

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re
Charlene Spraggins,
Debtor.

Chapter 13
Case No. 07-24728-svk

Supplemental Opinion to Address *Navejer v. King*

On April 11, 2008, this Court issued a Memorandum Decision overruling the Trustee's Objection to Confirmation of the Debtor's Chapter 13 plan, and on April 17, 2008, entered an Order Confirming the Plan. The Trustee appealed, and in his "Memorandum in Support of Motion to Stay Pending Appeal," noted that this Court's opinion "directly conflicts with the District Court's decision in *In re Navejer*, Case No. 07-C-654 (E.D.WI October 22, 2007)." This Court had intended to address *Navejer* in the April 11, 2008 decision, but failed to do so. The purpose of this Supplemental Opinion is to provide the Court's rationale for holding, in apparent conflict with *Navejer*, that one-half of the tax refunds of a below-median income debtor do not have to be dedicated to the Chapter 13 plan, if the debtor accurately accounts for the actual taxes incurred, or if the debtor dedicates the tax refunds for 3 years of the plan.

Effective October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) made sweeping changes to the Bankruptcy Code. Perhaps the most dramatic of those changes was a "means test" to determine a prospective debtor's eligibility for Chapter 7 bankruptcy relief. Generally, to apply the means test, the debtor's income is compared to the state median for the debtor's household size. If the debtor's income is below the state median, the debtor generally qualifies for Chapter 7 relief. If the debtor's income is above the median, the debtor is allowed to deduct expenses (some of which are standardized by local and national IRS standards, while others are actual expenses incurred by the debtor). If the net result shows that the debtor can fund a Chapter 13 plan, then the debtor is presumed to be abusing Chapter 7, and unless the debtor can demonstrate special circumstances, the debtor's case must be dismissed or converted to Chapter 13 or Chapter 11.

Under BAPCPA, whether the debtor is above or below the state median income also has great impact in Chapter 13. The "applicable commitment period" (a new BAPCPA term) is three years for below-median debtors and five years for above-median debtors. See 11 U.S.C. § 1322(d). Moreover, for above-median debtors, the expenses to be subtracted to reach the projected disposable income to be dedicated to the Chapter 13 plan, "shall be determined" in accordance with § 707(b)(2), i.e., the Chapter 7 means test. 11 U.S.C. § 1325(b)(3). Obviously, the definition of income is a critical component as the starting point for the application of the Chapter 7 means test and the Chapter 13 disposable income analysis.

And BAPCPA provides a completely new definition of income for these purposes. Section 101(10A) of the Bankruptcy Code, added by BAPCPA, states that

“current monthly income” is “the average monthly income that the debtor receives . . . without regard to whether such income is taxable income, derived during the 6-month period ending on the last day of the calendar month immediately preceding the commencement of the case . . .” Current monthly income is not “current” at all, rather it is a historical average of the debtor’s gross income from the six months prior to the petition. *See Coop v. Frederickson (In re Frederickson)*, 375 B.R. 829 (B.A.P. 8th Cir. 2007). Further, it is clear that current monthly income is gross income, including all sorts of income whether or not taxable. *See* 11 U.S.C. § 101(10A).

In Chapter 13, the debtor subtracts reasonably necessary expenses from current monthly income in order to arrive at projected disposable income. 11 U.S.C. § 1325(b)(2). Section 1325(b)(1)(B) provides that if an unsecured creditor or the Chapter 13 trustee objects, the plan cannot be confirmed unless it provides that all of the debtor’s projected disposable income received in the applicable commitment period will be applied to make payments to unsecured creditors under the plan.

Accordingly, under BAPCPA, the debtor’s gross income from the 6 months prior to the bankruptcy petition is averaged, and then reasonably necessary expenses are subtracted in order to determine projected disposable income. This is different than pre-BAPCPA, when the debtor’s Schedule I (Income) was compared with Schedule J (Expenses) to determine projected disposable income. The difference is especially critical when it comes to taxes because Schedule I is a “net” income number that includes a deduction for payroll deductions that are actually taken by the debtor, while Form B22C (the means test form) starts with a “gross” income number, does not include payroll deductions, but rather instructs the debtor to calculate the taxes “actually incurred.”

Using a comparison of Schedule I and J to determine projected disposable income it is easy to understand why pre-BAPCPA cases, like those relied upon in *Navejer*, held that tax refunds are projected disposable income required to be dedicated to the plan. The excess withholding was built into the calculation by the deduction of the payroll taxes withheld on Schedule I. Under BAPCPA, however, withheld taxes are not deducted to arrive at “current monthly income,” because current monthly income is gross income for the six months prior to the petition. As noted in the Court’s earlier decision, current monthly income is used as the starting point for both above-median and below-median debtors. The difference comes on the expense side of the equation. Accepting the proposition that Form B22C, not Schedule I, is used to compute a below-median debtor’s current monthly income – a proposition dictated by § 1325(b)(2) – distinguishes this case from *Navejer*. It is not clear from that case whether the debtors’ income was above or below the median. Apparently, the debtors argued that one-twelfth of their tax refunds was required every month to pay expenses. The state of the debtors’ Form B22C is not apparent. If the debtors in *Navejer* had deducted the actual taxes incurred from the current monthly income shown on Form B22C, the result may have been different, assuming the debtors’ other allowed expenses reduced disposable income to a net amount that they could afford to pay. On the other hand, if the debtors in *Navejer* deducted the amount of taxes withheld from their paychecks, and then refused to contribute the tax refunds to the plan to compensate for their inflated tax expense, this Court agrees with the result in *Navejer*.

Navejer also relies on *In re Risher*, a BAPCPA case holding that tax refunds constitute projected disposable income under § 1325(b)(1)(B). *See Navejer v. King*, 2007 U.S. Dist. LEXIS 82089 (E.D. Wis. Oct. 22, 2007) (citing *In re Risher*, 344 B.R. 833 (Bankr. W.D. Ky. 2006)). *Risher* applies the “crystal ball” approach of *In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006) which this Court declined to follow in *In re Guzman*, 345 B.R. 640 (Bankr. E.D. Wis. 2006).

In *Guzman*, this Court applied the plain meaning rule to determine projected disposable income under an analysis first set forth in *In re Alexander*, 344 B.R. 742 (Bankr. E.D.N.C. 2006) and *In re Farrar-Johnson*, 353 B.R. 224 (Bankr. N.D. Ill. 2006). This “bright line” approach starts with “current monthly income” defined as the six-month pre-petition average, less the reasonably necessary expenses incurred by the debtor on the date of the petition, as shown by the Form B22C for above-median debtors. No Court of Appeals has yet considered the issue, but the approach has been adopted by the District Court in the Western District of Wisconsin, a Bankruptcy Appellate Panel in the Eighth Circuit, and respected bankruptcy judges in the Northern and Southern Districts of Illinois among others. *See, e.g. Mancl v. Chatterton (In re Mancl)*, 381 B.R. 537 (W.D. Wis. 2008); *Coop v. Frederickson (In re Frederickson)*, 375 B.R. 829 (B.A.P. 8th Cir. 2007); *In re Ross*, 375 B.R. 437, 443 (Bankr. N.D. Ill. 2007); *In re Nance*, 371 B.R. 358 (Bankr. S.D. Ill. 2007). The contrary “crystal ball” approach to “projected disposable income” cited in *Risher* calls for a future estimate, incorporating Schedules I & J into the definition of projected disposable income, arguably adding a component that is no longer present in the text of the Bankruptcy Code as amended by BAPCPA. While pre-BAPCPA, tax refunds were definitely part of projected disposable income, after the amendments, the focus must be on the debtor’s deduction of the *actual* taxes incurred, rather than withheld. *See Boynton v. Boynton (In re Lawson)*, 361 B.R. 215 (Bankr. D. Utah 2007) (acknowledging pre-BAPCPA practice to submit future tax refunds); *see also In re Rither*, 2008 Bankr. LEXIS 1278 (Bankr. E.D. Wis. Apr. 16, 2008) (tax refunds are disposable income for pre-BAPCPA debtor, but for BAPCPA cases “over median income debtors do not have to pay one half of tax refunds because means test requires more rigorous estimation of actual taxes”) (citing *In re Balcerowski*, 353 B.R. 581 (Bankr. E.D. Wis. 2006)).

“Congress’ intent in line 30 [the line on which taxes are deducted] was to determine how much money debtors actually have in their paychecks each month after taxes are withheld and Form B22C ‘is all about hard numbers’ and not ‘crystal ball’ predictions about the size of future tax obligations,” or any other future financial occurrences for that matter. *Lawson*, 361 B.R. at 221. Recognizing that a tax refund is not “income” under BAPCPA, but rather the result of an inflated expense, the question becomes whether the debtor should be able to deduct the taxes withheld, but “even it out” by dedicating the tax refunds to the plan. This seems to be a comfortable way for debtors and trustees to avoid the calculations and complications in estimating actual taxes incurred, and this Court sanctioned the practice for above-median debtors in *In re Stimac*, 366 B.R. 889 (Bankr. E.D. Wis. 2007). In this District, debtors have historically dedicated 50% of the tax refunds to the plan, and the question raised in this case is whether the below-median debtor must dedicate 50% of the refunds for more than three years.

Given the nature of a tax refund as the over-estimation of an expense that is incurred as of the date of the petition, the Court does not find it logical that a below-

median debtor must continue to dedicate tax refunds beyond the three year applicable commitment period. In other words, a tax refund in the fourth year of a plan does not tie into the BAPCPA concept that projected disposable income is the debtor's historical income less expenses incurred as of the date of the petition. Furthermore, if the Court orders the turnover of tax refunds, then under the same rationale, it should also require a debtor to contribute any other expenses that were over-estimated or have decreased since the date of the petition. For example, if the below-median debtor's reasonably necessary expense for transportation in May 2008 is based on gasoline costing \$4 per gallon, but in 2012, gasoline prices revert to \$2 per gallon, the debtor whose plan was confirmed in 2008 would not be required to contribute the excess created by this over-estimation of expenses to the plan. This is because the expenses in the projected disposable income test are to be estimated as of the date of the petition. The same rule should apply for tax refunds. An over-estimation of taxes incurred should be part of the disposable income calculation for three years, but in year four and five, the calculation is so remote from the BAPCPA definition of projected disposable income so as not to qualify. Finally, in this Court's experience, debtors have more trouble with the tax refund requirement as the years tick by. Arguably it may not be feasible to require the debtor to dedicate these refunds. As long as the debtor makes all the periodic plan payments, and contributes one-half the tax refunds for the three-year applicable commitment period, BAPCPA's projected disposable income requirement has been satisfied.

In sum, the *Navejer* decision does not indicate whether the debtors were above-median or below-median, and whether they were attempting to deduct the payroll taxes actually withheld or the payroll taxes actually incurred. At least one of the decisions relied upon by *Navejer* was a pre-BAPCPA case which construed a statute that was radically different in its definition of income. Another was a "crystal ball" approach case from a Bankruptcy Court in Kentucky. While the approach is not without its followers, the plain meaning approach adopted by this Court in *Guzman* has found support of District Judge Crabb, the Eighth Circuit BAP, and Bankruptcy Courts in the Seventh Circuit. For all of the foregoing reasons, the Court respectfully disagrees with the conclusion of *Navejer* to the extent that conclusion is that income tax refunds of below-median debtors must be dedicated to the plan in the fourth and fifth year of the plan in order to comply with the disposable income requirement.

Date: May 14, 2008

By the Court:


Susan V. Kelley
U.S. Bankruptcy Judge