May an Above-Median Chapter 13 Debtor Deduct Automobile Ownership Costs When Computing His Plan Payments if He Owns the Automobile Free and Clear?

CASE AT A GLANCE

Jason Ransom, a chapter 13 debtor, proposed a payment plan. To be confirmed by the Bankruptcy Court, a plan must pay creditors "all of the debtor's projected disposable income." The Bankruptcy Code permits various income deductions including those set forth in certain Internal Revenue Service charts. One such chart is "Vehicle Ownership Costs." The code does not say, however, *who* is permitted to deduct the amount in the chart. Ransom deducted the specified amount for vehicle ownership costs; the creditors claim that the chart does not apply to him. The Bankruptcy Court, the Bankruptcy Appellate Panel, and the Ninth Circuit Court of Appeals all agreed with the creditors.

Ransom v. MBNA, America Bank, N.A.
Docket No. 09-907

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From: The Ninth Circuit

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This is a chapter 13 bankruptcy case. A chapter 13 petition may be filed only by an individual who has "regular income." The debtor proposes a plan, usually with the petition, whereby he proposes to make a monthly payment—the "plan payment"—to a chapter 13 trustee for a certain period, usually three to five years. If the plan meets the requirements of the code, it is "confirmed" by the court, usually about three months after the petition date. At the end of the plan period, if all the payments have been made, the debtor receives a discharge of all debts "not provided for in the plan" with certain exceptions and the case is closed. Creditors may object to the chapter 13 plan on the basis that the plan payment is not properly computed.

ISSUE

In calculating the debtor's "projected disposable income" during the plan period, may the debtor deduct automobile "ownership costs" pursuant to Internal Revenue Service charts even though the debtor's vehicle is completely paid for?

FACTS

Debtor Jason Ransom filed a chapter 13 bankruptcy petition in Nevada in 2006. He subsequently filed a chapter 13 plan proposing to make plan payments to the trustee of $500 per month for 60 months. The chapter 13 trustee and two creditors objected to confirmation of the plan, arguing that $500 per month was not the debtor's projected disposable income as defined in the Bankruptcy Code. They argued that the debtor improperly included a deduction against income for "vehicle ownership expense" of $471. The trustee and creditors claimed that the deduction should be disallowed and that the plan payment therefore should be increased.

The Bankruptcy Court agreed with the trustee and refused to confirm the plan. The Bankruptcy Appellate Panel, agreeing to hear the appeal on this interlocutory issue, affirmed the Bankruptcy Court as did the Ninth Circuit Court of Appeals.

CASE ANALYSIS

In the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) amendments in 2005, Congress divided consumer debtors into two categories: below median and above median. The median is the median "family income" in the debtor's state based on household size. If the debtor's median income is above the state median, he is an above-median debtor. Ransom is an "above-median" debtor.

The chapter 13 plan payment for an above-median debtor is set forth in § 1325(b) as follows:

> (b)(1) … the court may not approve the plan unless, as of the effective date of the plan -
> … (B) the plan provides [payment of] all of the debtor's projected disposable income to be received in the applicable commitment period …
> (2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor … *less amounts reasonably necessary* to be expended -
> (A)(i) for the maintenance or support of the debtor or a dependent of the debtor …
> (3) *Amounts reasonably necessary* to be expended under paragraph (2), … shall be determined in accordance with … *section 707(b)(2),* if the debtor [is an above-median debtor].

This means that an above-median chapter 13 debtor will pay his creditors, via the trustee, his projected disposable income, which is his current monthly income less deductions for amounts reasonably necessary for his support. The amounts reasonably necessary for his support must be "determined in accordance with" § 707(b)(2).

Section 707(b)(2) defines the "amounts reasonably necessary to be expended" as

> The debtor's monthly expenses shall be the debtor's *applicable* monthly expense amounts specified under the [IRS] National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent.

The National Standards and Local Standards are "charts" which can be found in the Internal Revenue Service's (IRS) Financial Analysis Handbook. The IRS uses these charts to determine a taxpayer's ability to pay his taxes. The IRS Local Standards include two charts relating to vehicle expense; one entitled "Ownership Costs" and one entitled "Operating Costs." According to the ownership costs chart, the debtor here is allowed $471 per month. According to the operating costs chart, the debtor is allowed $338 per month. The ownership chart is a "national table," that is, the amount allowed is the same regardless of where the debtor lives. The operating costs chart is "local" in that the amount allowed depends on where the debtor lives.

The debtor deducted both the ownership and operating costs in reaching his projected disposable income. The issue, according to the objections, is that the ownership costs deduction was improper because the debtor did not make loan or lease payments on his vehicle, i.e., he owned his vehicle "free and clear." The trustee argued that the ownership chart was not "applicable" to the debtor and therefore the plan payment had to be increased. The debtor argued that the chart is applicable because he owns a vehicle.

The initial concern for courts when construing this statutory text is determining whether the court should, or even may, look to IRS procedures, pronouncements, and internal rules for guidance. The IRS, when determining the taxpayer's ability to pay the tax, clearly "allows" the ownership deduction *only* when the taxpayer is making payments on a vehicle loan or lease. Is that binding on the court, or even relevant? May Congress pass a law which provides that the IRS may determine how much the plan payment will be?

The Ninth Circuit essentially passed on this first issue. It discussed that issue only in pointing out that a number of circuits have "reason[ed] that because Congress incorporated the IRS National and Local Standards into § 707(b)(2)(A)(ii)(I), it must have intended 'courts to look at how the IRS defines these categories, and how the IRS calculates those expenses.'"

The Ninth Circuit looked solely to the language of the code and agreed with the Bankruptcy Court saying,

> As did our BAP, we decide this issue not on the IRS's manual, but instead on the "statutory language, plainly read," which we believe does not allow a debtor to deduct an "ownership cost" (as distinct from an "operating cost") that the debtor does not have. An "ownership cost" is not an "expense"—either actual or applicable—if it does not exist, period. Ironic it would be indeed to diminish payments to unsecured creditors in this context on the basis of a fictitious expense not incurred by a debtor.

The Ninth Circuit adopted the language of the Bankruptcy Appellate Panel,

> The ordinary, common meaning of "applicable" further impels us to this conclusion. "Applicable," in its ordinary sense, means "capable of or suitable for being applied." Merriam-Webster's Collegiate Dictionary 60 (11th ed. 2005). Given the ordinary sense of the term "applicable," how is the vehicle ownership expense allowance capable of being applied to the debtor if he does not make any lease or loan payments on the vehicle? In other words, how can the debtor assert a deduction for an expense he does not have? If we granted the debtor such an allowance, we would be reading "applicable" right out of the Bankruptcy Code.

The Ninth Circuit points out that there is a significant split in the circuits on the issue. A number of circuits permit the deduction on the basis that "the adjective 'applicable'—rather than 'actual'—in relation to the 'ownership cost' deduction refers 'to the selection of an expense amount corresponding to the appropriate geographic region and number of vehicles owned by the debtor." On the other hand, a number of circuits, including the Ninth, hold that "a debtor is entitled to the ownership cost deduction only if the debtor actually has loan or lease payments on a vehicle."

The Ninth Circuit concluded with a comment,

> The "correct" answer to the question before us, which the courts have been struggling with for years—at the unnecessary cost of thousands of hours of valuable judicial time—depends ultimately not upon our interpretation of the statute, but upon what Congress wants the answer to be. We would hope, in this regard, that we the judiciary would be relieved of this Sisyphean adventure by legislation clearly answering a straightforward policy question: shall an above-median income debtor in chapter 13 be allowed to shelter from unsecured creditors a standardized vehicle ownership cost for a vehicle owned free and clear, or not? Because resolution of this issue rests with Congress, we have taken the unusual step of directing the Clerk of the Court to forward a copy of this opinion to the Senate and House Judiciary Committees.

The Supreme Court accepted certiorari.

In his brief the debtor argues that the deduction Congress has allowed is "amounts reasonably necessary for [his] support." The amounts reasonably necessary to be expended are the "applicable" amounts "specified" in the charts.

The debtor urges the Court to ignore the IRS methodology because

> From the outset, the Advisory Committee on the Bankruptcy Rules of the Judicial Conference of the United States recognized that there is a tension between the methodology of the Internal Revenue Service and the proper reading of the bankruptcy statute. The IRS treats the amounts in the Local Standards as caps on actual expenses, namely loan or lease payments. By contrast, the Judicial Conference adopted the position in drafting bankruptcy rules and forms that the amounts specified in the Local Standards serve in the means test as allowed deductions or expenses. The treatment of a transportation expense by the IRS is not the same as its treatment for the bankruptcy code even though the statute utilizes the Standards issued by the IRS.

Also, the debtor argues that the means test set forth in § 707(b)(2) permits both the deduction of the Local Standards amount and deduction of the actual payment to the secured creditor. Had Congress intended that the debtor deduct the IRS chart only if the debtor is paying for his vehicle, it would not have provided for both deductions. The debtor points out that the Judicial Counsel has determined that the debtor cannot deduct both, i.e., the same amount twice. If the debtor has a vehicle loan payment, he can deduct that or the Local Standards amount, whichever is higher. If he has no payment, he can deduct the ownership chart amount.

From a practical standpoint, the debtor argues that disallowing the deduction motivates the debtor to incur loan obligations before filing. Being obligated for even a very small vehicle debt allows the debtor to pay less. Where the debtor has even one payment remaining when the chapter 13 was filed, he can deduct the Local Standards chart permitting a lower plan payment. Allowing the deduction to everyone who owns a vehicle "levels the playing field." The debtor also argues that a person who owns his vehicle free and clear will nevertheless have expenses beyond normal operating expenses. The vehicle will have to be replaced someday and will likely have more repair costs than newer vehicles.

In its opening brief, MBNA argues that the Local Standards amount may be deducted only by those debtors to whom it is "applicable." Further, the law before the BAPCPA amendments required debtors to essentially pay as much as they could afford. Obviously a debtor could not deduct car payments he was not making. The amendments attempted to give the courts a more specific framework by which to determine how much was necessary for the debtor's support. MBNA asserts that the amendments were designed to insure that the debtor was deducting only reasonable expenses when computing the plan payments.

MBNA also argues that Congress intended courts to look to the IRS methodology when determining the applicable deductions. Specifically the code states that deductions are permitted *under* the IRS standards, not just that the amounts deductible are those in the charts. As MBNA asserts, "Congress expressly incorporated the Standards when it enacted BAPCPA, without revoking the IRS's authority to continue making alterations. Indeed, Congress expressly recognized in BAPCPA the IRS's authority to amend them."

The amicus brief for the National Association of Consumer Bankruptcy Attorneys (NACBA) urges the Court to find that the plain language of the text supports the debtor's position. According to NACBA, the statute provides that the deductions allowed *shall be* those set forth in the IRS charts. Further, this reading makes more sense because the other way of reading it penalizes thrifty debtors.

The issue the Supreme Court must deal with is a statute that is clear as mud. For one thing, why is the debtor allowed to deduct "ownership costs" from a chart *and* the actual payment to the vehicle creditor, especially if the ownership costs are intended to apply only to those who actually make car payments? But that is what the code says. Every court and the Judicial Conference has determined that the debtor cannot actually take both, even though the code seems to allow it. Congress attempted to take away the discretion of the bankruptcy courts and the ingenuity of debtor's counsel in proposing chapter 13 plans, but the charts are not clear and do not set forth what the debtor actually must pay. If the plan payment, as computed according to the charts and the § 707(b)(2) scheme is more that the debtor can pay, the case is dismissed. Congress intended, I think, to place limits on the amount a debtor can deduct as reasonable expenses, yet the charts in many cases allow deductions that debtors do not need and in many cases restrict deductions that debtors do need.

SIGNIFICANCE

What is most intriguing about this case is the issue of the IRS's ability to decide bankruptcy issues. The IRS changes the charts for its own purposes and without congressional input. The IRS could, for example, unilaterally decide that there is no deduction for ownership costs; and based on that, many debtors would be unable to confirm a plan. The IRS could reduce or eliminate the "operating costs" charts. Can Congress delegate that decision to the IRS? Did it delegate that decision to the IRS?

It is probable that the Supreme Court decision will not change the chapter 13 practice in any meaningful way. The courts and the chapter 13 trustees seem to understand that the plan payment computation pursuant to the means test is largely unworkable. Even in this case, the debtor's calculations lead to a required payment of $210, but the debtor's plan proposed a payment of $500. The debtor recognized that he had the actual ability to pay more than the computations required and knew that the court and the trustee would require the higher, actual amount. Debtors who have no vehicle obligations typically have a greater ability to pay into a plan than those who do have those payments. It will be interesting to see if the Supreme Court makes a comment to Congress about fixing this mess as is suggested by the Ninth Circuit's opinion.

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PREVIEW of United States Supreme Court Cases, pages 41–44.
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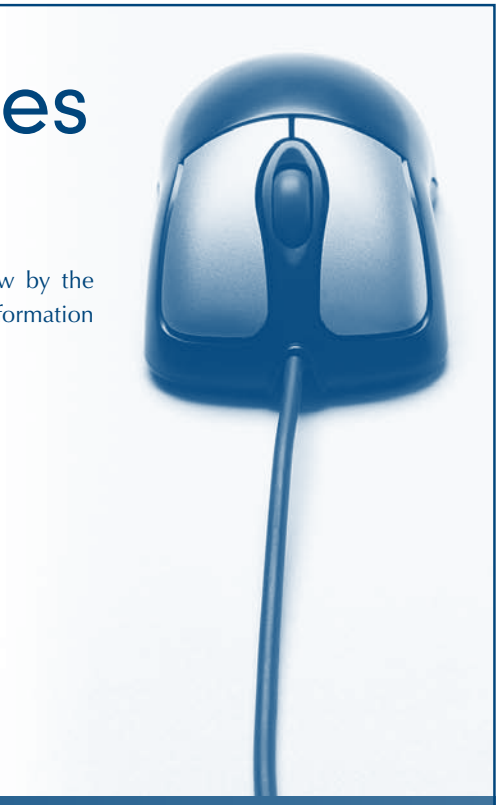

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