The Bankruptcy Code’s Disservice to Those Who Served

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Editor’s Note: ABI conducted its Eleventh Annual Bankruptcy Law Student Writing Competition during the first semester of 2019. Law students from around the nation submitted papers that focused on such topics as bankruptcy fraud exception, livestock in bankruptcy and applying undue hardship to aging debtors. All papers were judged by a panel of bankruptcy experts on style, substance and relevance. Jonathan S. Glover, a retired Army captain and a student at Stetson University College of Law, won second place in the competition. He received a $1,250 cash prize (sponsored by Wolcott Rivers Gates), a one-year ABI membership and publication of the paper in the ABI Journal.

In addition, ABI’s Task Force on Veterans and Servicemembers Affairs has a primary mission to “remediate and prevent adverse debt concerns and impacts on veterans and servicemembers to ensure that we financially strengthen those that strengthen us with the respect and dignity they deserve.” To that end, the Task Force has focused much of its initial attention on the Bankruptcy Code’s perplexing and inequitable treatment of veterans’ benefits in consumer bankruptcy cases. For more information, please contact Task Force Chair John W. Ames (Bingham Greenebaum Doll LLP; Louisville, Ky.) at james@bgdlegal.com or visit veterans.abi.org.

“Most disturbing, [the] Debtor’s original attorneys ... do not even now recognize that they put [the] Debtor into a chapter 13 case when she qualified for a chapter 7 discharge. The lawyers ... failed to recognize the rights of an active duty military person in bankruptcy.”

T he federal government provides a tax exemption to disabled persons, which allows such income to be excluded from gross income for tax purposes. The statutes are clear that all disability compensation should receive the maximum protection under the law. This article compares Veterans Administration (VA) disability to Social Security Disability Insurance (SSDI) compensation, how the Internal Revenue Code (IRC) treats each for tax purposes, and the exclusion of VA disability compensation in chapter 7 versus inclusion in chapter 13.

Veterans compensation is complex, and knowledge of that compensation system is needed to properly evaluate veterans for possible bankruptcy filings. An attorney who is not experienced in this type of compensation could advise a veteran to file under the wrong chapter. It is important to remember that disabled veterans either volunteered to serve their country or were drafted. According to the 2000 census, 12.7 percent of the population were veterans, and these veterans face unique challenges.

Sometimes, the only consistency for a veteran is the monthly disability compensation, and the attorney plays a key role in helping the veteran protect rights in that compensation.

The amount of veterans’ compensation varies based on several factors. Bankruptcy attorneys may not be aware of statutory considerations that could impact the case. The rules of professional conduct require that a lawyer provide competent representation to a client, and the quote at the beginning of

1 In re Love, 461 B.R. 29, 32 (Bankr. N.D. Ill. 2011).

2 “In Harm’s Way ... How Many Real Vietnam Vets Are Alive Today?,” American War Library (2007), available at americanwarlibrary.com/personnel/vietvet.htm (there are approximately 850,000 Vietnam Veterans still alive) (unless otherwise specified, all links in this article were last visited on May 31, 2019).


this article is a reminder of the consequences of failing to know the compensation system.

Attorneys who decide to represent veterans should understand veterans benefits, because a disabled veteran might need more help besides bankruptcy. For example, a veteran rated at 70 percent disabled might be individually unemployable, meaning that the veteran cannot work and is compensated at the 100 percent rate. This same veteran might not be aware of the option to apply for SSDI, which could result in an award with retroactive pay and a new source of income. Attorneys should take extra time to get a veteran’s background and history so that no stone is left unturned. Proper representation for veterans will give them the best opportunity for success and might avoid bankruptcy altogether.

VA Disability: Background and Purpose

The U.S. Department of Veterans Affairs was established in 1930, and title 38 was enacted on Sept. 2, 1958, to administer the laws and provide benefits to veterans and their families. Veterans file claims for VA disability compensation either prior to, or immediately following, discharge from military service, but there is no statute of limitations for filing a claim. After review, a disability percentage is determined correlating to the compensation received.

Veterans are released from active duty for many different reasons. As long as the veteran leaves service with a discharge that is not under dishonorable conditions, the veteran is eligible to file a claim for benefits. A disabled veteran is defined as someone who is entitled to compensation for a disability rated at 30 percent or more and receives compensation commensurate with the level of disability. Final ratings decisions by the VA could impact the veteran’s employability, and the wrong rating will impact a disabled veteran who cannot work. The exhibit lists the different rating percentages and employability determinations that affect the amount of compensation.

A veteran with a spouse and child rated with a disability rating of 70 percent due to post-traumatic stress disorder receives compensation of $1,566.48 per month. This veteran is permitted to work. However, if the veteran cannot work and was properly labeled as individually unemployable, then the payment to the veteran would be $3,261.10 per month. The proper classification results in additional compensation and was properly labeled as individually unemployable, then the payment to the veteran would be $3,261.10 per month.

The proper classification results in additional compensation of $1,694.62 per month. This is important because other disability-compensation programs such as SSDI can be impacted or stopped if the individual works.


7 See “How to File a VA Disability Claim,” U.S. Department of Veterans Affairs (2018), available at benefits.va.gov/compensation/process.asp (there is an eight-step process for filing claim, and VA does not provide timeline for making its determinations; rather, VA states that nature and type of claim can impact length of the process, and this is assuming that there are no rejections of filed claims requiring appeal that can take much longer).

8 Soldiers can be discharged for administrative reasons, discipline reasons and for injuries incurred while not on duty that resulted in an inability to carry on service. All of the discharges can have a different impact on the ability and amount of success in filing a claim for VA benefits.


10 A veteran who is rated with an individual unemployability rating is rated at less than 100 percent but is paid at 100 percent, but is prevented from working if the veteran wants to receive the 100 percent payout. On the other hand, a disabled veteran who is unable to work, but does not receive the full 100 percent rating or the individual unemployability signifier, receives compensation at the percentage rated by the VA.


SSDI

In 1938, Congress recognized that individuals who were permanently and totally disabled were in a desperate economic situation. SSDI was created to provide financial assistance to workers who paid long enough into Social Security who, due to a disability, cannot work. According to the Social Security Act, a disabled person is someone with a medically determinable physical or mental impairment that will either result in death or last longer than 12 months, and prevents any substantial gainful activity.

Individuals who apply for SSDI go through a similar process as veterans applying for VA disability compensation, but veterans are not automatically entitled to SSDI. Someone receiving SSDI can work, but the amount of income being earned is heavily regulated. For a disabled veteran, VA disability compensation is not affected by receipt of SSDI. SSDI awards are reviewed periodically based on the classification of the disability, and the review could result in a loss of benefits.

IRS Application to VA Disability and SSDI

The IRC defines “gross income” as all income regardless of the source, with caveats and exceptions. For veterans, the IRC excludes amounts received for personal injuries resulting from active service in the armed forces, as well as disability income resulting from injuries incurred directly from military action. The IRC also protects VA disability compensation from tax levy or garnishments.

<table>
<thead>
<tr>
<th>Rating</th>
<th>Employability</th>
<th>Compensation Level</th>
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<tr>
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</tr>
<tr>
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<td>No</td>
</tr>
<tr>
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<tr>
<td>70%**</td>
<td>Employable</td>
<td>70%</td>
<td>Yes</td>
</tr>
<tr>
<td>70%**</td>
<td>Unemployable</td>
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60 percent rating requires a single condition rated at 60 percent; otherwise, to qualify for individual unemployability, the combined rating must be 70 percent. ** 70 percent combined rating must include one disability rated at 40 percent or more.
The IRC provides exclusions for gross income from SSDI, but they are not as broad. Veteran-disability compensation is completely excluded, whereas SSDI is exempt based on a formula. The reduced taxation protection of SSDI compared to VA disability is probative of the legislative intent of protecting veterans compensation.

Exemptions overlap between VA disability and SSDI where the statute for compensation for injuries or sickness states that “gross income does not include ... amounts received by an individual as disability income attributable to injuries incurred as a direct result of ... military action.” This exception connects VA compensation and SSDI because an individual who receives compensation from both sources, if the cause of the disability is military action, can exclude all of the veteran compensation from income. This furthers the legislative intent that disabled veteran compensation remains with the veteran.

**Inequities in Application of Acts of Congress and Potential Impacts**

**Chronological History and Comparison of the Acts of Congress**

The Social Security Act was enacted on Aug. 14, 1935. Title 38, Veterans Benefits, was enacted on Sept. 2, 1958. The IRC’s exemption of veterans’ benefits from gross income was originally amended in 1960. The major reform of the Bankruptcy Code, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), was not passed until 2005.

The Social Security Act was the baseline of how to compensate disabled persons. Veterans-benefit legislation was enacted next and incorporated many of the concepts from the Social Security Act. However, the VA provides additional benefits. The IRC’s definition of “gross income” excludes VA disability compensation. Thus, as of the 1960 changes to the IRC, the acts passed by Congress created a system whereby veterans’ benefits received the same, and sometimes even more, protection as disability benefits.

With BAPCPA’s enactment, SSDI and VA disability compensation are excluded from income under the means test in chapter 7. Unfortunately, in chapter 13, SSDI is excluded unless voluntarily included by the debtor, while VA disability compensation is not.

When there are contradictions and inconsistencies in congressional acts, courts look to legislative intent, but that is not always dispositive. When Congress creates legislation, it often builds on previous legislation. An example is veterans-disability compensation, because it uses the framework of the Social Security Act but has numerous exceptions and application differences. The Bankruptcy Code deviates from this by providing fewer protections to veterans than persons receiving SSDI in chapter 13.

**Why Veterans Are Afforded So Many Protections in Other Areas of the Law, but Not in the Application of Chapter 7 vs. Chapter 13**

VA disability compensation is exempted from classification as gross income. It is not subjected to means testing for under chapter 7, but is included in the disposable-income calculation in chapter 13. The compensation is the same, the purpose is the same and the legislative intent of the compensation is the same regardless of the chapter of bankruptcy. Therefore, the compensation should be exempted from both chapters.

In chapter 7, the purpose and policy behind exempting VA disability compensation is to ensure that the debtor does not end up destitute. In chapter 13, the assumption is that the procedure for determining disposable income accounted for enough financial resources for the debtor to survive, leaving the remainder to be put toward the paying of creditors. A debtor who files for chapter 7 must satisfy the means test or face conversion to chapter 13 or dismissal for abuse. A veteran faces this same situation despite VA disability compensation being exempted, and, based on the totality of the circumstances, a judge can either convert or dismiss the case. There is little dispute that anyone with the means to repay a debt should not be allowed bankruptcy protection.

In *Brah*, the court ruled that a debtor’s decision to pursue chapter 13 relief is voluntary, so the debtor must include VA benefits in the disposable-income calculations. The justification that the debtor is filing voluntarily — or has their basic financial security resolved through the disposable-income calculation to avoid being destitute — cuts against the legislative intent behind veteran-disability compensation. Congress expressly stated that VA disability compensation is exempt from tax levy or creditor garnishment.

Congress also clearly intended the maximum protection of veteran disability compensation because it made it exempt from gross income, protects it from garnishment or levy, and prevents its use in the means test. Inclusion of this compensation in chapter 13’s disposable-income calculation is an outlier that contradicts legislative intent.

There is a good example of exclusion of VA disability compensation coupled with the court’s authority to dismiss

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22 26 U.S.C. § 86(c).
23 26 U.S.C. § 104(a); 26 U.S.C. § 86(c) (2012) (tax exemptions are based on total household gross income, and those amounts are based on party’s filing status).
30 “How to File a VA Disability Claim,” supra n.7.
34 In re Danny Ray Buren, Annie Laura Jones, Marian Frances Henderson, Bob Dwaine Penovich, Anetricia Hildebrand W. Standing Trustee, Chapter XIII v. The Social Security Administration, 725 F.2d 1080, 1081 and 1088 (1984); In re Brah, 562 B.R. at 925-26.
35 Pension Benefit Guar. Corp. v. LTV Corp., 486 U.S. 633, 650 (1990) (court looked at congressional intent and statutory construct regarding restoration of pension plan of chapter 11 debtor and held that subsequent legislative history is hazardous basis for inferring intent of earlier Congress, and equally tenable inferences might be drawn from language being omitted, including legislation that incorporated change).
37 11 U.S.C. § 101(10)(C) (2012); In re Brah, 562 B.R. at 924 (VA benefits are current monthly income, but Social Security benefits are excluded; distinction is that the two legislative acts are codified under different titles, despite fact that benefits have similar purposes).
39 In re Brah, 562 B.R. at 925.
40 Id.
43 In re Brah, 562 B.R. at 925.
the case for abuse. *Rowell* was a chapter 7 case in which the trustee moved for dismissal despite the debtor being exempted from the means test because of military service.\(^{46}\) The debtors were educated professionals who lived a lavish lifestyle with a combined annual income of $443,332.\(^ {47}\) The court dismissed the case for abuse, holding that the debtors were not needy and lived lavishly with unreasonable expenses.\(^ {48}\) There was no reason VA disability compensation cannot be excluded by chapter 13, and a totality-of-the-circumstances test be used to determine when a case should be dismissed or a debtor’s disposable income adjusted to allow for additional payments to creditors under a chapter 13 plan.

### Why Is SSDI Afforded More Protection in the Bankruptcy Code than VA Disability Compensation?

Congress intended for VA disability compensation to have broader protections and exemptions than SSDI.\(^ {49}\) Unfortunately, this protection of VA disability compensation stops at the gates of chapter 13.\(^ {50}\) On the other hand, SSDI is provided protection.\(^ {51}\)

In *Buren*, seven individuals who received Social Security benefits filed for chapter 13 protection, and they included their Social Security benefits as part of their regular income.\(^ {52}\) The court ordered the Social Security Administration to send the benefits to the trustee. On appeal, the court held that the Bankruptcy Code precluded this order, and bankruptcy courts cannot compel the government to pay a debtor’s Social Security benefits to the trustee.\(^ {53}\)

The court took the opposite approach in *Brah*. In this case, the trustee objected to a plan based on the debtor’s withholding VA disability compensation from the plan.\(^ {54}\) The debtors compared VA disability compensation to SSDI, arguing that Congress intended for VA disability compensation to be protected.\(^ {55}\)

The court disagreed and held that there is a similarity between them, but that no exception for VA disability exists.\(^ {56}\) The court never evaluated the legislative intent in drawing its conclusion.\(^ {57}\) The nonassignability and exempt-status-of-benefits section of the VA Act expressly states that the benefits are exempt from any claim of creditors.\(^ {58}\) Therefore, the protection already exists and should preclude VA disability benefits calculated as part of disposable income.

### Desired End-State and Takeaways

Veterans receive disability compensation because of permanent disabilities received while serving.\(^ {59}\) This money is paid to the veteran for life and is tax-exempt, exempt from gross-income calculations and virtually free from garnishment or levy.\(^ {60}\) The compensation is intended to ensure financial security for the veteran, yet in a chapter 13, the veteran must include it to pay creditors. The courts have ruled that this is required under the Bankruptcy Code because the debtor or voluntarily files for chapter 13 protection, and inconsistency in the statutes is legislature’s responsibility to correct.\(^ {61}\)

The argument that a debtor with multiple sources of compensation will only be required to pay an amount determined after calculation of disposable income is a strong argument.\(^ {62}\) However, other legislation is equally clear that these funds are intended to remain out of creditors’ reach.\(^ {63}\) The problem with including VA disability compensation in a chapter 13 disposable-income calculation is that if the debtor has the case dismissed or converted to chapter 7, or never files for bankruptcy protection, the VA disability compensation cannot be attached or garnished by creditors. This inconsistency highlights the irrationality of requiring only chapter 13 debtors to include veterans benefits as income payable to creditors.

Attorneys who work with disabled veterans facing financial hardship should take the time to understand the client’s entire picture, because financial hardship might be a symptom of a larger problem. Attorneys should use caution when a disabled veteran seeks assistance, because the rules of professional conduct require competent legal representation.

The number of veterans is large, and many face financial and physical challenges in their personal and professional lives.\(^ {64}\) It is important to remember that these heroes raised their right hand and volunteered to run into places from which most people would run away. They saw and did things that, quite honestly, are unimaginable, and they served in conditions that are deplorable.

These soldiers, sailors, airmen and Marines suffered physical and mental injuries and anguish resulting in permanent trauma to their person physically and mentally. Congress enacted legislation with safeguards to provide for this group and protect them out of recognition for what they endured.\(^ {65}\) It is our duty as legal scholars, practitioners and professionals to continue the fight, take note of inequities and do whatever it takes to protect those who have protected us.

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60 Rose v. Rose, 481 U.S. 619 (1987) (federal pre-emption does not preclude state from issuing garnishment order allowing garnishment of VA disability compensation to satisfy state support order); “How to File a VA Disability Claim,” supra n.7.
64 “Military Service,” supra n.3.