

Non-Consumer Debtors and the Abuse of Chapter 7

By Gary R. Stickell

Debtors whose debts are primarily business debts or other non-consumer debts are not subject to the Means Test and other provisions under 11 U.S.C. §707(b). The provisions of §707(b) are those provisions which the U.S. Trustee may dismiss or convert a Chapter 7 case for abuse of Chapter 7.

The provisions applying the Mean Test and other provisions of §707(b) are only for cases of "primarily consumer debts." A "Consumer debt" is "debt incurred by an individual primarily for a personal, family or household purpose."¹ If the debts are not primarily consumer debts, the U.S. Trustee cannot pursue the abuse provisions of 11 U.S.C. §707. In particular, Debtors with primarily business debts and/or other non-consumer debts are not be required to file a Means Test.

This inquiry is commonly viewed as consumer debts v. business debts, but instead, it is an issue of consumer debts v. non-consumer debts. "Business debt" is distinguished from "consumer" debt as a debt incurred with a "profit motive."² However the non-consumer debt inquiry is broader than just business debts. There are varieties of debts that have held to be neither a business debt nor a consumer debt.

"'Primarily' means 'for the most part.' *Webster's Ninth New Collegiate Dictionary* 934 (1984). Thus, when "the most part" - i.e., more than half-of the dollar amount owed is consumer debt - the statutory threshold is passed. *In re Kelly* 841 F.2d 908, at 913 (9th Cir. 1988).

Mortgages. The Purchase Money Security secured by Personal Residence are consumer in nature.³ However, if a mortgage is used to fund a business, the Debt may be characterized as non-consumer. The Fifth Circuit Court of Appeals used "the profit motive test" regarding three separate loans secured by a residence: "The district court erred, however, in its classification of the entire \$152,507.99 as consumer debt. Only \$75,000 was used to pay off the mortgage on the residence; the remainder, \$77,507.99, was applied to the marina venture. Only the initial \$75,000 may be properly characterized as consumer debt. Similarly, the district court erred in its determination that a signature loan, no matter what use to which it is put, is always consumer debt."⁴

So a refinance or a home equity loan used to finance a business or some other non-consumer debt will be rightly characterized as a non-consumer debt.

¹11 U.S.C. §101(8)

²*In re Stewart*, 175 F.3d 796, at 806 (10th Cir. 1999) citing *Citizens Nat'l Bank v. Burns (In re Burns)*, 894 F.2d 361, 363 (10th Cir.1990); *Cypher Chiropractic Ctr. v. Runski (In re Runski)*, 102 F.3d 744, 747 (4th Cir.1996); and *In re Booth*, 858 F.2d at 1054-55.

³*In re Kelly* 841 F.2d 908 (9th Cir. 1988); *In re Price*, 353 F.3d 1135 (9th Cir. 2004); *In re Praliskas*, 248 B.R. 140 (Bankr. W.D.Mo. 2000).

⁴ *In re Booth* 858 F.2d 1051, at 1055 (CA 5 1988)

Domestic Support Orders. In weighing where alimony is a consumer debt, the Courts look to the profit motive. [T]he weight of the case law on this issue conclusively shows it is a “consumer debt” if it is based on a non-profit motive. *In re Stewart*, 175 F.3d 796, at 807(10th Cir. 1999). In *Stewart*, the Court found the alimony is consumer debt as it was awarded for the former spouse for her support and benefit and not for a profit motive. See also *In re Kestell*, 99 F.3d 146, 149 (4th Cir.1996).

Tax Debts. Personal income tax debts are not consumer debts. *In re Westberry* 215 F.3d 589 (6th Cir. 2000). The Sixth Circuit in *Westberry* rejected the application of the profit motive test to determine if personal income taxes are *not* consumer debts. Rather, the Court found that personal income taxes were distinct from consumer debts for these reasons:

(1) Tax debts are not incurred like consumer debts. Consumer debts are incurred voluntarily. Taxes are imposed.

(2) Consumer debts are incurred for personal and household purposes. Taxes are assessed for the public wealth.

(3) Taxes arise from the earning of money. Consumer debts result from consumption.

In re Westberry 215 F.3d 589, 591 (6th Cir. 2000).

Personal Injury and Tort Debts. Debts resulting from motor vehicle accidents are *not* consumer debts. The Courts distinguish consumer debts from non-consumer debts on the basis that consumer debts are voluntarily incurred for family, household and personal purposes.⁵

Student Loans. There is a split as to whether or not student loans are *per se* non-consumer debts. Rather, the Courts will look to determine how the money was spent. See *In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *cf. In re Wisher*, 222 B.R. 634 (Bankr. D.Colo. 1998) [there was no testimony regarding how the student loan was used, so the Court held it was consumer debt]; *In re Vianese*, 192 B.R. 61 (Bankr. N.D.N.Y. 1996) [student loan for children’s education is a consumer debt]. In *In re Stewart*, 175 F.3d 796 (10th Cir. 1999), the Tenth Circuit looked to the evidentiary record and determined that a substantial portion of student loans were used for family expenses as opposed to tuition, books or other direct educational expenses.

Personal credit card – cash advances put directly into a business account. The Court in *In re Traub*, 140 B.R. 286 (Bkrtcy.D.N.M.,1992) held that on the Debtor’s uncontradicted testimony that he used a credit card solely for business, that such debt was business or non-consumer. Use of overdraft line and credit cards for “dabbling” in the stock market was consumer debt in *In re Berndt*, 127 B.R. 222 (Bankr. D. N.D. 1991).

⁵*In re Marshalek*, 158 B.R. 704 (Bankr. N.D. Ohio 1993); *In re White*, 49 B.R. 869 (Bankr. W.D.N.C. 1985). See also *In re Izzzi*, 196 B.R. 727 (Bankr. E.D. Pa. 1996).

Conclusion

When dealing with Debtors with substantial business debt, tax debt, or student loans, a side-by-side analysis is always the first step to determine the Debtors eligibility for Chapter 7 relief.

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