir. 2012) (same); *In re Cranmer*, 697 F.3d 1314, 1317–18 (10th Cir. 2012) (same); *Baud v. Carroll*, 634 F.3d 327, 345 (6th Cir. 2011) (same)).

²² 130 S. Ct. 2426, 2469 (2010) (reasoning Social Security income must be excluded from “disposable income” because of statutory construction).

periods.²³ Since Social Security monies are excluded from “current monthly income,” and “disposable income” includes “current monthly income,” disposable income also excludes Social Security monies.²⁴ The Court reasoned that Social Security income must also be excluded from “projected disposable income” since it is merely a multiplication of “disposable income.”²⁵

A second reason that Social Security income should be excluded from the determination of the debtor’s “disposable income,” is because the Social Security Act, a non-bankruptcy provision, protects Social Security income from bankruptcy law.²⁶ For example, in *In re Carpenter*, the Eighth Circuit concluded that the Social Security Act’s provision barred forcible inclusion of Social Security benefits in the bankruptcy estate under a chapter 7 proceeding.²⁷ By analogy, the Eight Circuit inferred that Congress also intended to protect a Social Security recipient’s benefits from a chapter 13 distribution proceeding.

Therefore, there is a strong consensus derived from case law and non-bankruptcy statutes that Social Security income shall not be included in calculating “projected disposable income.”²⁸ There is a lack of consensus, however, regarding whether that excluded Social Security money could be considered when determining the feasibility of a chapter 13 plan.²⁹

²³ *See id.* at 2469.

²⁴ *See id.*

²⁵ *See Ranta*, 721 F.3d at 251 (excluding Social Security income from “projected disposable income” based on reasoning of *Hamilton v. Lanning*).

²⁶ *See* 42 U.S.C. § 407 (2012) (“The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.”).

²⁷ *In re Carpenter*, 614 F.3d 930, 936 (8th Cir. 2010) (holding anti-assignment provisions of the Social Security Act completely bars forced inclusion of social security monies in bankruptcy estates).

²⁸ Some circuits have not yet addressed the issue of including Social Security benefits to a chapter 13 plan. *See In re Wheeler*, 503 B.R. 694 (Bankr. N.D. Ind. 2013). Recently, in *In re Wheeler*, a bankruptcy court determined that a debtor who failed to report a Social Security award she received during one year of her chapter 13 plan violated her duty to disclose under section 521(f)(4). Although the court did not specifically address the issue of Social Security income inclusion in a plan, this case is evidence that many lower courts are unsure of where Security funds fit within bankruptcy proceedings.

²⁹ *See Ranta*, 721 F.3d at 253.

II. Should a Court Find that a Plan is Feasible if the Debtor Proposes to Fund the Plan with His Social Security Income

As mentioned above, repayment plans under chapter 13 must satisfy a few conditions. First, unless otherwise stipulated, the plan must fully satisfy all allowed claims and administrative expenses that have priority pursuant to section 507.³⁰ Second, the plan must ensure that the property repayment to each unsecured claim is not less than the amount that would be paid if the debtor were to undergo liquidation under a chapter 7 proceeding.³¹ Additionally, in order for a court to confirm a plan, the debtor must ensure that his proposed plan meets the various requirements set out under section 1325(a).³² The main requirements include, among other things, that the plan must ensure that secured claims are paid in full,³³ be proposed in good faith,³⁴ and be considered “feasible.”³⁵ If all of the requirements are met, a court shall confirm the plan.³⁶

Courts are split on how to treat Social Security income when considering whether the plan is feasible. A minority of courts have decided that there should be a *per se* rejection of a plan if the required monthly payments under the plan are greater than a debtor’s “projected disposable income,” even if the debtor proposes to use other funds, such as Social Security

³⁰ See 11 U.S.C. § 507 (2012) (explaining priority repayment order of creditors).

³¹ See *id.* §1325(a)(4) (requiring chapter 13 plans to ensure a minimum amount of repayment as would be seen under a chapter 7 liquidation).

³² See *id.* §1325(a) (setting out various requirements chapter 13 debtors must meet for a court to confirm the repayment plan).

³³ *Id.* § 1325(a)(5).

³⁴ *Id.* § 1325(a)(3); see also Casey J. Davis, *Not So Secure: Should Social Security Benefits Be Considered in the Good Faith Analysis Under 11 U.S.C. S 1325(a)(3)?*, 47 AKRON L. REV. 255, 266–67 (2014) (explaining that although “good faith” is not defined in the Bankruptcy Code provisions, courts must determine, in the totality of the circumstances, if a debtor’s filing was done with respect and in spirit with the purposes of chapter 13).

³⁵ 11 U.S.C. § 1325(a)(6) (2012).

³⁶ See *id.* § 1325(a).

income, to fund the plan.³⁷ For example, in *In re Schanuth*, the bankruptcy court accepted the formalist rule that a plan is not feasible and cannot be confirmed if the monthly payment plans exceed the debtor's monthly disposable income.³⁸

In reaching that conclusion, the *Schanuth* court cited cases considered before the passage of BAPCPA.³⁹ Those pre-reform cases did not weigh the revised definition of “disposable income,” nor did they consider Congress's intent to pushing individual debtors away from chapter 7 and towards chapter 13 filings that ensure that these debtors who can pay a portion of their debts do pay.⁴⁰ Therefore, the *Schanuth* court presupposed that “the law on this point is clear,” without considering post-BAPCPA case law and Congressional intent.⁴¹

The majority view, however, weighs the purpose of the BAPCPA and Congress's reasoning behind the reforms while determining a plan's feasibility and relation to sources of disposable income. A majority of courts conclude that a debtor may use Social Security income, as well as other forms of income that are excluded from the definition of “disposable income,” to make payments under a plan.⁴² For example, the Sixth Circuit, in *Baud v. Carroll*, concluded that “a debtor with zero or negative projected disposable income may propose a confirmable plan by making available income that falls outside of the definition of disposable income”⁴³ As

³⁷ See *In re Schanuth*, 342 B.R. 601, 605 (Bankr. W.D. Mo. 2006) (rejecting the feasibility of debtor's plan because the monthly payments were in excess of the debtor's “disposable income”).

³⁸ *Id.*

³⁹ See *In re Sully*, 223 B.R. 582, 585–86 (Bankr. M.D. Fla. 1998) (rejecting a plan's feasibility where the payment schedule exceeded debtor's monthly income); see also *In re Wilkinson*, 99 B.R. 366 (Bankr. N.D. Ohio 1989) (same).

⁴⁰ See *Ranta*, 721 F.3d at 249 (rejecting application of *Schanuth*).

⁴¹ *Schanuth*, 342 B.R. at 605.

⁴² See *Ranta*, 721 F.3d at 254.

⁴³ 634 F.3d 327, 352 n. 19 (6th Cir. 2011).

such, the majority view adopts a functional approach; oftentimes the use of Social Security income is the only way a debtor can propose and fulfill his feasibility plan.⁴⁴

Additionally, the pragmatic majority approach coincides with other provisions within the Bankruptcy Code and congressional intent. Even when a court has doubts about feasibility of a plan, the debtor should usually be permitted to attempt their proposed plan.⁴⁵ So although the Congress intended to prevent fraudulent bankruptcy filings and the abuse of the bankruptcy system when it passed BAPCPA, Congress did not intend to “throw this kind of obstacle to relief in the way of Social Security recipients”⁴⁶

Many Post-BAPCPA cases are consistent with Congress’s intent, and the overall purpose of bankruptcy, which urges debtors to repay creditors to the greatest possible extent. For example, in *In re Kibbe*, the Bankruptcy Appellate Panel for the First Circuit explained, “Congress intended that debtors pay the greatest amount within their capabilities. Nothing more; nothing less.”⁴⁷ Similarly, in *Baud v. Carroll*⁴⁸ the Sixth Circuit concluded “it is appropriate to calculate a debtor's projected disposable income using the inclusions and exclusions from disposable income . . . that are known or virtually certain at the time of confirmation.”⁴⁹ If the Social Security income is a certain and stable source of income, it follows in the best interest of creditors and the debtor for a court to consider such income when determining whether a plan is feasibility. Moreover, if a debtor can use money from family and friends to fund his plan even

⁴⁴ *See id.*

⁴⁵ *See generally* § 1326(a)(6); *see also* 8-1325 COLLIER ON BANKRUPTCY, ¶1325.07 (16th ed. 2013) (“Even when the court has serious doubts about feasibility, these debtors should usually be given a chance to attempt their proposed plan, especially if they have substantially complied with their plan obligations prior to confirmation.”).

⁴⁶ *Ranta*, 721 F.3d at 254.

⁴⁷ *In re Kibbe*, 361 B.R. 302, 314 (B.A.P. 1st Cir. 2007) (indicating Congressional intent behind BAPCPA reforms).

⁴⁸ 634 F.3d at 349 (citing *Kibbe*, 661 B.R. at 314).

⁴⁹ *Id.*

though that money is not included in projected disposable income,⁵⁰ it seems rational to allow a debtor to use his Social Security income to fund his plan.⁵¹

III. Implications

The primary purpose of bankruptcy law is to allow debtors to pay back creditors to the fullest extent possible, in a fair and organized procedure and to give the debtor a “fresh start.” A Social Security recipient who withholds his Social Security income will have a lower projected disposable income, which in turn will allow him to confirm a plan that provides for lower payments to unsecured creditors. However, by allowing debtors to use exempt monies to fund repayment plans,⁵² the majority view increases the likelihood that a debtor who proposes to use Social Security income to fund a plan will be able confirm that plan because the bankruptcy court must consider that income in evaluating the plan’s feasibility under section 1325(a)(6). This outcome likely benefits the debtor because it increases the chances that the debtor can confirm a plan that provides for lower payments to creditors.

Although chapter 13 debtors may appear to gain the upper hand by excluding Social Security income from their “projected disposable income,” unsecured creditors may not lose out in the long run. The majority approach will likely further the goals of the BAPCPA reforms. In particular, under the majority approach, a debtor who receives Social Security benefits will now

⁵⁰ See *In re Hanlin*, 211 B.R. 147, 149 (Bankr. W.D.N.Y. 1997) (noting assistance from family and friends can fund plans for debtor’s eligible for Chapter 13).

⁵¹ See generally *In re Antoine*, 208 B.R. 17, 20 (Bankr. E.D.N.Y. 1997) (quoting *In re Fischel*, 103 B.R. 44, 48 (Bankr. N.D.N.Y. 1987) (determining whether an individual has “regular income” sufficient to remain eligible for Chapter 13, depends on the income’s “stability and regularity” and not its source)).

⁵² See *Baud*, 634 F.3d at 349 (concluding a debtor “may propose a confirmable plan by making available income that falls outside of the definition of disposable income”); see also *Kibbe*, 661 B.R. at 314 (same).

be able to use funds otherwise excluded from the plan to pay back creditors to the fullest extent possible.

Conversely, the minority approach may inadvertently undermining congressional intent. Under the minority approach, the court will consider a debtor’s proposal to use his Social Security in to fund the payments under the proposed plan when the court determines whether the proposed plan is feasible. This refusal makes it less likely that the debtor will be able to confirm the plan, which in turn makes it less likely that the individual debtor will repay a portion of his debt to creditors to the maximum extent possible.⁵³ Such a result is at odds with one of the fundamental goals of BAPCPA.

Conclusion

The purpose of the BAPCPA was to ensure that those who can repay creditors “should be forced to do so”⁵⁴ Before the 2005 reforms, only one-third of chapter 13 petitioners successfully completed their repayment plans;⁵⁵ the majority approach may increase the chapter 13-success rate. Although exclusion of Social Security income will shrink the amount of “projected disposable income” available in chapter 13 consumer debtor repayment plans, the function approach to reviewing the feasibility requirement will allow debtors to use these exempt Social Security funds to make more regular, stable payments to creditors.

⁵³ See BAIRD, JACKSON & ADLER, *supra* note 1 at 25-26 (stating purposes of chapter 13).

⁵⁴ *Id.* at 624.

⁵⁵ *See id.*