

THE NON-CONSUMER CHAPTER 7 CASE

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Lou Jones Breakfast Club
Presented February 12, 2013

I. DETERMINING THAT THE CASE IS A NON-CONSUMER CASE

A. The dismissal and filing requirement provisions of §707(b) apply only to debtors whose debts are “primarily consumer debts”.

1. Majority approach: If more than half the dollar amount of the total debt is consumer, the debt is primarily consumer. In re Stewart, 175 F.3d 796 (10th Cir. 1999). See also Judge Pepper's analysis noting that primarily means “for the most part” and following the In re Stewart approach. In re Kinnee, Case No. 06-21356 (Bankr. E.D. Wis.) (unpublished decision available on court website).
2. Minority approach: If more than half the dollar amount of the total debt is consumer **and** the number of consumer debts is higher than the number of non-consumer debts, the debt is primarily consumer. In re Booth, 858 F.2d 1051 (5th Cir. 1988).

B. Classifying individual debts as consumer or non-consumer.

1. A consumer debt is defined in §101(8) as a “debt incurred by an individual primarily for a personal, family, or household purpose.”

Consumer debts include:

- a. Mortgages on homesteads where funds were used to acquire or improve the property. In re Cox, 315 B.R. 850 (B.A.P. 8th Cir. 2004).
- b. Automobile loans or leases for vehicles for personal use.

- c. Personal credit card debt used for personal expenses and to purchase goods for personal use.
- d. Medical bills.
- e. Personal loans for personal use.
- f. Domestic support obligations. See In re Stewart, where alimony awarded to a former spouse for her support was not for a “profit motive”. Alimony, child support, lump-sum award, attorneys fees and share of profit from a rental property all consumer debt because “not incurred with a profit motive or in connection with a business transaction”. In re Kestell, 99 F.3d 146, 149 (4th Cir. 1996).

2. Non-consumer debts are not defined in the code.

Non-consumer debts include:

- a. “Some courts have distinguished a 'consumer debt' from a 'non-consumer debt' by referring to a non-consumer debt as a debt with a 'profit motive'. In re Kinnee citing In re Stewart and In re Booth.
- b. Mortgages taken on homestead where funds were used primarily for business.
- c. Mortgages on income property.
- d. Automobile loans or leases for business use vehicles.
- e. Business debts personally guaranteed by the debtor.
- f. Income taxes are considered to be involuntarily imposed in the course of earning income and not part of a consumption activity. In re Brashers, 216 B.R. 59 (N.D. Ohio 1998); In re Westberry, 215 F.3d 589 (6th Cir. 2000).

- g. Personal injury and tort debts. “[D]ebts on account of motor vehicle accidents are not consumer debts.” In re Thongta, 401 B.R. 363 (Bank. E.D. Wis. 2009). See also, In re Marshalek, 158 B.R. 704 (Bank. N.D. Ohio 1993).
- 3. Student loans. Courts are split on whether student loans are consumer debt. Student loan for child's education was a consumer debt. In re Vianese, 192 B.R. 61 (Bankr. N.D.N.Y. 1996). The court refused to use a per se test for student loan debt and instead stated that “each debt, including each student loan debt, must be evaluated according to its purpose.” In re Rucker, 454 B.R. 554 (Bank. M.D. Ga. 2011).
- 4. Mixed Debts. For example, debtor borrows \$50,000 on a second mortgage. \$25,000 is used to pay off a personal credit card and \$25,000 is used to purchase the hard assets of the business. The debt should be apportioned 50% consumer and 50% non-consumer. Ask the client to identify and be prepared to verify what percentage of the debt was used for consumer and what percentage was used for non-consumer purposes. It is also a good idea to get credit card statements before the debtor is locked out of on-line printouts upon the filing of the bankruptcy.
- 5. Debts not relevant to the analysis include debts of the debtor's business that are not personally guaranteed, but still prudently listed in Schedule F as debts of the business in the event the debtor is unaware of his or her personal guaranty or if the creditor otherwise wants to claim personal liability on some other theory.

II. PREPARATION OF THE NON-CONSUMER CASE

A. The Means Test and §707.

- 1. The Means Test does not apply to non-consumer cases because §707(b) only allows dismissal for abuse for individual Chapter 7 debtors who have primarily consumer debt. See In re Kinnee. It should also be noted that the B22A form itself states that it must be completed by debtors whose debts are primarily consumer.
- 2. §707(a) dismissal for “cause” does apply. Courts vary widely on what “cause” means other than what is already stated at §707(a) as unreasonable delay, nonpayment of fees and failure to file documents. Courts are divided on whether bad faith is a proper standard to dismiss under §707(a).

- a. The Third Circuit and the Sixth Circuit have used bad faith as a standard. See In re Perlin, 497 F.3d 364 (3d Cir. 2007); In re Tamecki, 229 F.3d 205(3d Cir. 2000); Industrial Ins. Servs., Inc. v. Zick (In re Zick), 931 F.2d 1124 (6th Cir. 1991). Both the Ninth and the Eighth Circuits have rejected bad faith as a standard. See In re Sherman, 491 F.3d 948 (9th Cir. 2007); In re Padilla, 222 F.3d 1184 (9th Cir. 2000); In re Huckfeldt, 39 F.3d 829 (8th Cir. 1994).
- b. The “ability to repay is not in and of itself sufficient proof of bad faith”. In re Tamecki, 229 F.3d at 208. Bad faith dismissal “should be confined carefully and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence.” Industrial Ins. Servs., Inc. v. Zick (In re Zick), 931 F.2d at 1129.

B. Additional differences.

1. Petition page:
 - a. Check the box under “Nature of Debts” that states “Debts are primarily business debts.”
 - b. List only the name of the debtor on the petition page. Do not list the names of corporations or limited liability companies under “other names”. This creates confusion that the corporation or limited liability company is also filing bankruptcy. However, a sole proprietorship should be listed under “other names”.
2. Statement of Financial Affairs: Answer the question at The Statement of Financial Affairs #3b instead of #3a, which increases the preferential threshold from \$600 to \$5,850.
3. Means Test: check the box in Debtor Declaration in Exclusion From Means Test that states “1B. Non-consumer debts”.

III. EXEMPTING AND VALUING THE DEBTOR'S INTEREST THE BUSINESS

A. Exempting the debtor's interest in the business on Schedule C.

1. Keep in mind what you are seeking to exempt is the debtor's ownership interest in the business, not the individual assets of the business, where the business is a corporation or limited liability company.
 - a. An individual's interest in a corporation or partnership is property of the bankruptcy estate, but the assets themselves are not. The debtor may not treat corporate property like personal property for the purpose of exemptions without violating the principles of incorporation. The debtor was not permitted to use Wisconsin motor vehicle exemption for Mack truck owned by corporation. Fowler v. Shadel, 400 F.3d 1016, (7th Cir. 2005) citing Button v. Hoffman, 61 Wis. 20, 20 N.W. 667 (1884).
 - b. Debtor and limited liability company are separate legal entities. Homestead exemption may not be used where debtor does not have legal title to real estate. In re Coenen, Case No. 12-12141 (Bankr. W.D. 2012) (Judge Martin).
2. Exemptions available for the debtor's ownership interest in a corporation or limited liability company.
 - a. The federal exemption for the debtor's ownership interest in a corporation or limited liability company is only available under the "wildcard" exemption found at §522(d)(5).
 - b. The Wisconsin exemption for the debtor's ownership interest in a corporation or limited liability company is found at §815.18(3)(b)2. "If the debtor does not claim an exemption under subd. 1., any interest of the debtor, not to exceed \$15,000 in aggregate value, in a closely held business that employs the debtor or in whose business the debtor is actively involved."
3. Exemptions available for the debtor's business assets used in a sole proprietorship.

- a. The federal exemption for business assets used in a sole proprietorship is found at §522(d)(6). "The debtor's aggregate interest, not to exceed \$2,175 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of the dependent of the debtor." Keep in mind that the "wildcard" exemption is also available.
 - b. The Wisconsin exemption for business assets used in a sole proprietorship is found at §815.18(3)(b)1. "*Business and farm property*.
 1. Equipment, inventory, farm products, and professional books used in the business of the debtor or the business of a dependent of the debtor, not to exceed \$15,000 in aggregate value."
4. If the business is still operating, the debtor may also have an individual asset in the form of member or shareholder loans, back wages, or other claims against the business. The federal "wildcard" would be the only exemption available for these types of assets of the debtor.
- B. Determining the value the debtor's interest in a corporation or limited liability company on Schedule B. See Exhibit A.
1. List the assets of the business with corresponding values on Schedule B at item #13 "Stock and Interests In Businesses".
 - a. Bank accounts titled in the name of the business. Ask the client to provide on-line print outs as of the day of filing.
 - b. Accounts receivable of the business. Be prepared to document any discount for the age of receivables. These should be current as of the day of filing.
 - c. Real estate titled to the business. Treat it like any other real estate. Review deeds and mortgages. Establish the value with a tax bill, appraisal, or market analysis.
 - d. Vehicles titled to the business. Who is the titled owner of the vehicle? Is it jointly owned with the debtor and business? Establish the value through internet websites like Kelley Blue Book or get an offer to purchase from a dealer like Carmax.
 - e. Equipment and tools of the business. Request an itemized list with corresponding resale values.

- f. Inventory of the business at cost.
 - g. Life insurance owned by the business. The bank holding the general business security agreement often requires this as additional security for extending credit to the business.
 - h. Claims of the business. Are refunds owed the business? Does the business have any pending litigation that may result in monies payable to the business? A CCAP search may uncover these types of claims.
 - i. Going concern value. In the event the trustee would seek to sell a business that is still operating as a going concern.
2. List the debts of the business by the nature of the debt and amount of the liability at #13 "Stock and Interests In Businesses".
- a. Priority Debts.
 - (1) Wages and vacation pay.
 - (2) Taxes. Include sales and payroll taxes. Watch for personal property taxes incurred before the case is filed due within one year of the filing of the bankruptcy pursuant to §507(8)(b).
 - b. Secured Debts.
 - (1) Review commercial loan documents including notes, mortgages, general business security agreements and personal guarantees.
 - (2) Watch for cross-collateralization clauses in mortgage documents. These clauses may drag in the business debt as an additional debt owed on the homestead mortgage. List these debts as mortgages on Schedules A and D as well as on Schedule B as a debt of the business.
 - (3) Real estate taxes due on real estate owned by the business.
 - (4) Review car loan documents with an eye toward whether the business or individual or both incurred the debt.

- c. Unsecured Debts.
 - (1) Leases of business equipment, business vehicles and the business location.
 - (2) Credit cards titled to the business.
 - (3) Vendors of the business.
 - (4) Officer and member loans. Can they be documented? Distinguish between capital contributions and loans.
- d. Debts incurred solely in the debtor's name for a business purpose should not be listed in Schedule B as a debt of the business. For example, a credit card on the debtor's name used entirely for business purpose.

3. Calculate the equity in the business.

- a. First, total the assets and then total the debts of the business itemized at #13 on Schedule B. Next, subtract the total debts from the total assets to determine the equity in the business, if any.
- b. Apply the debtor's interest in the business to the equity. For example, if the equity in the business is \$5,000 and the debtor has a 50% interest, the debtor's interest in the business is \$2,500. It is the debtor's \$2,500 interest in the business that you are seeking to exempt.

IV. PREPARING FOR THE §341 HEARING AND THE CHAPTER 7 TRUSTEE

- A. Additional documents likely to be requested by the Chapter 7 Trustee.
 - 1. Corporate tax returns for the last two years.
 - 2. Final or Current Balance Sheet and Final Profit and Loss Statement.

B. Common inquiries of the Chapter 7 trustee at the §341 hearing.

1. A business that has stopped operating.

- a. What happened to the assets? Ask your client for a copy of the Voluntary Surrender Agreement with the secured creditor or Bill of Sale from the liquidation of assets if there is no secured creditor.
- b. In the event that the business, rather than the bank, sold the assets, what happened to the proceeds of the sale of the assets? Ask your client for business bank statements showing the deposit from the sale of assets.
- c. After all of the assets are liquidated, accounts receivable collected and priority and secured creditors of the business are paid, is there any value left for the debtor's ownership interest?
- d. Will the debtor be able to collect on officer or membership loans?

2. A business that is still operating.

- a. What are the accounts receivable of the business? Have the account receivables been calculated and exempted as part of the debtor's interest in the business?
- b. Will the debtor ultimately be able to collect in full or part on officer or membership loans?

In re John Debtor

Case No. Exhibit A

Debtor

SCHEDULE B - PERSONAL PROPERTY
(Continuation Sheet)

Type of Property	N O N E	Description and Location of Property	Husband, Wife, Joint, or Community	Current Value of Debtor's Interest in Property, without Deducting any Secured Claim or Exemption
11. Interests in an education IRA as defined in 26 U.S.C. § 530(b)(1) or under a qualified State tuition plan as defined in 26 U.S.C. § 529(b)(1). Give particulars. (File separately the record(s) of any such interest(s). 11 U.S.C. § 521(c).)	X			
12. Interests in IRA, ERISA, Keogh, or other pension or profit sharing plans. Give particulars.	X			
13. Stock and interests in incorporated and unincorporated businesses. Itemize.		JD, LLC, value, \$2,817; debtor's 50% membership interest, \$1,408	-	1,408.00
		Assets: 1. Associated Bank, checking acct. #-1234, \$1,217 2. accounts receivable, \$2,700 3. real estate located at 205 Elm St., Milwaukee, WI, value based on 2012 real estate tax bill value, \$125,000 4. 2009 Ford F-150, \$10,500 titled to JD, LLC and John Debtor, one-half interest is \$5,250 5. equipment, \$4,100 6. inventory, \$750 7. State Farm, life insurance policy acct. #-6789, on the life of John Debtor, \$3,238 8. David Smith, Milwaukee County judgment, case #09SC0987, \$988 Total: \$143,243 Debts: 1. Wisconsin Dept. of Revenue, sales tax, \$2,100 2. Associated Bank, loan payable, also secured by general business security agreement and cross-collateralized with debtor's homestead located at 3679 N. 91st. St., Milwaukee, WI, \$32,410 3. Associated Bank, mortgage, dated 1/22/09 on 205 Elm St., Milwaukee, WI, \$54,408 4. Properties 1000, LLC, lease of business location, \$11,222 5. credit cards, \$5,262 6. vendors, \$11,323 7. loan payable, John Debtor, \$23,701 Total: \$140,426		

Sub-Total > 1,408.00
(Total of this page)

Sheet 1 of 3 continuation sheets attached to the Schedule of Personal Property