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Doctor bankruptcy filers face more complex proceedings

Personal Finance. By Katherine Vogt, *AMNews* staff. April 11, 2005.

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New federal bankruptcy legislation could spell bad news for physicians who are forced to turn to the courts to dig out of debt, experts warn.

The days of a relatively quick trip through bankruptcy proceedings likely will be gone for most physicians, they say. Instead, filing for personal bankruptcy will be a more complex, time-consuming and costly process.

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Some assets, such as homes, that previously were untouchable in some states during bankruptcy proceedings might be at risk under the legislation. But the bill would leave some other safety nets intact, and protections could be strengthened for other assets, such as IRAs.

The changes are spelled out in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The bill, designed to cut down on abuse of the nation's bankruptcy system and supported by the credit card industry, was approved by the Senate in mid-March. It is expected to be passed by the House and signed into law by President Bush some time in April.

The measure could be especially significant to physicians, who sometimes rely on bankruptcy courts as their last protection when faced with excessive judgments in malpractice cases, said Marc Singer, senior partner with the Coral Gables, Fla.-based financial services firm Singer Xenos Wealth Management, whose clients are predominantly physicians.

"Bankruptcy is not a dirty word for physicians. It actually can be a very useful tool," he said. "[But] the bankruptcy bill being proposed will directly impact the protection physicians can get through bankruptcy courts."

The law essentially would leave business reorganization proceedings unchanged, but it could have dramatic implications for individual filers, such as doctors, said John T. Hansen, a bankruptcy attorney in San Francisco with Nossaman, Guthner, Knox, Elliott LLP.

"It's the most major overhaul since the changes in the law that occurred during the Great Depression," he said.

Perhaps the most significant change is that fewer individuals will be eligible to file for protection under Chapter 7 of the bankruptcy code, which allows a debtor's unsecured assets to be liquidated and used to pay creditors. The debts owed can be discharged in just a few months through this procedure, giving the individual a fresh start.

Chapter 7 is attractive not only because it is a relatively quick process, but also because certain assets, such as homes in some states, remain protected from creditors. Only unsecured items are used to pay off the debt. That means physicians who have taken some asset protection measures might end up turning over "close to zero" in assets, Singer said.

But the legislation would mean that more people likely would have to file under Chapter 13, which typically calls for an individual to follow a budget to repay creditors over several years. The repayment plan can gobble up all disposable income, causing major lifestyle changes.

"The real bottom line is that if they have children in private school or expensive habits, like vacation homes, they're going to be really damaged and they're going to have to go into their exempt assets to make ends meet," said Rob Lambert, president of Asset Protection Corp., a New York-based financial services firm.

Observers say the bill would prevent most physicians from being able to use Chapter 7 because of the way eligibility would be determined. Debtors whose annualized incomes are above the median income in their states likely would be forced into Chapter 13 by creditors under the legislation's rules.

Some other highlights of the bill that could impact physicians include:

- A rule limiting homestead protection to $125,000 if the debtor bought the home within 40 months of bankruptcy. This provision aims to prevent people from loading up on this type of asset protection. It could have a major impact on people in states such as Florida or Texas, where homes have been fully protected from creditors. The federal legislation would trump those state protections. But the bill wouldn't afford additional protection to people in states such as Michigan, which have very low caps on homestead protection, said Jeff Morris, resident scholar at the American Bankruptcy Institute.
- A provision allowing people who file bankruptcy to protect up to

$1 million in an IRA from creditors. Morris said this federal exemption was created so IRAs would be treated more like traditional pension plans, which are generally protected in bankruptcy proceedings. But Morris said 35 states have laws saying they won't recognize this type of federal exemption, so it would be a moot point in those states.

- A requirement that all potential filers must go through consumer credit counseling before their cases are accepted, and they must complete a personal financial management course before their cases are discharged.

The effect of all this could prevent some physicians from seeking a bankruptcy filing at all, Hansen said.

"A lot of people won't file because they will see it isn't going to do them much good because they have too many assets or too much income, and they will just try to continue to deal with it outside of court," he said.

Those who do file could find themselves paying more because the new law requires attorneys involved in such cases to assume some liability for the accuracy of their clients' filings, so they likely will raise their rates, he added.

Singer said physicians who face the possibility of bankruptcy might consider filing for protection before the measure goes into effect. If the bill is signed into law in April, most provisions wouldn't kick in until October.

But he said even physicians who don't have bankruptcy in their sights should take this bill as a reminder that good asset-protection planning should be done far in advance of having a problem.

"Doctors are on notice that they need to be more preventive, not reactive," he said.

Vogt *is a reporter for the Business section. You can send her tips or suggestions by e-mail or call her at 312-464-4426.*

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