

BANKRUPTCY PROTECTION

House Bill 5740 (Substitute H-4) First Analysis (9-17-98)

**Sponsor: Rep. Charles Perricone
Committee: Commerce**

THE APPARENT PROBLEM:

According to the Federal Deposit Insurance Corporation (FDIC), declarations of personal bankruptcy are at an all time high in the United States, and are expected to exceed 1.3 million this year. Since the early 1970s, the rate has risen from less than one per thousand population annually to almost five per thousand population for the year ending September 30, 1997.

Some financial industry experts have attributed the increase in personal bankruptcies to changes in lender or borrower behavior: Lenders have become more aggressive and borrowers have become less prudent. These experts point to changes in marketplace rules: In 1978 and 1994 federal bankruptcy laws were modified, in part, to increase the level of assets that could be protected in a bankruptcy filing; and also, in the late 1970s consumer interest rates were deregulated after the Supreme Court's *Marquette* decision [(*Marquette National Bank of Minneapolis v. First Omaha Service Corp.* (1978)], an event that set the United States on a course of rising credit card volumes and [permitting the expansion of credit card debt to more high-risk borrowers] consumer debt.

Yet other experts argue the increase in the personal bankruptcy rate is attributable to business cycle activity. In fact, a February 1998 study and an accompanying analytic model developed by an economist with the Federal Deposit Insurance Corporation (FDIC) argues that approximately two-thirds of the increase in bankruptcies can be explained by the pattern of consumer indebtedness and business cycle activity alone. (Other demographic and social factors, such as relocation, job loss, and divorce, or a regional economic downturn can also contribute to the increase in the bankruptcy rate.)

Earlier this year, the U.S. Congress passed bankruptcy protection legislation to exempt contributions to churches and charitable organizations under certain circumstances. The bills (H.R. 2604 and S. 1244) protect donations to charity and tithing to

churches when a person declares bankruptcy, prohibiting creditors from seizing certain donations to either group, according to *Congressional Quarterly Weekly* (5-16-98).

In this era of increased bankruptcy filings, some here in Michigan have argued that the state's bankruptcy laws should be amended so that certain assets such as retirement accounts or annuities are protected from creditors during bankruptcy proceedings. (See *BACKGROUND INFORMATION*, below.) Some also have argued that the state's bankruptcy laws should be further amended to correspond directly to the federal law, so that the contributions a person makes to a church or charitable organization should be protected when personal bankruptcy is declared.

THE CONTENT OF THE BILL:

House Bill 5740 would amend those provisions of the Revised Judicature Act that list the kinds of property that are protected from creditors executing a judgment. Under the bill, the protected property (that is to say, that exempt from levy and sale under a declaration of bankruptcy) would include "a gift, donation, tithe, or offering made by an individual to a qualified religious or charitable entity as described in the Internal Revenue Code if the amount of the contribution is not more than 15 percent of the gross annual income of the individual for the year in which the transfer of the contribution is made."

MCL 600.6023

BACKGROUND INFORMATION:

Other Michigan Legislation. Earlier this session the House passed House Bill 5648, which would protect all of an individual's Roth individual retirement accounts (IRAs) from creditors during bankruptcy proceedings. House Bill 5648 was referred to the Senate Committee on Financial Services on June 10, 1998. The House also passed House Bill 5612 in

March 1998. That bill would protect only one of an individual's Roth IRAs from creditors during bankruptcy proceedings. That bill is also under consideration by the Senate Committee on Financial Services. Finally, Senate Bill 856, a bill identical to House Bill 5612, passed both the House and Senate and was signed into law on April 22, 1998 as Public Act 61 of 1998. Public Act 61 will protect one Roth IRA from creditors when an individual declares bankruptcy.

Federal legislation. According to *Congressional Quarterly Weekly* (5-16-98), both the U.S. Senate and the U.S. House of Representatives rewrote the nation's bankruptcy code during the past year. The most significant rewrite in two decades, the policy changes were embodied in S. 1301 and H.R. 3150. Fearful that bankruptcy had become a financial planning tool for many who could repay their debts, a bipartisan group of U.S. representatives passed legislation based on the idea that Chapter 7 of the bankruptcy code--which allows people to walk away from most unsecured debts, such as credit cards--should be available only to those who truly cannot pay their bills. The House bill established a strict "means test" (an income threshold set at 100 percent of the median income) to determine who is eligible for Chapter 7 bankruptcy protection, sending those who do not qualify home or to Chapter 13 bankruptcy, which requires a repayment plan. Some argued, however, that the House-passed bill favored creditors too much, and they pointed out that by giving high priority to repayment of credit card and other unsecured debt, it makes child support collections more difficult.

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that House Bill 5740 is expected to have no significant fiscal impact on state or local government. (9-16-98)

ARGUMENTS:

For:

Donations to churches are a special kind of charitable donation, and they deserve a special kind of protection during bankruptcy proceedings. They are special because a church connects human beings in a caring community of friends who are concerned about each others' spiritual and physical well-being. Contributions to such organizations help their

members sustain each other during times of personal crisis. What is more, some personal dignity and financial assets should be afforded to debtors, so they are able to once again participate in the exchange

economy. For example, some equity in their homes should be shielded through a homestead exemption. Likewise, debtors' connections to their spiritual communities should also be protected, and their contributions to them should be shielded from creditors.

For:

Michigan's bankruptcy laws should correspond to their counterparts, the federal bankruptcy laws. This legislation would bring Michigan's laws into conformity with recently enacted changes in federal law that provide bankruptcy protection for a gift, donation, tithe, or offering made by an individual to a qualified religious or charitable entity as described in the Internal Revenue Code, but only if the amount of the contribution is not more than 15 percent of the gross annual income of the individual for the year in which the transfer of the contribution is made.

Against:

According to press reports, the rallying cry of those who would toughen eligibility for personal bankruptcy declarations has been "personal responsibility and personal accountability." They argue that bankruptcy should not be easy, and that repayment for unsecured debt should be disciplined and systematic. Strict financial hygiene of this sort cannot be successful if whole categories of unwise expenditures, even church contributions, are simply forgiven.

Response:

This legislation is not intended to discharge people from paying their debts. Indeed, during committee deliberations, a provision was deleted which might have allowed for such abuse.

POSITIONS:

There are no positions on the bill.

Analyst: J. Hunault

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.