Legislative Analysis

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EXEMPTIONS FROM BANKRUPTCY CLAIMS

House Bill 5763 (Substitute H-2)
Sponsor: Rep. Alexander C. Lipsey
Committee: Judiciary
First Analysis (5-25-04)

BRIEF SUMMARY: The bill would increase the exemption thresholds for various types of property in a bankruptcy proceeding.

FISCAL IMPACT: The bill would have an indeterminate impact on the judiciary.

THE APPARENT PROBLEM:

When a person files a petition for bankruptcy, certain classes of property, and certain amounts of those property types, are protected (or exempted) from the claims of creditors by state and/or federal bankruptcy laws. Historically, the purpose of having exemptions in bankruptcy proceedings was to enable a person who had fallen upon hard times a chance at a new start. The exemptions were meant to provide the debtor enough assets and enough "necessities" to rebuild his or her life without needing public assistance. However, in Michigan, the monetary threshold of most property types that can be exempted hasn't been adjusted since the early 1960s.

Last year, an advisory committee to the Civil Law and Judiciary Subcommittee of the House Judiciary Committee was formed in response to a request by Representative Alexander Lipsey for recommendations on possible updates to the state's exemption laws. The committee comprised attorneys from around the state with backgrounds in debtor/creditor and bankruptcy laws. Not surprisingly, members found the current exemption thresholds inadequate to enable debtors enough assets to successfully begin anew. Legislation has therefore been offered to increase the thresholds and update the types of property that can be exempted from creditors in bankruptcy proceedings.

THE CONTENT OF THE BILL:

House Bill 5763 would add Chapter 54a, entitled "Bankruptcy" and Chapter 60, entitled "Enforcement of Judgments", to the Revised Judicature Act (MCL 600.5451 and 600.6023a). The bill would list the types of property that would be exempt in bankruptcy proceedings from levy and sale under an execution and adjust for inflation the dollar amounts of the interest in a property that can be exempted.

Under the bill, a debtor in bankruptcy under the federal bankruptcy code could choose to apply the federal property exemptions or the state exemptions as listed below:

- Family pictures; arms and accoutrements required by law to be kept by a person; wearing apparel (excluding furs); cemeteries, tombs, and rights of burial in use as repositories for the dead of the judgment debtor's family or kept for burial of the judgment debtor; and professionally prescribed health aids.

- Six months worth of provisions and fuel;

- The interest, not to exceed a value of $450 in each item and an aggregate value of $3,000, in household goods, furniture, utensils, books, and jewelry.

- The interest, not to exceed $500 in value, in a seat, pew, or slip occupied by the judgment debtor or his or her family in a house or place of worship.

- The interest, not to exceed $2,000 in value, in crops, farm animals, and animal feed.

- Up to $500 in value of a family pet.

- The interest in one motor vehicle up to $2,775 in value

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- Up to $500 in value in one computer and its accessories.

- The interest, not to exceed $2,000 in value, in tools, materials, stock, etc. to enable a person to carry on his or her trade, occupation, profession, or business.

- Disability benefits paid by an insurance company regardless of whether the debt or liability was incurred before or after the accrual of benefits under the insurance policy or contract, with the exception of actions to recover for necessities contracted for after the accrual of the benefits.

- Except for homesteads exempted under the general laws of the state, the interest, not exceeding $1,000 in par value, in shares held by a member of a savings and loan.

- With certain specified exceptions, all individual retirement accounts, including Roth IRAs, and the payments or annuities from those accounts as allowed under federal bankruptcy laws.

- With certain exceptions, the right or interest of a person in a pension, profit-sharing, stock bonus, or other plan qualified under federal law.

The interest of a debtor, a codebtor, and the debtor's dependents in a homestead, not to exceed $30,000 in value or, if the debtor or a dependent of the debtor at the time of the filing of the bankruptcy petition were 65 years of age or older or disabled, not to exceed $45,000 in value, would be exempt. Real property held jointly by a husband and wife as a tenancy by the entirety would be exempt, unless both the husband and the wife were debtors in bankruptcy.

The exemptions would not apply to a mortgage, lien, or security interest in the exempt property that was consensually given or lawfully obtained unless the lien was obtained by judgment, attachment, levy, or similar legal process in connection with a court action or proceeding against the debtor. If property exempted under this provision were sold, damaged, destroyed, or acquired for public use, the right to receive proceeds or, if the owner received proceeds and held them in a manner that made them identifiable as proceeds, the proceeds received would be exempt from the property of a federal bankruptcy estate in the same manner and amount as the exempt property. Exemption under this provision could be claimed up to one year after the receipt of the proceeds by the owner.

Beginning on March 1, 2005 and at the end of each three-year period after 2005, the state treasurer would have to adjust each dollar amount in Section 6023 (or each adjusted amount after March 1, 2005) for inflation as specified in the bill. The adjusted amounts would have to be published. Adjusted amounts would apply to cases filed on or after April 1 following the adjustment date.

Under the new Chapter 60, Section 6023a would specify that real property held jointly by a husband and wife as a tenancy by the entirety would be exempt from execution under a judgment entered against only one spouse.

ARGUMENTS:

For:

Property exemption thresholds in federal and state bankruptcy laws have not kept pace with inflation or even with changing times. For instance, current law pertaining to property exemptions exempts ten sheep, two cows, five pigs, five roosters, and 100 chickens for each debtor, and only $3,500 in equity in a person's home. The bill would update the property classes that could be exempted and increase the amount of interest in the properties that could be protected to compensate for inflationary changes. (For example, the bill would protect an interest in a computer and computer accessories up to a certain value, to reflect modern life.)

In arriving at the figure pertaining to home equity protection, the advisory committee considered cost of living increases over the last 40 years (the homestead exemption was last increased in 1963 when the state Constitution was adopted), the average mortgage balance and equity in homes in Michigan, the homestead exemption under the U.S. Bankruptcy Code, homestead exemptions offered by other states, and special exemptions for the elderly and disabled. In its research, the advisory committee found that home equity made up more than one-half of the net wealth of most U.S. homeowners and that the importance of home equity increased in importance as the homeowner aged. For example, a Freddie Mac report reviewed by the committee revealed that about 40 percent of the net assets of households of people between the ages of 65 and 70 years of age consisted of their residence alone. Therefore, it is very important that the home equity that can be protected from creditors when a person files for bankruptcy be increased.

Another important provision of the bill is that it would clarify (and codify current judicial interpretation) that real property held jointly by a husband and wife as a tenancy by the entirety would be exempt from an execution under a judgment entered against only one spouse. This would protect the home of the person whose spouse had an unsuccessful business venture or ran up debts in his or her own name due to substance abuse or other reasons. However, in the case of bankruptcy, if both the husband and wife were codebtors, the real property would not be protected and would be subject to the exemption thresholds contained in the bill. Further, the bill would require that the thresholds be adjusted every three years to account for cost of living increases.

Against:

Some feel that the exempted property thresholds are being increased too generously and will therefore hinder legitimate collection attempts. For example, the exemption for a motor vehicle would be increased to nearly $3,000. However, a tradesperson, such as a painter, could further exempt $2,000 of tools of his or her trade, such as ladders. This would bring the exemption for the vehicle closer to $5,000, making it more difficult to collect on the claim. Further, fewer and fewer people are retiring at 65. With the increased life expectancy and numbers of people retiring at 70 or older, the age at which the exemption for real property increases to $45,000 should either be increased or scrapped altogether.

Response:

Again, the purpose of exemptions in bankruptcy proceedings is to leave a debtor with enough means to start over and not wind up as a public charge. Therefore, it is very important to protect the tools and equipment of a tradesperson so that he or she can continue to work and support his or her family. As for eliminating the increased protection for those 65 years of age or older, many people are unable to work past 65 due to poor health that does not meet the level of being disabled. And, with the high cost of prescription drugs, and health care, it is also important to protect a reasonable amount of equity in a person’s house so that he or she is not left destitute and totally dependent on state-supported services such as nursing home care.

POSITIONS:

A representative of the Michigan Creditor Bar Association indicated support for the bill. (5-20-04)

A representative of the Michigan Court Officers and Deputy Sheriffs Association indicated a neutral position on the bill. (5-20-04)

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