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**UNITED STATES BANKRUPTCY COURT
IN AND FOR THE DISTRICT OF ARIZONA**

**KENNETH and JESSICA
ELLSWORTH**

Debtors.

Chapter 13 proceedings

Case No. 2-07-bk-986-CGC

**UNDER ADVISEMENT DECISION
RE: OBJECTION TO CHAPTER 13
PLAN**

10 **I. Introduction**

11 This matter comes before the Court on LifeScape Medical Associates, P.C.’s
12 (“Lifescape”) Objection to the Debtors’ Chapter 13 Plan.

13 The dispute revolves around how to calculate the Debtors’ income and expenses.
14 Debtors take the position that the application of the admittedly mechanical “snapshot”
15 approach of BAPCPA’s means test leads to a modest amount of money to be devoted to
16 payment of unsecured creditors (a class of creditors of which Lifescape is the only member).
17 Lifescape asserts that the Debtors’ income is grossly understated and their expenses are
18 grossly overstated, leading to the conclusion that this plan cannot be confirmed since Debtors
19 have adequate income to pay LifeScape’s claim in full.

20 One critical issue involves attorneys fees incurred by the Debtors individually in
21 unsuccessfully defending a lawsuit brought by Lifescape to enforce a non-compete covenant.
22 At the end of the hearing, the Court took that issue under advisement.

23 The resolution of this matter has been complicated by a confusing record as well as
24 the complexity and internal inconsistencies of the Code and the cases interpreting it. The
25 Court regrets any inconvenience to the parties caused by the delay in ruling on the matters
26 pending.

27 **II. Facts**

28 *A. Noncompete Litigation*

1 In October 2003, Dr. Ellsworth and others founded Lifescape. As part of Lifescape's
2 formation, Dr. Ellsworth agreed to a non-compete contract. Dr. Ellsworth decided to leave
3 Lifescape within a year and gave notice; based on the timing of the notice, Dr. Ellsworth
4 apparently believed that she was not bound by the non-compete contract. Lifescape thought
5 otherwise and brought suit to enforce the contract. On April 5, 2006, the Superior Court of
6 Arizona ruled in Lifescape's favor and issued a preliminary injunction. On appeal, the
7 Arizona Court of Appeals affirmed and awarded Lifescape's attorneys' fees and costs. The
8 Arizona Supreme Court denied review in late November or early December 2006. On
9 August 16, 2007, after the Court granted stay relief, the Superior Court entered judgment (the
10 "Judgment") awarding \$69,086.00 in attorneys' fees and \$5,156.19 in costs with interest at
11 10%. Additionally, the Court of Appeals awarded attorneys' fees and costs of \$58,344.00
12 with 10% accruing as of June 29, 2006. As of the date of filing, March 8, 2007, the
13 approximate amount owed under the Judgment was \$133,000.

14 *B. Debtors' Income and Expenses*

15 The record is a shambles on the issue of Dr. Ellsworth's income. Schedules I and J
16 reflect monthly income of \$27,137.66 with expenses of \$26,903.71. On Schedule I the
17 Debtors list Dr. Ellsworth's employer as "Family Practice of Scottsdale - Self" with monthly
18 wages of \$23,437.71 and self employment taxes of \$1,209.00. Also on Schedule I, the
19 Debtors list Mr. Ellsworth's wages of \$6,666 per month; these wages are not in dispute and
20 have remained constant throughout the proceedings. On Schedule J Debtors list \$20,507.11
21 in regular expenses from operation of business and total monthly expenses of \$26,903.71.
22 The income from Schedule I and the expenses from Schedule J leave the Debtors \$233.95
23 in monthly net income.

24 Soon after filing, the Debtors submitted Form 22C. In Part I, box 3 of Form 22C the
25 Debtors list Dr. Ellsworth's gross receipts as \$23,437.71 with ordinary business expenses of
26 \$20,507.11 for a total business income of \$2,930.60. This together with Mr. Ellsworth's
27 income produced a total monthly income of \$9,597.26. The Debtors calculate their allowed
28

1 deductions as \$10,529.07 leaving negative \$931.81 in monthly disposable income.

2 However, on July 3, 2008, the Debtors filed an Amended Form 22C. On the
3 Amended Form 22C box 3 is left blank and box 5 lists \$2,247.13 in interest, dividends and
4 royalties for Dr. Ellsworth. This, together with Mr. Ellsworth's income, produced a total
5 monthly income of \$8,913.79. The Debtors calculated their allowed deductions as
6 \$10,061.73 leaving negative \$1,147.94 in monthly disposable income.

7 The Debtors include payments made to the law firm Bonnett Fairbourn for services
8 rendered during the noncompete litigation as business expenses. Payments to Bonnett
9 Fairbourn total \$43,290.45 ("Attorneys's Fees") of which \$34,290.45 were made in 2006 and
10 \$10,290.45 were made in the six months prior to the bankruptcy filing.¹ Only those expenses
11 incurred in the 6 months prior to filing are even arguably relevant to confirmation of the
12 Plan; claiming the entire \$34,000 is clearly inappropriate.

13 To support their business expenses the Debtors produced two revenue and expense
14 statements and a cash flow statement. The first revenue and expense statement, entitled
15 "Family Practice of Scottsdale Statement of Revenue Expenses - Income Tax Basis for the
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17 ¹ Payments are detailed below:

<u>Date</u>	<u>Payment</u>
11/03/2005	\$ 3,000.00
11/29/2005	\$ 3,000.00
12/27/2005	\$ 3,000.00
01/26/2006	\$ 3,000.00
02/17/2006	\$ 3,000.00
03/27/2006	\$ 3,000.00
04/25/2006	\$ 3,000.00
05/26/2006	\$ 3,000.00
06/29/2006	\$ 3,000.00
07/29/2006	\$ 3,000.00
08/30/2006	\$ 3,000.00
09/27/2006	\$ 3,000.00
10/26/2006	\$ 3,000.00
11/15/2006	\$ 4,290.45
Total Payments	\$ 43,290.45
2006 Payments	\$ 34,290.45
6 Months Prior to Petition	\$ 10,290.45
Date Payments	

1 Twelve Months Ending December 31, 2006,” lists revenue of \$281,252.60; costs of sales of
2 \$74,343.38; gross profit of \$206,909.22; expenses of \$151,741.99; and net income of
3 \$35,167.23. The second revenue and expense statement, entitled “Family Practice of
4 Scottsdale Statement of Revenue & Expenses - Income Tax Basis for the Twelve Months
5 Ending December 31, 2006,” lists revenue of \$269,074.73; costs of sales of \$70,656.62;
6 gross profit of \$198,418.11; expenses of \$191,508.69; and net income of \$6,909.42. Both
7 revenue and expense statements list \$34,290.45 in legal fees. The cash flow statement,
8 entitled “Family Practice of Scottsdale Statement of Cash Flow For the three Months Ended
9 March 31, 2007,” lists year-to-date net income of \$49,128.08 and month to date net income
10 of \$10,827.63. Presumably, this leaves a net income for the months of January and February
11 of \$38,300.45.

12 *C. Nature of Family Practice of Scottsdale*

13 There is no concrete evidence on whether Family Practice of Scottsdale operated as
14 a sole proprietorship, a professional limited liability company or both. While all of the
15 financial statements are for Family Practice of Scottsdale, they do not distinguish Family
16 Practice of Scottsdale as a sole proprietorship or as a professional limited liability company.
17 The Debtors claim in a post-trial memorandum that Family Practice of Scottsdale operated
18 as a sole proprietorship until December 31, 2006 (“Sole Proprietorship”) and began operating
19 as a professional limited liability company on January 1, 2007 (“PLLC”). In a post-trial
20 memorandum Lifescape counters the Debtors’ claim by submitting a copy of the Articles of
21 Organization for “Family Practice of Scottsdale, P.L.L.C.” dated December 21, 2004. The
22 Debtors counter Lifescape’s allegations by submitting an Affidavit of Publication showing
23 that the articles were not published until October 2007.

24 The contention that Family Practice of Scottsdale operated as a sole proprietorship
25 through the end of 2006 is consistent with statements made by the Trustee during the hearing
26 indicating that the Debtors listed Dr. Ellsworth as self-employed on their 2006 tax returns.
27 Further, the Trustee’s Evaluation and Recommendations filed September 18, 2008 indicates
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1 that he has a copy of the Debtors 2006 IRS income tax return, but the IRS' proof of claim
2 indicates that it has not been filed. However, The Trustee does not have completed and
3 signed copies of the Debtors' 2007 State and Federal Tax returns, W-2's and 1099's. The
4 Court does not have copies of any of the Debtors' tax documents.

5 **II. Arguments of the Parties**

6 *A. Lifescape*

7 Lifescape objects to various deductions and listings of the Debtors including: listing
8 their residence is as worth \$900,000 while encumbered by liens of only \$650,000; listing
9 their interest in Family Practice of Scottsdale as zero dollars; claiming a depreciation expense
10 of \$45,834.92; and claiming a \$7,000 payment on a new Mercedes Benz as an expense.
11 Particularly germane to the issue before the Court is Lifescape's objection to the payment of
12 the Attorneys' Fees. Lifescape claims that the \$34,000 in fees were paid by the PLLC.
13 Lifescape claims that this is inappropriate because the fees were incurred by Dr. Ellsworth
14 individually, not by the PLLC and that they are not reasonably necessary to be expended for
15 the maintenance of the debtor.

16 *B. Debtors*

17 In their pleadings the Debtors argue that the legal expenses are allowed deductions
18 because *In re Kagenveama*, 527 F.3d 990 (9th Cir. 2008) (superceded by *In re Kagenveama*,
19 541 F.3d 868 (9th 2008)) requires the an analysis of income from the PLLC. Additionally,
20 the Debtors argue that an analysis of Dr. Ellsworth's income that includes income of the
21 PLLC is inappropriate because the PLLC's income is separate from Dr. Ellsworth's income.
22 However, this approach changed after the hearing. In their post hearing memorandum, the
23 Debtors claim that Dr. Ellsworth operated Family Practice of Scottsdale as the Sole
24 Proprietorship up until December 31, 2006. According to the Debtors, payment of
25 Attorneys' Fees were made by the Sole Proprietorship and therefore Dr. Ellsworth is entitled
26 to categorize the expense as a business deduction and reduce her income accordingly. At
27 bottom, Debtors argue that payment of the fees was necessary to preserve the debtor's
28

1 business and therefore qualifies as a business expense under Section 1325(b)(2)(B) whether
2 paid by the Debtor or the PLLC and that, at worst, if the fee payment were treated as a
3 distribution from the PLLC to the Debtors, the income and expense would be a wash.

4 **III. Analysis**

5 While the Court will consider whether payments made by the PLLC on debts owed
6 by Dr. Ellsworth constitute current monthly income, a more basic issue presents itself - what
7 exactly is income?

8 *A. What is Income?*

9 The term “current monthly income” is defined under 11 U.S.C.A. §101(10A).²
10 However, “[w]hile the Code defines current monthly income, it does not define ‘income.’”
11 *In re Wiegand*, 386 B.R. 238, 242 (9th Cir. BAP 2008) (“*Wiegand II*”). Prior to BAPCPA,
12 the Ninth Circuit Bankruptcy Appellate Panel defined income as ““undeniable accessions to
13 wealth, clearly realized over which the taxpayers have complete dominion.”” *In re Shelley*,
14 184 B.R. 356, 359 (9th Cir. BAP 1995) (citing *Commissioner v. Glenshaw Glass Co.*, 348
15 U.S. 426, 431 (1955)). Further, under the Tax Code, “gross income means all income from

16
17 ²11 U.S.C.A. §101(10A) reads:

The term “current monthly income”--

18 (A) means the average monthly income from all sources that the debtor receives (or in a joint
19 case the debtor and the debtor's spouse receive) without regard to whether such income is
20 taxable income, derived during the 6-month period ending on--

21 (i) the last day of the calendar month immediately preceding the date of the commencement
22 of the case if the debtor files the schedule of current income required by section
23 521(a)(1)(B)(ii); or

24 (ii) the date on which current income is determined by the court for purposes of this title if
25 the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii);
26 and

27 (B) includes any amount paid by any entity other than the debtor (or in a joint case the debtor
28 and the debtor's spouse), on a regular basis for the household expenses of the debtor or the
debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent), but
excludes benefits received under the Social Security Act, payments to victims of war crimes
or crimes against humanity on account of their status as victims of such crimes, and
payments to victims of international terrorism (as defined in section 2331 of title 18) or
domestic terrorism (as defined in section 2331 of title 18) on account of their status as
victims of such terrorism.

1 whatever source derived, including (but not limited to) the following items: (1)
2 Compensation for services, including fees, commissions, fringe benefits, and similar items;
3 (2) Gross income derived from business; ... (7) Dividends; ... (12) Income from discharge of
4 indebtedness.” 26 U.S.C.A. § 61(a).

5 1. Other courts’ definitions

6 In an attempt to define “income” under Section 101(10A) some courts have turned to
7 *Blacks Law Dictionary*. It defines income as “[t]he money or other form of payment that one
8 receives, usu. periodically, from employment, business, investments, royalties, gifts and the
9 like.” BLACK’S LAW DICTIONARY 778 (8th ed. 2004). See *In re Zahn*, 391 B.R. 840 (8th Cir.
10 BAP 2008), *In re Marti*, 393 B.R. 697, 2008 WL 3166129 (Bankr.D.Neb. 2008), *In re*
11 *Breeding*, 366 B.R. 21 (Bankr.E.D.Ark. 2007). While others, such as *In re DeThampl*, have
12 used the standard dictionary definitions to understand current monthly income:

13 “Income” is “a gain or recurrent benefit usually measured in money that
14 derives from capital or labor.” “Received” means “to come into possession of”
15 or “acquire.” And, “derived” is largely redundant of “received,” meaning “to
16 take, receive, or obtain especially from a specified source.”
17 *Id.* 390 B.R. 716, 720 (Bankr.D.Kan. 2008)(citing *In re Sanchez* 2006 WL 2038616
18 (Bankr.W.D.Mo. Jul. 13, 2006) and <http://www.merriam-webster.com/dictionary/income>).

19 The most basic definition of income is a simple formula: “Income = Revenue -
20 Expenses.” Robert W. Hamilton and Richard A. Booth, *Business Basics for Law Students:*
21 *Essential Terms and Concepts* 130-135 (Aspen Law & Business/Panel Publishers 1998)
22 reprinted in Robert W. Hamilton, *Corporations Including Partnerships and Limited Liability*
23 *Companies* 92 (West Group 2001). This approach has been adopted by other courts. For
24 instance, in *In re Sharp*, 394 B.R. 207 (Bankr.C.D.Ill. 2008) current monthly income is
25 compared to the median family income as published by the U.S. Census Bureau. The U.S.
26 Census Bureau treats income as receipts minus as expenses. As stated in *Sharp*, the U.S.
27 Census Bureau’s definition of income:

28 includes “earnings” and, in turn, its definition of “earnings” which provides in
part: “[n]et income from nonfarm self-employment is the net money income
(gross receipts minus expenses) from one’s own business, professional

1 enterprise, or partnership.” See “Earnings” at
2 <http://www.census.gov/population/www/cps/cpsdef.html>. A review of the
3 definitions the U.S. Census Bureau relies on in calculating the median family
4 income data used for comparison to a debtor's current monthly income on the
5 B22C form clearly establishes that business expenses are deducted from gross
6 receipts in making the calculation. Thus, if business expenses are not deducted
7 from a debtor's current monthly income before the comparison is made, the
8 comparison is skewed and becomes meaningless.

9 *Id.* at 215-16. The court in *In re Wiegand*, 2007 WL 2972603 (Bankr.D.Mont. October 9,
10 2007)(“*Wiegand I*”) also adopts a revenue minus expenses approach concluding:

11 in determining “current monthly income” under 11 U.S.C. § 101(10)(A) and
12 disposable income under 11 U.S.C. § 1325(b), this Court will follow the
13 longstanding definitions of “income” and of “adjusted gross income”
14 permitting debtors to deduct basis and allowable ordinary and necessary
15 business expenses under the IRC as though they were preparing their Form
16 1040.

17 *Id.* at *5.

18 While all of this seems fairly obvious, the problem is that *Weigand I*'s definition was
19 overturned by the BAP in *Wiegand II*.

20 2. Definition under *Wiegand II*

21 Under *Wiegand II*, the Ninth Circuit Bankruptcy Panel adopts a definition under
22 which a self employed debtor cannot deduct expenses when calculating current monthly
23 income stating:

24 [A] chapter 13 debtor engaged in business may not deduct ordinary and
25 necessary business expenses from gross receipts for the purpose of calculating
26 current monthly income as defined under § 101(10A). Rather, such
27 deductions are authorized under § 1325(b)(2)(B) and, therefore, are to be
28 subtracted from current monthly income when calculating disposable income
pursuant to § 1325(b)(2). To the extent that Part I of Form 22C requires a
business debtor to calculate current monthly income by subtracting ordinary
and necessary business expenses from gross receipts, we hold that Part I of
Form 22C is inconsistent with § 1325(b)(2).

Id. at 241-42. Under the *Wiegand II* definition of income a self employed debtor, such as
Dr. Ellsworth, can not deduct business expenses when calculating current monthly income
even though Form 22C directs otherwise. Instead, a debtor must deduct expenses pursuant
to Section 1325.

3. This Court's Definition

1 This Court disagrees with the *Wiegand II* panel, but for the reasons stated below, that
2 disagreement may not be relevant in this case. This Court is of the view that the definition
3 of income found in the Tax Code is more consistent with the real world. Income, as defined
4 in 26 U.S.C.A. Section 61(a) above, is further defined under 26 CFR Section 1.61-3 which
5 states “[i]n a manufacturing, merchandising, or mining business, ‘gross income’ means the
6 total sales, *less the cost of goods sold*, plus any income from investments and from
7 incidental or outside operations or sources.” (Emphasis supplied). Under this provision,
8 business expenses directly related to the creation of revenue (such as the cost of goods sold)
9 can be deducted before arriving at “income.” However, “[w]here the business is engaged
10 primarily in the providing of a service, rather than mining, manufacturing or merchandising,
11 the business gross receipts will constitute gross income.” *Guy F. Atkinson Co. of California*
12 *and Subsidiaries v. I.R.S.*, 82 T.C. 275, 298 (1984). Here, operating a medical practice is
13 primarily a service business. As such, there is little practical difference between applying
14 the *Wiegand II* definition of income and this Court’s definition of income.

15 The definition of current monthly income found in Section 101(10A) is the same for
16 a potential Chapter 7 debtor and a potential Chapter 13 debtor.³ *See Norton Bankruptcy*
17 *Rules*, 2005-2008 Committee Note (B) to Forms 22A-22C, 1149 (Hon. William L. Norton
18 et al eds., 2008-2009 Edition, Thomson West 2008) (stating “[a]lthough Chapters 7, 11, and
19 13 use [current monthly income] for different purposes, the basic computation is the same
20 in each.”) Following *Wiegand II* may have unintended consequences for otherwise eligible
21 Chapter 7 debtors.

22 For example, a hypothetical debtor operates a dress shop where she makes hand made
23 dresses for her customers. She has \$8,000 per month in revenues with \$6,000 a month in
24 cost of goods sold (“COGS”) leaving \$2,000 in gross income per month. Also assume that
25

26 ³Box 4 of Form 22A - Statement of Current Monthly Income and Means Test Calculation
27 (Chapter 7) is identical to Box 3 of Form 22C Chapter 13 Statement of Current Monthly Income and
28 Calculation of Commitment Period and Disposable Income.

1 the hypothetical debtor has an additional \$1800 a month in allowed expenses under
2 707(b)(2). In Arizona the medium family income for a one person household is \$39,811.
3 See U.S. Trustee Program, Census Bureau Median Family Income By Family Size,
4 http://www.usdoj.gov/ust/eo/bapcpa/20071015/bci_data/median_income_table.htm (last
5 visited December 4, 2008). Under this Court’s approach, the hypothetical debtor would
6 deduct COGS from the revenue, multiply by twelve to reach an annualized income of
7 \$24,000. Thus the hypothetical debtor is below the median family income for Arizona and
8 is eligible for Chapter 7 relief.

9 Under the *Wiegand II* definition of income, a deduction for COGS could not be
10 made by a potential Chapter 7 debtor. Under *Wiegand II*, the hypothetical debtor would not
11 be able to deduct ordinary and necessary business expenses in Box 4(b) of Form 22A and
12 her annualized current monthly income would equal \$76,000. Because her annualized
13 applicable median family income exceeds Arizona’s median family income she would be
14 required to fill out the remainder of Form 22A. Following *Wiegand II*, the hypothetical
15 debtor would deduct COGS under Section 707(b)(2)(A)(ii)(I). *Wiegand II* at 243, fn. 11.
16 After the COGS of \$6,000 and other allowed expenses of \$1,800 are deducted, the
17 hypothetical debtor has \$200 per month in disposable income. This amount over 60 months
18 equates to \$12,000 in 60-month disposable income which exceeds \$10,950. Accordingly,
19 a presumption of abuse arises and an otherwise eligible Chapter 7 debtor may be forced into
20 a Chapter 13. This would be an unjust result.

21 However, as noted by this Court, “decisions of the BAP that are ‘on point’ and not
22 ‘meaningfully distinguishable’ should be followed and treated as precedential even where
23 the trial court disagrees with the BAP’s analysis.” *In re Sawicki*, 2008 WL 410229
24 (Bankr.D.Ariz. 2008) (citing to *In re Muskin, Inc.*, 151 B.R. 252, 253 (Bankr.N.D. Cal
25 1993)). Here, *Wiegand II* is on point and will be followed in this Chapter 13 case; however,
26 this Court will not extend its reasoning to Chapter 7 cases for the reasons stated.

27 *B. Can the Attorneys’ Fees be Deducted as Expenses Under 1325(b)?*
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1 The starting point for statutory interpretation is a review of the language used by
2 Congress in the current version of the law. *See Hughes Aircraft Co. v. Jacobson*, 525 U.S.
3 432, 438 (1999). Where the text is plain, the court is to apply the statute as written, unless
4 the application would lead to absurd results. *Lamie v. U.S. Trustee*, 540 U.S. 526 (2004).
5 Meaning must be given to a statute’s every word. *Miller v. United States*, 363 F.3d 999,
6 1008 (9th Cir. 2004). A subsection of a statute is defined in the context of the entire statute
7 and the statutory scheme as a whole. *In re Rufener Const., Inc.*, 53 F.3d 1064 (9th Cir.
8 1995). Here under the plain language of the statute past business expenses may not be
9 deductible.

10 Under *Wiegand II*, a debtor cannot deduct business expenses when calculating
11 current monthly income; instead a debtor is required to deduct business expenses when
12 calculating disposable income under Section 1325. Section 1325(b)(2) allows deductions
13 for amounts “to be expended.” This is a future looking phrase and applies to both
14 maintenance expenses under subsection A and business expenses under subsection B. “[T]o
15 be expended’ . . . indicates that the amounts to be deducted are amounts that will be paid in
16 the future.” *In re McPherson*, 350 B.R. 38, 74 (Bankr.W.D.Va. 2006). The Debtor argues
17 that *Kagenveama* requires a calculation of both the income and expenses for the six months
18 prior to filing the petition. This is not correct; current monthly income was the focus in
19 *Kagenveama*, not expenses. Here, the Court will follow the language of Section 1325(b)
20 which provides for deduction of future expenses.

21 A final issue is whether Section 1325(b)(3)’s direction to Section 707(b)(2)(A) and
22 (B) for determination of “amounts reasonably necessary to be expended” affects this result.
23 The Court concludes that it does not. At first blush, the reference to Section 707(b)(2) seems
24 to apply only to maintenance expenses of the type described in Section 1325(b)(2)(A) as
25 there is no direct reference in Section 707(b) to business expenses. However, Section
26 707(b)(2)(A)(ii)(I) allows deductions of “the debtor’s actual monthly expenses for the
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1 categories specified as Other Necessary Expenses⁴ issued by the Internal Revenue Service.”
2 Business expenses may be allowed as other necessary expenses in the Internal Revenue
3 Service Financial Analysis Handbook. *In re Arnold*, 376 B.R. 652, 654-655
4 (Bankr.M.D.Tenn.) (cited to by *Wiegand II* at 243, fn. 11). However, Section 1325(b)(3)
5 still applies to amounts “reasonably necessary to be expended.” Thus, while Section
6 707(b)(2) effectively delimits the types of expenses, Section 1325(b)(2) and (3) still require
7 a forward looking analysis of the amount of expenses to be allowed. Here, there is no
8 suggestion that attorneys fees of the sort incurred by the Debtor pre-petition will be
9 reasonably necessary to be expended in the future, even if such fees were allowable
10 expenses under the IRS Financial Analysis Handbook. Accordingly, they cannot be
11 deducted by the Debtor whether paid by the Debtor or the PLLC.

12 *C. Did the payment of the fees constitute income to the Debtor?*

13 The above analysis does not resolve, however, whether the payment of the fees
14 during the six months prior to the filing should be considered as part of the debtor’s current
15 monthly income. The record is unclear whether the Sole Proprietorship or the PLLC paid
16 the fees. The Court does not have the Debtors’ tax returns, W-2s or any other tax
17 documents and the financial statements provided by the Debtor are unclear as to the status
18 of Scottsdale Family Practice. However, regardless of the source, payment of the Attorneys’
19 Fees do not constitute additional income to the Debtors.

20 1. If the Attorneys’ Fees were paid by the Sole Proprietorship do they
21 constitute income?

22 If the Attorneys’ Fees were paid by the Sole Proprietorship the payments do not
23

24 ⁴ Other Necessary Expenses include:

25 state and federal income, self-employment, social security, and Medicare taxes;
26 dental, vision, long-term care, and life insurance; childcare expenses; court ordered
27 payments such as spousal and child support payments; mandatory payroll deductions
28 for such things as uniforms, pension contributions, and union dues; and business
expenses.

In re Rajender, 2007 WL 2345018, *2 (Bankr.E.D.Cal. 2007).

1 constitute additional income. However, under *Wiegand II*, the Attorneys' fees cannot be
2 deducted as business expenses on line 3c of Form 22C. Here, the Debtors incorrectly
3 deducted these expenses, along with all business expenses. Therefore, the Debtors' stated
4 current monthly income is incorrect.

5 2. If the Attorneys' Fees were paid by the PLLC do they constitute income?

6 The definition of gross income includes dividends under the Tax Code. 26 U.S.C.A.
7 § 61(a)(7). A dividend can be constructive and exists when "corporation has conferred a
8 benefit on the stockholder in order to distribute available earnings and profits without
9 expectation of repayment." *Noble v. I.R.S.*, 368 F.2d 439 (9th Cir. 1966). In *Noble*, a
10 constructive dividend was found where a company, whose sole shareholders were husband
11 and wife, made payments for items of a personal nature. *Id.* at 441. Here, the facts are
12 similar to *Noble*. The PLLC's member is Dr. Ellsworth. The lawsuit and Judgment were
13 against the Debtors personally. If the PLLC paid the Attorneys' Fees, it paid a personal
14 debt. As such, if *Noble* were applied to this PLLC as if it were a corporation, payment by
15 the PLLC would constitute a constructive dividend and be income of the Debtors.

16 However, income derived from the PLLC is not treated the same as income from a
17 corporation. As stated in J. William Callison & Maureen A. Sullivan, *Limited Liability*
18 *Companies: A State-by-State Guide To Law And Practice* § 12:42 (2008):

19 Although the answer is unclear, member-managers and members who
20 otherwise participate in LLC business should be treated as general partners,
21 and their distributive share of LLC income and loss should constitute net
22 earnings from self-employment. On the other hand, the distributive share of
income and loss of members who do not participate in LLC business activities
(and are therefore similar to investor limited partners) should not constitute net
earnings from self-employment.

23 The BAP implicitly accepted this conclusion in *Wiegand*, where the debtor's income
24 was from an LLC. *Wiegand I* at *1. This issue was not addressed by either *Wiegand I* or
25 *II*, but both the bankruptcy court and the panel apparently considered revenues and expenses
26 of the LLC to come from "self-employment." The Court will conclude the same here and
27 find that payment of the Attorneys Fees did not constitute income even if it came from the
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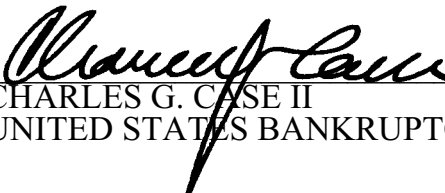
1 PLLC.

2 **V. Conclusion**

3 For the foregoing reasons, the Court concludes :

- 4 1. Payments of the attorneys are not includable within current income to the Debtor
5 whether made by the Sole Proprietorship or the PLLC;
- 6 2. None of the attorneys fees paid may be deducted as expenses under Section
7 1325(b)(2).
- 8 3. Debtors must submit an amended Form 22C and a second amended plan consistent
9 with this decision within thirty days.
- 10 4. Debtors shall address all outstanding issues raised in the Trustee's amended
11 recommendation (docket 85) within thirty days.
- 12 5. Confirmation of the Debtors' plan is denied without prejudice to the foregoing.

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15 **DATED:** January 10, 2009

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17 CHARLES G. CASE II
18 UNITED STATES BANKRUPTCY JUDGE

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