Chapter 7 Bankruptcy Means Test: Can I Qualify For Chapter 7 If My Income Is ABOVE Average?

If you are a repeat reader, you may have heard me discuss the means test. Specifically, I have a tendency to blabber something along the lines of "if you current income is lower than the IRS average income for a comparable family size, you are allowed to file for chapter 7 bankruptcy protection."

I have to admit, that this description is a gross simplification of the means test. However, I do this on purpose. See, most potential chapter 7 debtors that I consult with qualify under this first step of the means test. Thus, in most cases, further explanation is not necessary. However, what happens when your household income is higher than the IRS mean income as adjusted for family size?

For those potential debtors wondering this same question, you are in luck. Today I am going to take a few moments to explain the chapter 7 means test in its entirety.

The Chapter 7 means test is more than just an arbitraty cut off between chapter 7 and chapter 13 bankruptcy. A formula is applied to determine whether or not the consumer should have enough money available to make some minimal payment to creditors in a Chapter 13 bankruptcy plan.

The goal is to reserve Chapter 7 bankruptcy for those who really have no means to pay and to push those who have available income into Chapter 13 bankruptcy plans, so that their creditors will receive at least partial payment. See, it would be a waste of time and resources for a debtor to participate in a chapter 13 plan if they have little or no disposable income to pay unsecured debtors. However, it would be unfair to creditors to allow an individual with considerable disposable income to complete a chapter 7 bankruptcy.

Now, back to the means test. As I stated earlier, the means test consists of several steps. The first step in the Chapter 7 bankruptcy means test is simple: it compares your income to the median income in your state for a family the same size as yours.

As I have previously mentioned, the IRS mean income as reported for the state of Arizona can be found below:

Family Size of 1: $41,915

Family Size of 2: $54,510

Family Size of 3: $58,696

Family Size of 4: $66,030

If your income adjusted for family size falls below the above numbers, that's it. You can be fairly certain that it is possible to file for chapter 7 bankruptcy in Arizona.

If your income is higher than the median income, it doesn't necessarily mean that you can't file for Chapter 7 bankruptcy; it just triggers the second step in the test.

In this second arm of the means test, a bankruptcy attorney will review your financial situation as it would apply to a chapter 13 bankruptcy. The intent is to determine the degree of repayment a chapter 13 plan would afford your unsecured creditors. Certain allowable expenses (as determined by IRS guidelines) are subtracted from your income to find your "disposable income."

If your projected disposable income over the next five years totals less than $6,000 ($100/month), you likely "pass" and can file under Chapter 7. The assumption is that your ability to repay unsecured creditors is severely limited by your lack of disposable income. Thus a chapter 13 plan is irrational.

If your disposable income is greater than $10,000 over the next five years, a presumption arises that you don't really need to file for Chapter 7 bankruptcy and you may only be allowed to do so if you can demonstrate special circumstances. See, in this case, a significant repayment could be made to creditors via your monthly disposable income.

In the gray area between $6,000 and $10,000, yet another calculation is often required which compares your disposable income over the next five years to a percentage of your unsecured debt to determine whether any significant repayment to your creditors is possible.

If your disposable income over that five years is greater than 25 percent of your unsecured, non-priority debts, you'll probably find yourself in the same circumstances as if you'd had more than $10,000 in disposable income. However, if it is less than 25 percent of your unsecured, non-priority debts, you will likely "pass" the means test.

Note that even if you 'fail' miserably, if your calculated income and disposable income are too high, there may still be special circumstances that allow you to file for chapter 7 bankruptcy protection. One obvious "special circumstance" might be that the debtor is now unemployed and doesn't really have the ability to pay that the artificial test suggests.

As you can see, the means test is complicated. It requires an understanding of the rules concerning how your income is calculated for means test purposes and which debts are classified as unsecured and non-priority. Note that the Means Test applies only to individuals whose debts are "primarily consumer" debts. Case law holds that taxes are not consumer debts.

As always, I recommend consulting with an experienced bankruptcy lawyer to discuss your unique financial situation.

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