

UNDERSTANDING THE NEW BANKRUPTCY LAW: The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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A. Overview

On April 20 this year, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 which was designed to prevent abuse of the existing bankruptcy options available to financially stressed borrowers from the business and consumer sectors. The new bankruptcy code will prevent many Americans from easily resorting to the “fresh-start” Chapter 7-style of bankruptcy where debts are discharged. Instead, many debts will be settled through a Chapter 13 bankruptcy arrangement which requires the borrower make payments according to a schedule stipulated by a court for a period of 3 to 5 years.

Proponents of this law perceive it as a way of lowering bankruptcy rates at the national and local levels, which have been increasing over the past several years (details provided in a later section). Supporters in the Congress and in the industry argue that abuses of the current bankruptcy laws could come from “gamblers, impulsive shoppers, divorced or separated fathers avoiding child support, and multimillionaires ... who buy mansions in states with liberal homestead exemptions to shelter assets from creditors” (CBS News).

Its opponents, however, contend that this revamp of the bankruptcy laws is actually a devastating blow to an overwhelming majority of debtors who are forced into personal bankruptcy due to unexpected financial hardships arising from illnesses, job loss, or divorce. The Leadership Conference on Civil Rights substantiates this claim by explaining that divorced women are 300 percent more likely to go bankrupt than single or married women due to “lower wages, reduced access to health insurance, and the financial strain of rearing children alone” (Aslam). Results of a recent Harvard study indicate that about 50% of personal bankruptcies are actually due to illness or high medical bills.

Other critics have used racial undertones in their arguments as they point out that most moderate- and low-income families be affected by the new law are most likely Blacks or migrants (Aslam). In the House debate while deliberating on the then bankruptcy bill, Representative Alcee Hastings of Florida declared that the legislation “protects the credit industry at the expense of the consumer ... (and) it will drive more Americans deeper into financial crisis and weaken the nation’s economy and social structure” (CBS News).

The law becomes effective 180 days after the Presidential approval. The homestead provisions (which will be discussed later) have actually been enforced immediately, while the rest of the provisions of the new law will become effective on October 17, 2005. Thus, debtors are rushing to take advantage of leniency of the Chapter 7 bankruptcy option while there is still time to do so.

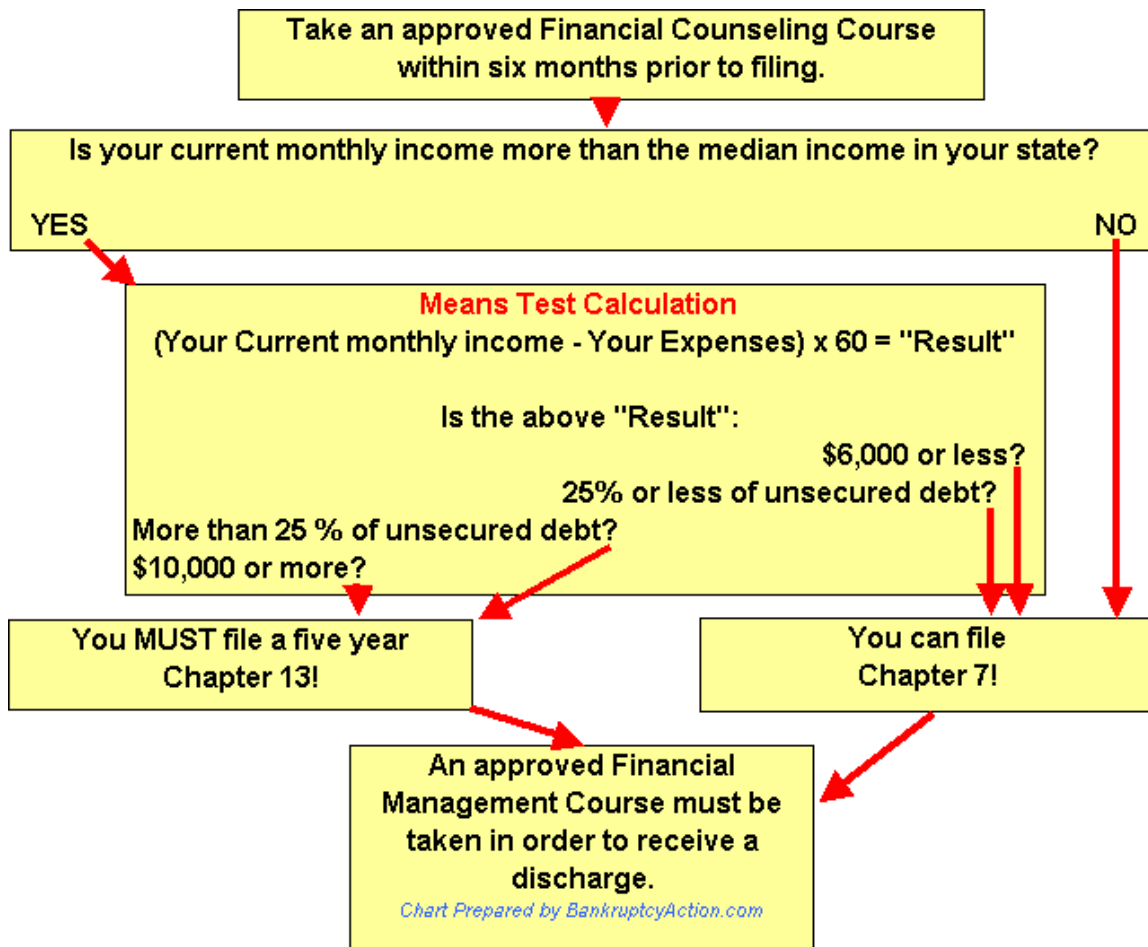
B. Definitions of Bankruptcy Options

In a Chapter 7 bankruptcy, a debtor’s assets, net of those exempted in the state of residence, are liquidated and used to pay the creditors. Under this arrangement, most of the remaining debts are cancelled and the debtor is able to “wipe the slate clean” and embark on an almost “fresh start.” Non-exempt assets are taken over by a trustee who takes care of liquidating the assets and repays the creditors in the order of their secured interests. An important feature of this option is that the wages earned by the debtor is off limits to the creditors with vested interest on the date of filing.

Chapter 13 bankruptcy involves the restructuring of debt with a new payment schedule. This is the option available to those that have more than enough disposable income to qualify for Chapter 7 or own assets that they want to protect.

C. Changes under the New Law

The following chart prepared by BankruptcyAction.com summarizes the mechanics of the implementation of the new law:



The new law initially requires debtors contemplating on bankruptcy to take an approved financial counseling course within 6 months before the bankruptcy claim is filed. Aside from this new requirement, there are two important changes in the new law: the use of a means test to determine eligibility under either Chapter 7 or 13; and amendments in the homestead exemptions. These shall be discussed separately in the following sections:

C.1 The Means Test

A means test is used to determine the type of bankruptcy a debtor will be qualified to file under when the debtor's current monthly income is more than the median income in the state of residence. The new law recommends Chapter 13 bankruptcy if the debtor's current monthly income reduced by allowable amounts for personal and living expenses and multiplied by 60 is NOT LESS THAN the lesser of

- i. 25% of debtor's non priority unsecured claims or \$6,000, whichever is greater; or
- ii. \$10,000.

The new law requires judges and trustees to accept without discretion the Internal Revenue Service (IRS) national standards for living expenses in determining an individual's disposable income. These standards are applied to all individuals in all circumstances automatically. The following figures on the IRS standards were compiled in the website on personal bankruptcy tips (<http://www.personal-bankruptcy-chapters-7-13-filing-laws.com/index.htm>):

Income Class (Based on Gross Monthly Income Earned)	National Standard for Monthly Living Allowance (\$)			
	One Person	Two Persons	Four Persons	More Than Four Persons*
Less Than \$830	344	675	838	125
\$831 to \$1,249	393	679	847	135
\$1,250 to \$1,669	456	741	877	145
\$1,670 to \$2,499	514	834	902	156
\$2,500 to \$3,329	598	895	969	165
\$3,330 to \$4,169	670	982	1,175	175
\$4,170 to \$5,829	701	1,020	1,249	185
\$5,830 and over	1,016	1,414	1,497	195

* Add this amount to the four persons' rate for each additional person

C.2 Homestead Exemptions

The homestead provisions actually take effect as soon as the bill was signed by the president. The new law now requires home ownership for a minimum of 40 months. This means that if you filed for bankruptcy and you purchased your new home within the last 3.3 years, that home will no longer be spared from the creditors, even if the home is located in the state that offers homestead exemptions. Five states (Florida, Iowa, Kansas, South Dakota, and Texas) that have unlimited homestead exemptions will be most affected by this change.

The new law limits the homestead exemption to \$125,000 if the property was acquired within the 40-month or 3.3 year period. Homes that were purchased prior to the cut-off, however, will still qualify for the full exemption allowed in the state where it is located. A 2-year state residence requirement has to be satisfied in order to enable the filer to use the exemptions allowed in the state of residence.

C.2.1 Georgia Homestead Exemptions:

The following information on Georgia homestead exemptions was obtained from the same website on personal bankruptcy tips (<http://www.personal-bankruptcy-chapters-7-13-filing-laws.com/index.htm>):

Homestead allowed by Georgia bankruptcy exemptions:

- *Real or personal property, including co-op, used as residence to \$5,000; unused portion of homestead may be applied to any property*

Insurance allowed by Georgia bankruptcy exemptions:

- *Fraternal benefit society benefits*
- *Annuity & endowment contract benefits*
- *Disability or health benefits to \$250 per month*
- *Group insurance*
- *Industrial life insurance policy owned by someone you depended on, needed for support*
- *Life insurance proceeds if policy owned by someone you depended on needed for support*
- *Unmatured life insurance contract*
- *Unmatured life insurance dividends, interest, loan value or cash value to \$2000 if beneficiary is you or someone you depend on*

Alimony and allowed by Georgia bankruptcy exemptions:

- *ERISA qualified benefits*
- *Employees of non-profit corporations*
- *Public employees*
- *Other pensions needed for support*

Personal property allowed by Georgia bankruptcy exemptions:

- *Animals, crops, clothing, appliances, books, furnishings, household goods, musical instruments \$200 per item, \$3,500 total*
- *Burial plot in lieu of homestead*
- *Health Aids*
- *Jewelry to \$500*
- *Lost future earnings needed for support*
- *Motor vehicles to \$1,000*
- *Personal injury recoveries to \$7,500*
- *Wrongful death recoveries needed for support*

Public payments allowed by Georgia bankruptcy exemptions:

- *Aid to the blind or disabled*
- *Crime victims' compensation*
- *Unemployment compensation, applying for unemployment benefits Georgia, unemployment insurance GA, filing for unemployment in Georgia*
- *Workers' compensation*
- *Local public assistance*
- *Old age assistance*

- *Social Security*
- *Veterans' benefits*

Tools allowed by Georgia bankruptcy exemptions:

- *Implements; books, tools or trade to \$500*

Wages allowed by Georgia bankruptcy exemptions:

- *Minimum of 75% of earned but unpaid wages for private and federal workers; judge may authorize more for low income.*
- *Unemployment compensation Georgia, unemployment application GA*

Wild card allowed by Georgia bankruptcy exemptions:

- *\$400 of any property*
- *Unused portion of homestead exemption, of any property*

D. What about Farm Bankruptcies?

Farm business-related bankruptcies are filed under Chapter 12, which has been permanently enacted by the new bankruptcy law. The new law has eliminated a number of barriers usually experienced by farmers that attempt to restructure their debts under either Chapter 11 (corporate bankruptcy) or 13. Chapter 12 has now been made less complicated and less expensive than Chapter 11 (which is more suited for large corporate reorganization) and Chapter 13 (designed for wage earners who have smaller debts). The following improvements in the Chapter 12 bankruptcy provisions are noted:

- (Sec. 1002) Provides for triennial adjustments of the debt limit for family farmers.
- (Sec. 1003) Cites circumstances under which the claim of a governmental unit that arises from the disposition of a farm asset used in the debtor's farming operation shall be treated as an unsecured claim not entitled to priority.
- (Sec. 1004) Increases from \$1.5 million to \$3.237 million the maximum aggregate debt that qualifies an individual, or individual and spouse engaged in a farming operation as family farmers for debt adjustment purposes. Reduces from 80 percent to 50 percent the minimum percentage of aggregate, non contingent, liquidated debts arising out of such a farming operation.
- (Sec. 1005) Repeals the requirement that the family farmer and spouse receive over 50 percent of income from farming operations in the year before a bankruptcy petition is filed. Allows such income requirement to be met during either the taxable year preceding the year in which the bankruptcy petition is filed, or the taxable year in the second and third taxable years preceding the bankruptcy petition.
- (Sec. 1006) Allows the court to confirm a family farmer bankruptcy plan, notwithstanding the objection of the trustee or holder of an allowed unsecured claim, if the value of the property to be distributed under the plan in a specified period is not less than the debtor's projected disposable income for such period.

This section also prohibits any post-confirmation modification of a bankruptcy plan that would increase the amount of payments that were due before such modification. Provides that, unless the debtor proposes the modification, a modified plan may not: (1) require payments to unsecured creditors in any particular month greater than the debtor's disposable income for that month based on an increase in the debtor's disposable income; or (2) if the modification takes place in the plan's last year, require any payments that would leave the debtor with insufficient funds after plan completion to carry on the farming operation.

- ❑ (Sec. 1007) Extends Chapter 12 coverage to family fishermen.

E. Historical Bankruptcy Filing Statistics

Table 1 presents a tabulation of the total number of cases filed at U.S. bankruptcy courts during the period 2000 to 2004 classified according to the type of bankruptcy:

	2000	2001	2002	2003	2004
Total Filings	1,253,444	1,492,129	1,577,651	1,660,245	1,597,462
General Categories					
Business	35,472	40,099	38,540	35,037	34,317
Consumer	1,217,972	1,452,030	1,593,111	1,625,208	1,563,145
Percent of Consumer	97.17	97.31	97.56	97.89	97.85
By Type*					
Chapter 7	859,220	1,054,975	1,109,923	1,176,905	1,137,958
Chapter 11	9,884	11,424	11,270	9,404	10,132
Chapter 12	407	383	485	712	108
Chapter 13	383,894	425,292	455,877	473,137	449,129
Percent of Chapter 7	68.55	70.70	70.35	70.89	71.24

Note: * There is a slight discrepancy in the sum of these four categories versus total filings not explained in the data source (<http://www.uscourts.gov/bkprpctstats/statistics.htm#quarterly>)

The summary indicates that the number of bankruptcy filings have steadily increased from 1.25 million in 2000 to almost 1.60 million in 2004, although it reached 1.66 million in 2003. The share of consumer debt-related filings also exhibited the same trend, increasing from 97.2% in 2000 to 97.9% in 2004.

Chapter 7 bankruptcies grew from 0.86 million in 2000 to 1.18 million in 2003 before dropping just slightly to 1.14 million in 2004. The proportion of Chapter 7 bankruptcies reached its peak of 71.24% in 2004.

The number of Chapter 7 bankruptcies is expected to shoot up in the first three quarters of 2005 as debtors will take advantage of the lax provisions of the existing law that will only last until October 17, 2005. Thereafter, fewer Chapter 7 filings are expected as more borrowers will be forced to file under Chapter 13.

Table 2 provides the same summary for the bankruptcy filings in the state of Georgia over the same time period.

	2000	2001	2002	2003	2004
Total Filings	59,927	70,095	75,713	81,205	77,960
General Categories					
Business	1,012	1,162	1,359	1,585	2,090
Consumer	58,915	68,933	74,354	79,620	75,870
Percent of Consumer	98.31	98.34	98.24	98.05	97.32
By Type*					
Chapter 7	21,985	28,117	32,200	37,200	36,253
Chapter 11	265	270	312	268	299
Chapter 12	11	30	12	39	7
Chapter 13	37,664	41,676	43,189	43,677	41,400
Percent of Chapter 7	36.69	40.11	42.53	45.83	46.50

Source: <http://www.uscourts.gov/bkrpctystats/statistics.htm#quarterly>

In Georgia, the total number of bankruptcy filings reached its peak in 2003 at 81,205, which consistently increased annually from its level of 59,927 in 2000. The trend in the share of consumer credit contrasts the national trend as the proportion for Georgia decreased steadily from 98.34% in 2001 to 97.32% in 2004.

Notably, the proportion of Chapter 7 filings in Georgia is significantly much lower than the national figure in each year. Like the national trend, this proportion is also increasing through the five-year period from 36.7% in 2000 to 46.5% in 2004.

E.1 Regional Patterns in Bankruptcy Filings

Table 3 presents a summary of bankruptcy filings in the 12 district courts in the country in 2004. The district courts cover not only the 50 states but also territories of the United States (Puerto Rico (PR), Virgin Islands (VI), Guam, and Northern Marianas Islands (NMI)).

District Court	Chapter 7	Chapter 11	Chapter 12	Chapter 13	Total	% Chapter 7
Washington, DC	1,437	25	0	471	1,933	74.34
1 (ME, MA, NH, RI, PR)	32,197	381	3	12,447	45,030	71.50
2 (CT, NY, VT)	72,778	3,271	5	16,935	93,099	78.17
3 (DE, NJ, PA, VI)	70,548	938	8	32,794	104,288	67.65
4 (MD, NC, SC, VA, WV)	85,531	516	4	47,482	133,536	64.05
5 (LA, MS, TX)	81,022	1,060	8	62,653	144,745	55.98
6 (KY, MI, OH, TN)	168,384	811	13	74,088	243,300	69.21
7 (IL, IN, WI)	125,815	444	21	35,825	162,107	77.61
8 (AR, IA, MN, MO, NE, ND, SD)	80,593	324	11	26,093	107,021	75.31
9 (AK, AZ, CA, HI, ID, MT, NV, OR, WA, GUAM, NMI)	211,791	1,212	14	39,645	252,668	83.82
10 (CO, KS, NM, OK, UT, WY)	87,124	329	14	16,446	103,914	83.84
11 (AL, FL, GA)	120,738	821	7	84,250	205,821	58.66

Source: <http://www.uscourts.gov/bnkrpctystats/statistics.htm#quarterly>

Districts 9 and 6 lead the nation in the total number of bankruptcy filings in 2004. These two districts also had the two highest number of Chapter 7 cases filed. Absolute numbers, however, could be misleading unless the number of cases filed is weighted by the size (population) of the districts.

The proportion of Chapter 7 cases will provide more insights and implications. Based on the summary, Districts 5 and 11 registered the lowest proportion of Chapter 7 filings. Interestingly, these two districts include the Southern states of Louisiana, Mississippi, Texas, Alabama, Florida, and Georgia. Analysts have pointed out that the culture in the South influences the bankruptcy filing trend. They contend that “there is more social pressure in the South to pay off your debt” (Axtman, Christian Science Monitor). Thus, in these areas, fewer people opt for the “fresh start” style of Chapter 7 bankruptcy and more debtors try hard to honor their debts under restructuring plans allowed in Chapter 13. Thus, the Southern states are expected to embrace the new bankruptcy law more easily than other areas in the country where debtors are more used to take the Chapter 7 bankruptcy refuge.

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