

Is Your Debt Consumer Debt and Why Does it Matter?

By Camille J. Iurillo and Gina M. Pellegrino

As some of you may be aware, one of the many purposes of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) is to make it more difficult for individuals to file Chapter 7 bankruptcy. BAPCPA established a median income test. If the individual’s yearly income is above the median, then, generally speaking, the individual does not qualify to file a Chapter 7. However, this median income test only applies if the individual filing bankruptcy has primarily consumer debt. Therefore, the imperative question is: does the individual seeking to file bankruptcy have primarily consumer debt or primarily non-consumer or business debt?

One of the many issues to be considered in this analysis is whether a loan originally obtained for a business purpose is deemed a consumer debt for bankruptcy purposes if the loan is used for a different purpose than was originally intended. For example, suppose the principals of a company obtain a business loan for a business purpose; thereafter, one of the principals of the company, who personally guaranteed the business loan, uses the money for a down payment on his personal residence. If that principal of the company later decides to file personal bankruptcy, is the debt, originally obtained as a business loan, deemed a consumer debt or business debt?

Section 101(8) of the Bankruptcy Code provides that “consumer debt” means “debt incurred by an individual primarily for a personal, family, or household purpose.” 11 U.S.C. § 101(8).

According to the applicable case law, in determining whether a debt is primarily consumer debt or business debt, courts generally evaluate the circumstances under which the debt was originally incurred.

For instance, in In re Bertolami, 235 B.R. 493, 497-8 (Bankr. S.D. Fla. 1999), the debtors initially obtained a loan for their homestead property; however, by the time the debtors filed bankruptcy they no longer considered the property to be their homestead and were using the property for a business purpose. The Court in Bertolami determined the debt to be a consumer debt, reasoning that if the debtors executed the note and mortgage with the intention of making it their homestead property, even though the debtors no longer reside at the property and use it as an investment property, that does not change the fact that the debt was originally incurred by the debtors for a personal or household purpose.

With respect to our hypothetical scenario above, it is arguable that the debt, originally incurred by the principals of the company as a business loan, would be deemed business debt in the principal's personal bankruptcy case because when the debt was originally incurred it was not incurred for a personal, family, or household purpose; therefore, it is not deemed consumer debt under section 101(8) of the Bankruptcy Code.

This is just one of the many issues that should be considered in determining whether an individual qualifies for a Chapter 7 bankruptcy. However, all of the issues to be considered are beyond the scope of this article.

Iurillo & Associates, P.A., located in downtown St. Petersburg, is comprised of **Camille J. Iurillo**, Shareholder, **Gina M. Pellegrino**, Associate, and **Sabrina C. Beavens**, Associate. The primary areas of practice of **Iurillo & Associates, P.A.** are Commercial and Bankruptcy Litigation, Debtors' and Creditors' Rights, and Foreclosures/Workouts.