

Elder Bankruptcy

Fixed incomes and fixed assets make older adults particularly vulnerable to financial fluctuations. A bad investment, an unexpected medical crisis, a financial predator, or an unwise financial decision resulting from cognitive decline can quickly turn an older adult's financial world upside down.

Elder law attorneys regularly see these clients, but we often dance around a simple question: should an older client consider filing bankruptcy?

Can my client gain anything from bankruptcy?

A bankruptcy filing will harm an individual's ability to obtain financial credit, but credit is usually less of a concern for older clients. Additionally, filing for bankruptcy can hurt a client's pride, so first you need to determine if your client is collectible; that is, establish which assets are at risk and which the client can protect or exempt in bankruptcy. Elder law attorneys need to understand that the limited "excluded assets" for Medicaid qualification differ greatly from the bankruptcy exemption.

In Michigan, individuals filing bankruptcy can elect to claim exemptions under either state or federal law.¹ The available exemptions vary between the two, and the types of property owned and the nature of the ownership interest must be evaluated. To claim Michigan's exemptions, the individual must have his or her domicile in the state for at least two consecutive years immediately before the filing.² Otherwise, the exemptions in the state where the individual was previously domiciled might apply.

Under the Federal Bankruptcy Code³ and as of February 16, 2016,⁴ the residential real estate exemption is limited to \$23,675 in equity; a motor vehicle up to \$3,775; household goods up to \$12,625 with no one item exceeding \$600 (household goods are defined in the statute); cash value of a life insurance policy up to \$12,625; and a \$1,250 "wild card" exemption to be used as the debtor chooses.⁵ If a debtor does not have residential real property with equity or the equity is limited, he or she can use up to \$11,850 of the unused real estate exemption on other items.⁶ In a joint case, married



couples are *each* entitled to claim these exemptions as long as they have an ownership interest in the property.⁷

Michigan's exemptions may prove to be more useful if a client needs to protect real property.⁸ In Michigan, real property held as tenants-by-the-entireties is fully exempt if the debts belong to only one spouse. The entireties exemption does not protect both spouses from creditors holding joint claims against them.⁹ However, the state also allows homeowners a much more generous real property homestead exemption of \$57,350 in equity for individuals who are over age 65 or disabled.¹⁰ This homestead exemption can only be claimed once.¹¹

Michigan's exemptions might also be better if a client needs to protect a significant cash value in life insurance. Unlike the limited federal exemption, the cash value of a life insurance policy may be fully exempt, particularly if the beneficiary is a spouse or a child of the insured.¹²

Both federal and Michigan laws are generous when it comes to protecting retirement assets. Most retirement plans are exempted entirely; except under the federal exemption, IRAs and Roth IRAs have a substantial \$1,245,475 exemption.¹³

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FAST FACTS

Accepted Medicaid planning advice can cause issues for a client who may need to file for bankruptcy.

Assets that are exempt from bankruptcy differ greatly from Medicaid's exempt assets.

A client's income may determine his or her eligibility to seek a discharge of debt under Chapter 7.

Even if most of a client's assets are already exempt, his or her income could still be exposed to garnishment if the client does not discharge the debt through bankruptcy. For example, Social Security¹⁴ and disability-related veterans' pensions¹⁵ are exempt from private creditor garnishment, but a creditor can garnish pension income once it is paid out. Even if a client's assets might be exempt, bankruptcy still may be a good option to protect needed retirement income.

A client might also be able to avoid bankruptcy by using the threat of filing to negotiate settlements with creditors. This requires the attorney to analyze the client's financial circumstances and convincingly explain the client's financial position to individual creditors to resolve the debt. Surprisingly, creditors who are properly advised of a client's financial condition will often become understanding once they are convinced the client is uncollectible. They understand the futility of spending good money with the limited hope of ever collecting.

Which chapter?

If a client chooses to file bankruptcy, the client must decide between Chapter 7 or Chapter 13. Chapter 7 provides the debtor with a discharge and a clean slate after the bankruptcy process concludes. Chapter 13 requires a payment plan to pay creditors some or all of their debt with future income for up to five years.¹⁶

Chapter 7 may seem like the better choice, but sometimes there are reasons not to use it. First, a client may have too much income. Beginning in 2005, Congress created an income-based means test for consumer Chapter 7 filings.¹⁷ Generally, a client with primarily consumer debt can file a Chapter 7 bankruptcy only if their household income is less than the state's median household income for the size of the

individual's household (or if household income would be less than the median income after certain exemptions).¹⁸ Average median household incomes for individuals over age 65 are usually less than the general population. Therefore, more older adults are likely eligible to file Chapter 7.¹⁹ However, the means test may prevent a Chapter 7 filing for some.

A key reason to file Chapter 13 is to delay or stop a home foreclosure. In a Chapter 13 filing, an individual can stop a foreclosure sale from taking place as long as the petition is filed *before* the sheriff's sale occurs.²⁰ The Chapter 13 payment plan can then catch up arrearages.²¹ Delaying or preventing foreclosure through Chapter 13 could provide an older adult with precious years in his or her home.

Where bankruptcy attorneys and elder law attorneys differ

Most elder law attorneys refer the actual bankruptcy work to other lawyers. But it is also important to know how certain decisions might affect a potential bankruptcy. A bankruptcy attorney might question an elder law attorney who:

- **Liquidates retirement assets.** In bankruptcy, retirement assets are essentially completely protected. In Medicaid planning, retirement assets count as any other asset. Elder law attorneys often understand the tax consequences of surrendering retirement assets, but should also pause if a client has significant debts.
- **Overinvests in houses, vehicles, and tangible property.** In Medicaid planning, attorneys love to invest in houses, vehicles, and other tangible property because these assets are exempt for Medicaid purposes. But as previously discussed, the bankruptcy protection for these assets is limited.

- **Destroys a tenancy by the entirety.** Elder law attorneys regularly destroy tenancy-by-the-entirety deeds by transferring houses to a community spouse or a trust. But if only one spouse owes a debt, that house may now be exposed to bankruptcy.
- **Makes a fraudulent transfer.** Medicaid planning sometimes involves making a strategic gift. If a client makes the gift while insolvent, that gift might be voided as a fraudulent transfer in a bankruptcy proceeding.

There are many good reasons to do any of the above when planning for Medicaid benefits. However, if a client carries a lot of debt, it would be useful to talk to a bankruptcy attorney before proceeding.

Preventing bankruptcy

Most elder law attorneys successfully assist clients on minimizing the financial impact of long-term care, but they must be equally cognizant of other common causes of financial disruption. Here are just a few examples:

- **Obtaining good Medicare plans.** Elder law attorneys may dismiss the financial devastation of a medical crisis, figuring Medicare will cover it. But this assumes the client has proper Medicare coverage. A surprising number of clients make mistakes when signing up for Medicare, such as thinking an employer-paid plan will remain in effect at Medicare age or retirement. Even those on Medicare may have improper prescription drug coverage, be in an inappropriate Medicare Advantage plan, or not have any additional medical coverage at all.
- **Trust planning.** Fear of financial exploitation should not be used as a scare tactic to sell overpriced and boilerplate trust documents. Client-centered trust planning and smart drafting can often minimize the risk of financial exploitation.
- **Ensuring investment diversification.** Elder law attorneys are not financial advisors, but we can recognize when a client is overexposed to an economic downturn. Even though a past employer's company stock served a client well and the client is justifiably proud of it, the stock should generally not make up 90 percent of an older adult's financial portfolio.
- **Assisting with suspected financial exploitation.** Empower a client to involve the police or Adult Protective Services if you suspect financial exploitation. Refer the case to an experienced probate litigator who can evaluate the case and determine if there is potential for financial recovery.

Even without practicing bankruptcy, elder law attorneys can still assist older clients by suggesting how financial hardship might be avoided, by identifying when a client should

consider bankruptcy, and by being aware of how Medicaid planning could potentially impact an eventual bankruptcy. ■



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ENDNOTES

1. 11 USC 522(b)(3)(A); MCL 600.5451.
2. *Id.*
3. 11 USC 522(d), with the numbers adjusted every three years pursuant to 11 USC 104.
4. Judicial Conference of the United States, *Revision of Certain Dollar Amounts in the Bankruptcy Code*, 81 Fed Reg 8748 (February 22, 2016).
5. *Id.*
6. *Id.*; 11 USC 522(d)(5).
7. 11 USC 522(b)(1).
8. MCL 600.5451.
9. MCL 600.5451(1)(m) and MCL 600.5451(1)(n).
10. Michigan last updated its exemptions numbers on January 25, 2017; see State of Michigan, Dept of Treasury, *Property Debtor in Bankruptcy May Exempt from Levy or Sale Inflation Adjusted Amounts*, available at <https://www.michigan.gov/documents/treasury/Notice_BankruptcyExemptions2017_550393_7.pdf>. All websites cited in this article were accessed December 6, 2017.
11. MCL 600.5451(1)(m). See also *In re Lindstrom*, 331 BR 267 (Bankr ED Mich 2005).
12. MCL 500.2207(1).
13. 11 USC 522(d)(12) and 11 USC 522(n); MCL 600.5451(1)(k).
14. 42 USC 407.
15. 38 USC 5301.
16. See generally Administrative Office of the United States Courts, United States Courts, *Bankruptcy Basics* <<http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics>>.
17. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub L No 109-8, 119 Stat 23.
18. 11 USC 707(b).
19. As of November 1, 2017, the median income for a household of two in Michigan is \$59,541; see US Dept of Justice, *US Census Bureau Median Family Income by Family Size* <https://www.justice.gov/ust/eo/bapcpa/20171101/bci_data/median_income_table.htm>. In 2016, the median income for an individual in the United States was \$31,099, whereas the median income for individuals 65 and over was \$23,395; see US Census Bureau, *Current Population Survey Tables for Household Income*, available at <<https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-hinc.html>>.
20. 11 USC 362(a)(4) and 11 USC 362(a)(5).
21. 11 USC 1322(c)(1).