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*Treatment of Health Care Expenses under the Bankruptcy
Abuse Prevention and Consumer Protection Act*

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Abstract. If enacted, the Bankruptcy Abuse Prevention and Consumer Protection Act would subject prospective debtors under the U.S. Bankruptcy Code to a means test to determine whether they could liquidate under chapter 7 or reorganize under chapter 13. Large outstanding medical expenses alone will not determine eligibility to liquidate or reorganize. They will, however, affect the means test in one of two ways. Prebankruptcy health care expenses are likely to raise the amount of a debtor's unsecured debt. Health insurance premiums and ongoing costs for care of the debtor's dependents may be deducted from the debtor's monthly income to determine the level of disposable income.

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Treatment of Health Care Expenses under the Bankruptcy Abuse Prevention and Consumer Protection Act

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Summary

If enacted, the Bankruptcy Abuse Prevention and Consumer Protection Act would subject prospective debtors under the U.S. Bankruptcy Code to a means test to determine whether they could liquidate under chapter 7 or reorganize under chapter 13. Large outstanding medical expenses alone will not determine eligibility to liquidate or reorganize. They will, however, affect the means test in one of two ways. Prebankruptcy health care expenses are likely to raise the amount of a debtor's unsecured debt. Health insurance premiums and ongoing costs for care of the debtor's dependents may be deducted from the debtor's monthly income to determine the level of disposable income.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),¹ if enacted, would amend the U.S. Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, to subject debtors to a means test to determine whether they may file under chapter 7 of the U.S. Bankruptcy Code and liquidate their debts, or whether they would have to file under chapter 13, governing consumer reorganization, in order to realize a discharge of indebtedness.² A debtor who, pursuant to the complex means test determination, is presumed to have \$100 a month in disposable income would either have to refrain from filing, or would be subject to a three- to five-year reorganization plan.³

¹ S. 256, 109th Cong., 1st sess. (2005), passed the Senate on March 10, 2005. It was reported favorably by the House Judiciary Committee on March 16, 2005. See also H.R. 685, 109th Cong., 1st sess. (2005).

² In order to file under chapter 13, there is a jurisdictional debt limit of no more than \$307,675 in unsecured debt and \$922,975 in secured debt. An individual whose indebtedness exceeds these amounts could reorganize under chapter 11, which is designed for business reorganization.

³ For more information about the means test provisions, see CRS Report RS22058, *Bankruptcy Reform: The Means Test*, by Mark Jickling.

Shortly before the Senate considered and passed the reform bill, researchers at Harvard University released a study indicating that a high percentage of bankruptcy filers cited medical expenses as a contributing factor for the bankruptcy filing.⁴ Amendments were introduced to address medical expenses in the bankruptcy process, and several were adopted by the Senate. This report summarizes the specific role of medical expenses under the reform bill.

The Bankruptcy Abuse Prevention and Consumer Protection Act is intended to ensure that those who are able to pay unsecured indebtedness in bankruptcy do so. Under chapter 7, a debtor liquidates all of his or her assets as of the date of filing and receives a discharge for permissible debts incurred prior to the filing. In chapter 13, a debtor pledges future income to repay past debts. Secured indebtedness, such as home mortgages and automobile liens, are treated differently under the U.S. Bankruptcy Code, and the law in general; they cannot be fully discharged. Unsecured claims, which are essentially contractual obligations to repay without a pledge of collateral, may be. Historically, chapter 7 has been utilized by debtors to discharge unsecured debts such as credit card debts or medical expenses.

Medical Expenses as Debt. The BAPCPA does not confer special treatment upon health care expenses as a category of unsecured debt or as a driving cause for a bankruptcy filing. Indeed, proponents of the legislation explain that medical indebtedness is not intended to receive unique treatment. As explained by Senator Sessions:

... If they [debtors] make above the median income and are able to pay off some of their debts to their doctor and their hospital, why shouldn't they? You mean they have no obligation to pay a hospital that may have spent a lot of money helping them get well or a physician who took care of them and provided medical care to them? If they are making \$80,000 a year and in bankruptcy under chapter 13 the judge finds that a person could pay back 25 percent, why should they not pay 25 percent? The judge will not order it unless he believes based on the person's income level they have the ability to repay.

When a person in America undertakes an obligation to pay someone, they ought to pay them, and in any country that is so. We are drifting a bit to suggest there is no real obligation to pay the debts we incur. If we get to that point, then we have eroded some very important fundamental moral principles about commerce in America.

... I believe this bill says plainly and clearly, if one can pay back some of their debts, they ought to do so. There is no reason why somebody making \$100,000 who can pay back 20 percent of the debts he owes to the person who fixed his car or the doctor who helped him get well should not pay that back. Why should they wipe out all of those debts?⁵

Generally, debts owed for medical services, hospitalizations, and/or medicine incurred *prior* to the bankruptcy are general unsecured claims. The aggregate outstanding amount

⁴ David Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Illness and Injury As Contributors to Bankruptcy*, MARKETWATCH: HEALTH AFFAIRS — Web Exclusive (February 2005), at [<http://content.healthaffairs.org/cgi/content/abstract/hlthaff.w5.63v1>].

⁵ 151 CONG.REC. S1820 (daily ed. March 1, 2005).

will be a component of the means test calculation of the debtor's ability to pay unsecured debt from future income. The larger the amount of unsecured debt, the greater the income necessary to pay it off. The means test does factor in ongoing medical expenses as a living expense in various contexts. They are discussed below.

The Means Test. The means test is a complex formula that calculates income and expenses to determine whether an individual is considered to have “disposable” monthly income. It combines living expenses that the Internal Revenue Service considers to be reasonable with the individual debtor's actual expenses in certain categories.⁶ For a debtor whose income exceeds the applicable state median income, if the sum of hypothetical expenses and real expenses measured against monthly income results in a surplus of \$100 or more a month, the debtor would *not* be permitted to file under chapter 7.⁷ If a debtor is ineligible for chapter 7, he or she may file under chapter 13. The duration of the chapter 13 plan will also depend upon a debtor's median income. When the debtor is in chapter 13, determining repayment ability (i.e., disposable income under the reorganization plan) will also calculate monthly disposable income by a comparable method.

For means test purposes, a debtor may exclude from monthly income *actual* expenses for:

- reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the debtor's spouse, and dependents; and
- reasonably necessary care and support of an elderly, chronically ill, or disabled household member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such expenses.

If the means test indicates that a debtor does have the ability to pay, the debtor may still assert the existence of special circumstances, such as a serious medical condition, that should be considered as an allowable deduction from monthly income.

Conclusion. Health care expenses will generally be considered in one of two contexts in a bankruptcy filing. Significant expenses incurred prior to the bankruptcy filing may be calculated as unsecured claims; if the debtor cannot afford to pay 25 percent of unsecured claims or \$100 a month, the debtor may be eligible to file under chapter 7.

Ongoing health care expenses and health insurance premiums may be deducted from the debtor's monthly income. Factoring in these expenses may also reduce the debtor's disposable income under the means test.

⁶ The Internal Revenue Service has national living standards governing food, housekeeping, supplies, apparel and services, personal care supplies and services. It has separate standards for housing, utilities, and transportation.

⁷ The statutory language provides that if the debtor's current monthly income is greater than “the lesser of — (1)25 percent of the debtor's nonpriority unsecured claims in the case, or \$6,000, whichever is greater[.]” then the debtor is not eligible to file under chapter 7.