

2005 BANKRUPTCY REFORM ACT

OVERVIEW & SUMMARY

This is a brief summary and overview of (what one experienced bankruptcy attorney believes to be) the highlights of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, better known as the Bankruptcy Reform Act. The Bankruptcy Reform movement that began eight years ago was based on a detailed report on bankruptcy reform by the National Bankruptcy Review Commission. Since the report the Bankruptcy Reform movement has worked to drastically change the nature of bankruptcy. A truly massive lobbying effort for bankruptcy reform followed, funded by the Credit Card Industry, US Chamber of Commerce, and other business interests. For various reasons bankruptcy reform legislation failed to pass, until 2005. Large gains by republicans in the House and Senate, coupled with the momentum of President Bush's reelection, almost assured passage of the Bankruptcy Reform Act, despite serious opposition by scholars and consumer advocates.

Much has been written about the Bankruptcy Reform Act, we offer this brief overview and summary because we think that the overall scheme of bankruptcy reform will have far greater impact than any single provision.

1. CREDIT COUNSELING – Bankruptcy Reform has the stated purpose of implementing “needs based” bankruptcy laws. It also has the obvious intent of promoting personal responsibility for debts and making bankruptcy relief more difficult and expensive to obtain. Before anyone can file bankruptcy under the Bankruptcy Reform Act, they must receive a certificate from an APPROVED non-profit credit counseling agency that states that they have received a briefing on opportunities for available credit counseling and have been assisted in performing an individual budget analysis. This seems simple and reasonable; however it assumes that non-profit credit counseling services have no financial interest in favoring their services over relief in bankruptcy. This is simply not the case, as we all know from the hundreds of TV ads for credit counselors, even non-profit credit counseling is “big business”. ([Sec 106 from Senate version](#))

It seems likely that those people who are marginally able to repay some of their debts will be strongly encouraged to utilize the services of the non-profit counseling service, even if doing so imposes the hardship of repaying a higher percentage of debts than in a Chapter 13 bankruptcy plan. By providing incentives to creditors, the Bankruptcy Reform Act favors credit counseling plans that provide for repayment of 60% or more of debts. This may seem like a reasonable percentage, however you need to realize that the debt is to be paid back over a shorter period (i.e.- the Credit Counseling plan may be for 36-60 months, where the original credit card debt might have been payable over 20 years!). It is possible to have a 40% reduction in credit card debt that results in just a 10% to 20% reduction in monthly payments.

It is important to contact a reputable credit counseling agency. Most current agencies will not be approved under the Bankruptcy Reform Act. The US Trustee's Office will (eventually) provide a list of Credit Counselors. Once it is published you should choose ONLY an agency on the list. Until then, make sure any Credit Counseling Agency you deal with belongs to the AICCCA or the National Foundation of Credit Counseling.

If the counseling agency says it cannot help you, or the proposed plan payments are more than you can afford, you may go to a debt relief agency (an attorney or bankruptcy petition preparer) to discuss

filing a Chapter 7 or a Chapter 13 bankruptcy petition. Because the Bankruptcy Reform Act adds so much complexity we suggest that you consult with an experienced bankruptcy attorney to answer any legal questions you may have.

2. MEANS TEST – The most talked about feature of the Bankruptcy Reform Act is the “mean’s test”. Basically, if the combined gross income of your family is greater than the median family income in your state, you may be required to file a Chapter 13 repayment plan where you repay a percentage of your debts over a 36-60 month period, and not allowed to file a traditional Chapter 7 bankruptcy where your debts are eliminated. Many people will not be effected by this provision, simply because the median gross income (total of all your income - W-2’s, 1099’s, etc.) for a family of four in most states is over \$50,000 per year (e.g.- in KY it is \$53,200 – but in WV it is \$43,200). ([Sec 102 from Senate version](#))

None-the-less, there is a potential risk that middle income family’s need to consider. Over the last few years many middle income families have purchased or refinanced a home, and have a significant mortgage payment. A large number of these families also have substantial credit card debt and automobile debt. The mean’s test looks back over the last 6 months income, when middle income families may have been earning more than the threshold amount. So long as the economy is improving and your health stays good, no problem. However, if you are subject to the means test and you lose a job or your wages go down, or you lose income due to medical problems, the means test may force you to pay a higher monthly payment in a Chapter 13 plan than you are able to afford. This could lead to wages being garnisheed, repossession of your cars, and foreclosure actions on your house.

It is far more important **NOW** than it was in the past to make certain that you do not overspend and get too deeply in debt. You must plan for reductions in future income, and keep debt low enough that you could survive even if your income or your spouse’s income goes down.

3. CALCULATION OF INCOME AND EXPENSES – In general, the rules for calculating what you must repay to creditors have been altered to favor creditors. If you are required to file a Chapter 13 case under the means test, then your monthly expenses will be closely compared to the IRS National and Local Standard Expense guidelines. The Bankruptcy Reform Act strictly limits the amounts you can claim as expenses. The court may require you to eliminate or greatly reduce spending on luxury items (like expensive cars, SUV’s, jewelry, etc.), extracurricular events for children (sports, etc.), vacations, etc. The tight budget required under the Bankruptcy Reform Act can result in a substantial burden on your family that is not imposed under the current law.

The Bankruptcy Reform Act does provide several allowed expenses in addition to the IRS guidelines. For example, up to \$1,500 per year per child may be paid for a dependent under age 18 to attend a private or public elementary or secondary school. Charitable contributions up to a total of 15 percent of gross income may be made to qualified religious or charitable entities or organizations. Actual expenses that are reasonable and necessary for the care and support of an elderly, chronically ill, or disabled family member are also allowed.

If you earn less than the median state income, the mean’s test does not apply, however the Ch 13 Trustee will probably still consult the national and local IRS expense guidelines to determine if your proposed expenses are reasonable. A large number of those who file bankruptcy under the new law will be held to a very lean budget for a full five years.

Many subtle, minor, changes have been made. For example, non-purchase (i.e.-the money borrowed was not used to buy the item) liens held by Finance Companies on electronic household goods can now be avoided only on 1 radio, 1 television, 1 VCR, and 1 computer. The practical effect is that if you have 2 TV's, 2 computers, a vicar plus a DVD, etc., you must pay the finance company "replacement value" (retail value considering condition) for those items to keep them (in both Ch 7 and Ch 13 cases). ([household goods in Senate version](#))

If you financed a car within 2 ½ years of filing, or made any other major purchase within 1 year, you must pay the full balance owed to the creditor to keep the item, even if, for example, the car has high mileage and is worth only half of what is owed. You may return the car to the creditor, but with financial problems you would probably have a difficult time replacing it with a reliable vehicle.

One of the most significant changes is that the person preparing a bankruptcy petition must give assurances about the accuracy of the contents of the petition. In the case of attorneys they must make "reasonable inquiry to verify that the information contained in such documents is well grounded in fact". In the existing system the debtors sign the petition under penalty of perjury, under the Bankruptcy Reform Act the attorney must verify the petition and schedules. That requirement alone will probably significantly increase the cost to file bankruptcy, furthering the goal of Bankruptcy Reform to discourage people from filing at all. ([Debt Relief Agency from Senate version](#))

4. CONVERSION TO CHAPTER 7 – In the past debtors often converted from a Chapter 13 case to a Chapter 7 case after the secured portion of their debts were paid in full by paying creditors the value of the items securing the debts. Under the Bankruptcy Reform Act, if there is an unsecured portion of a debt, and a debtor converts to a Chapter 7 case, the lien secures repayment of 100% of the unsecured portion, and the debtor may find themselves in instant default. For practical purposes, most debtors will be required to complete their Chapter 13 plan (36-60 months) to get the benefit of a reduction in the amount they pay to secured creditors.

A SELECTION OF MISCELLANEOUS PROVISIONS –

If a judgment for possession of a leased or rented apartment or house has already been given to a landlord, a debtor must certify that a defense exists in state court and must pay the entire rent owed within 30 days – usually a very difficult task.

The minimum time between filing Chapter 7 cases has been raised from 6 years to 8 years. If a discharge has been granted in a Ch 7 case, a Ch 13 case apparently may be filed but before a discharge can be entered in the Chapter 13 case the debtor's Ch 13 plan must continue until at least 4 years from the date of the Ch 7 discharge.

Several provisions strongly discourage multiple filings, even if additional bills accrue after a first case. The effect of the automatic stay that prevents creditors from continuing collection activity is reduced or eliminated in new cases where the debtor has previously filed cases. In some situations it is easier for creditors to terminate the automatic stay to allow them to recover security when debts are not reaffirmed or security redeemed within 45 days of the filing of the statement of intent to keep a specific item. ([Abusive filings from Senate version](#))

In general, tax returns that have not been filed must be filed. The dischargeability of taxes in bankruptcy has been further reduced.

The length of time that a debtor must live in a state to claim that states exemptions has, in most cases, been increased to 720 days, and a cap of \$125,000 has been put on homestead exemptions for property acquired in the last 3+ years. ([homestead from Senate version](#))

The Chapter 13 “super-discharge” that is obtainable under current law is greatly reduced under the Bankruptcy Reform Act.

Child and spousal support obligations are given top priority and, with very few exceptions, must be brought current and kept current during the pendency of a bankruptcy. Obligations for repayment of debt that are in the nature of alimony, maintenance, or support, and that arise out of a state court divorce proceeding, are already non-dischargeable – however the Bankruptcy Reform Act makes it easier for the non-filing ex-spouse to preserve the non-dischargeability and enforce those payments. ([support obligations from Senate version](#))

Retirement, pension, and profit sharing accounts, along with loans against those funds, receive very favorable treatment under the Bankruptcy Reform Act. ([retirement from Senate version](#))

GENERAL ADVICE –

There is no question that the current bankruptcy laws offer more relief from the burden of debt than the Bankruptcy Reform Act will. If you have a lot of credit card debt, large medical bills, high mortgage payments (or have a variable rate mortgage), high car payments, you need to carefully review your financial situation **NOW**. If you think that your income may go down, if your credit is already damaged, or if you have any other reason to believe that you may be in financial trouble in the future, you need to act **NOW**. Most of the provisions of the Bankruptcy Reform Act will not take effect until 6 months after the date President Bush signs it into law. You have that long to get your finances in order and decide if you need to file bankruptcy. After 6 months it will be too late, and your wages, house, and cars may be at risk.

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Many thanks to attorney Paul Snyder who has granted us permission to reprint this article. For complete information, including the full text of the new law, please visit:

<http://www.bankruptcyfinder.com/bankruptcyreformnews.html>