

Chapter Eight

Consumer Bankruptcy

Many Americans find themselves in serious debt. The creditors keep calling, but the debt just keeps growing. Historically, debtors were sent to prison. But in America, we have a system of bankruptcy law that provides relief and a fresh start to those who are in financial trouble.

Bankruptcy is one of the alternatives for financial distress. You need to examine the options available to you for dealing with your financial problems and decide which course of action is best for you.

Some people in financial trouble can improve their situation by negotiating directly with creditors. Others get help from a local financial counseling program or a consumer credit counseling service with experience in negotiating with creditors and in formulating and establishing repayment plans. For some people, some form of bankruptcy may be the only realistic alternative.

The choice of a remedy is not always easy. As a first step, consider the pros and cons of filing for bankruptcy. Then consider which type of consumer bankruptcy is right for you: **Chapter 7** (“straight bankruptcy”) or **Chapter 13** (sometimes called “wage earner bankruptcy”). Each of these types of bankruptcy is a section of the federal **Bankruptcy Code**, under which bankruptcies are filed all over the country. Bear in mind that a new bankruptcy law, the **Bankruptcy Abuse Prevention and Consumer Protection Act**, came into effect on October 17, 2005. This law made several changes to existing bankruptcy law and procedures, including making it more difficult for some people to file for bankruptcy under Chapter 7. The new law will be discussed in more detail below.

The purpose of this chapter is to provide you with information that will help you make informed choices and to provide references to other sources of information. Also, see the chapter on Family Law for topics regarding bankruptcy and marriage and the chapter on consumer credit for bankruptcy-related discussions.

If after you have reviewed this material you decide to seek protection in bankruptcy, you should select a lawyer who is familiar with bankruptcy law.

Bankruptcy Basics

Jason has been spending out of control for months. Most of his income is spent paying credit card bills, and he needs to borrow more just to pay the rent. Jason's debts keep growing and he is falling behind on some payments. Jason thinks he may have to declare bankruptcy, but he is worried that it will have implications if he wants to get a loan in the future.

Bankruptcy is a serious legal procedure with long-term consequences. Before he takes that step, Jason should learn more about bankruptcy and how it works, and explore his other options with a credit counselor.

Alternatives to Bankruptcy

Q. Right now, I cannot pay my debts. Besides bankruptcy, do I have any options?

A. Yes, there are alternatives that you may use to take care of debts that you cannot pay. Creditors might be willing to settle their claim for a smaller cash payment, or they might be willing to stretch out the term of the loan and reduce the size of the payments. This would allow you to pay off the debt by making smaller payments over a longer period of time. The creditor would eventually receive the full economic benefit of its bargain.

You may also find you are **judgment proof** and do not need to file for bankruptcy to protect your property and wages. Judgment proof simply means that you have so little money and property that you couldn't pay a court judgment against you. Under state exemption laws, creditors are not allowed to seize certain income, such as social security or wages below certain levels, and personal property. If there's no point in creditors going after you in court, there may be less reason for you to declare bankruptcy.

Discuss this option with your credit counselor. However, remember that if you don't declare bankruptcy, the creditors can continue their collection efforts and will be able to enforce court judgments against you if your financial situation improves.

Q. Is there anybody in particular I should contact about these options?

A. Yes. If you are behind on your payments, the collectors for each of your creditors may already be calling or writing you. You might be more successful if you phone each creditor, ask for the collection department, ask and note the name of the person you talk to, and explain your intent to repay the account and your need to stretch out the number of monthly payments and reduce the dollar amount of each payment. You might offer to come to the collection department office to discuss your situation. Ask each creditor to agree to a voluntary plan for the repayment of your debts.

In dealing with creditors, ask them to reduce late fees and interest. Get all agreements in writing before making payment. If you reach a settlement for a single payment, when the payment is made be sure to include language on the face and back of the check indicating that the payment is “in full, final and complete satisfaction of account no. xxxx.” Never give creditors information that would enable them to directly access your checking account. Maintain control over the payment.

Q. I owe money to many creditors. What should I do?

A. The problem of dealing with many creditors is that some of them might not want to give you more time to pay without knowing what the other creditors are willing to do. Unless your debts are very large, it will be difficult for you to arrange for a meeting of your creditors and negotiate a reduction in your monthly payments or the amount of your debt. You can seek the help of a lawyer to negotiate an arrangement with your creditors. Some universities, local courts, military bases, credit unions, and housing authorities have credit counseling programs, but may not have the ability or experience to negotiate with your creditors to gain their consent to reduce your monthly payments.

Your best bet may be to seek the help of a profit or nonprofit consumer credit counseling service (CCCS). As noted in the chapter on Consumer Credit, you can find the nearest CCCS by calling 1 800 388 2227 or going online at <http://www.nfcc.org/>. Some of these centers charge a small monthly service fee. However, you should be aware that creditors provide most of the support for financial counseling services. Some observers think that, as a result, they may tend to downplay bankruptcy as an option.

The repayment plans arranged through credit counseling centers enable you to make monthly payments that are then distributed by the program among creditors until all your debts are paid in full. Creditors usually prefer this kind of plan, since they will eventually get more of their money with this approach than they will under Chapter 7 bankruptcy.

Under a repayment plan through a financial counseling service, you still might have to pay interest charges on your debts. However, many creditors will waive or reduce interest charges and delinquency fees.

A Word of Warning

Be cautious when seeking out a for-profit counseling service. If you choose a for-profit service be sure you understand its fees. Investigate the service and its credentials carefully. Consider calling your Better Business Bureau for information on the service.

Q. Should I consolidate my debt?

A. Occasionally, you may buy time by consolidating your debts. That is, you can take out a big loan to pay off your smaller debts. The primary danger of this is that it is very easy to go out and use your credit cards to borrow even more. In that case, you end up with an even bigger total debt, and no additional income to meet the monthly payments. Indeed, if you have taken out a second mortgage on your home to get the consolidation loan, you might lose your home as well. You should also analyze the interest rate thoroughly. Make sure your consolidation loan's interest rate is lower than your credit cards' rate

Bankruptcy Defined

Q. What exactly is bankruptcy?

A. **Bankruptcy** is a legal process through which people and businesses can obtain a fresh financial start when they are in such financial difficulty that they cannot repay their debts as agreed. The fresh start is achieved by eliminating all or a portion of existing debts and/or by stretching out the monthly payments under the protection and supervision of a court. The process is also designed to protect creditors, because general unsecured creditors share equally in whatever payments the debtor can afford to make.

During your bankruptcy case, most creditors cannot try to collect their debts from you directly. Nor can they try to collect from you after the conclusion of the case for any and all “discharged” debts (described later in this chapter).

Q. What is the process of filing for bankruptcy?

A. Filing for bankruptcy is a very personal, very serious decision. Most people file when they have made a good-faith effort to repay their debts, but see no way out other than to file for bankruptcy. Such people and businesses may declare bankruptcy by filing a petition with the U.S. Bankruptcy Court—that is, a request that the court provide protection and relief under the Bankruptcy Code. In addition to that request, the debtor must provide information about his or her assets, liabilities, income and expenditures. Complete disclosure, candor, and honesty are required. Often, debtors have a lawyer prepare and file the petition and other information for them, but some debtors represent themselves.

Use Bankruptcy with Caution

Bankruptcy may be the best, or only, solution for extreme financial hardship. However, it should be used only as a last resort, since it always has long-lasting consequences. The record of a bankruptcy can remain in your credit files in credit bureaus for as long as 10 years, which is a long time in today’s economic system, in which so much depends on having good credit. Moreover, there are limits on how often you can fully benefit from certain forms of bankruptcy. If you have equity in your home or car you may lose the asset, since that equity may be realized for the benefit of your creditors. (Most of this depends on state law exemptions).

Study the pros and cons carefully before resorting to bankruptcy as a means of solving your economic troubles and be sure you understand the types of bankruptcy cases you can file. Do not wait until the last-minute to seek help—the day before a foreclosure or court date may be too late to get good advice or to take advantage of non-bankruptcy options. Get advice when you find you cannot pay your monthly expenses in full for more than three months, or if you face a sudden large debt, such as a medical bill, for which you cannot make payment arrangements.

Secured and unsecured debts

A **secured debt** is one that the creditor is entitled to collect by seizing and selling certain assets of the debtor if payments are missed, such as a home mortgage or car loan. With those two major exceptions, most consumer debts are **unsecured**, and creditors are not allowed to seize your assets if you miss payments.

Q. What are the advantages of filing for bankruptcy?

A. There are several advantages to filing for bankruptcy.

By far the most important advantage is that debtors may obtain a fresh financial start. As we shall see below, consumers who file for Chapter 7 may be **discharged from** (forgiven from paying) most *unsecured* debts.

You may be able to **exempt** (that is, keep) many of your assets, although state laws vary widely in defining which assets you may keep.

Another big advantage is that collection efforts must stop. As soon as your petition is filed, there is by law an **automatic stay**, which prohibits most collection activity. If a creditor continues to try to collect the debt, the creditor may be cited for contempt of court or ordered to pay damages. The stay applies even to the loan that you may have obtained to buy your car. If you continue to make payments, it is unlikely that your creditor will do anything. However, if you miss payments your creditor will probably petition to have the stay terminated in order either to repossess the car or to renegotiate the loan.

Federal law protects your right to file for bankruptcy. For example, you cannot be fired from your job solely because you filed for bankruptcy.

Getting Credit After Bankruptcy

A study by the Credit Research Center at Purdue University found that about one-third of consumers who filed for bankruptcy had obtained lines of credit within three years of filing. One-half had obtained them within five years. However, the new credit itself may reflect the record of bankruptcy. For example, if you might have been eligible for a bank card with a 14 percent rate before bankruptcy, the best card that you can get after bankruptcy might carry a rate

of 20 percent—or you might have to rely on a card secured by a deposit that you make with the credit card issuer. Use your cards only when necessary, and pay them off each month.

Q. Is there more than one type of bankruptcy?

A. Yes, there are several types, each provided for in a separate chapter of the federal Bankruptcy Code.

Proceedings under **Chapter 7** (straight bankruptcy) involve surrendering most of the borrower's assets. A bankruptcy trustee is appointed in every Chapter 7 case to administer the assets (if any) and distribute either the assets themselves or the proceeds from **liquidating** (selling) them among the creditors. Some assets are exempt under Chapter 7, and cannot be sold to satisfy debts. The assets that are exempt depend on specific federal laws and on state laws that vary significantly around the country. Depending on your income, you may not be able to file for bankruptcy under Chapter 7. Eligibility to file for Chapter 7 is discussed in more detail below.

Proceedings under **Chapter 13** (wage earner's bankruptcy) require the debtor to propose a plan for repaying all or a portion of the debt in installments from the debtor's income. Plans can extend as long as five years, but some plans are much shorter.

Chapter 11 of the Code generally covers businesses that are restructuring while continuing operations. While an individual may file for Chapter 11 bankruptcy under some circumstances, such proceedings are more expensive and complex, and consumer debtors normally use Chapter 7 or Chapter 13.

Under any chapter, once the bankruptcy case ends, most borrowers are **discharged from** (no longer liable for) most of the debts they incurred before filing their bankruptcy petition, called **pre-petition debts**. This means the court has excused the borrower from having to pay most debts. The borrower then starts over again with a clean financial slate except that the record of the bankruptcy will remain on the borrower's credit record for up to 10 years.

It should be noted, however, that in a Chapter 7 case, the discharge does not wipe out a secured creditor's lien, student loans or support payments to children: these are still due and payable, along with, perhaps, certain other, specifically non-discharged debts. In some cases a discharge may be denied altogether.

When Are Debts Discharged?

The bankruptcy court enters a discharge order relatively early in a Chapter 7 case. In Chapter 13 cases the borrower makes full or partial payment to creditors under a court-confirmed plan over a period of at least three years and up to five years, and then receives a discharge.

Q. A bankruptcy filing could remain on my credit record for up to 10 years. How will that affect my future finances?

A. Ten years is the outer limit for all types of bankruptcy. The consequences of having a bankruptcy noted on your credit record could be severe. Creditors may deny you credit in the future or charge you significantly higher interest rates. So long as your credit record has unfavorable information, you may have credit problems. This means that you may have trouble renting an apartment, getting a loan to buy a car, or obtaining a mortgage for a house.

In one respect, bankruptcy may improve your records. Because Chapter 7 provides for a discharge of debts no more than once every six years, lenders know that a credit applicant who has just emerged from Chapter 7 cannot soon repeat the process.

If You're Self-Employed

Chapter 13 can be an effective tool for a self-employed individual: the business income and debts could be included in the payment plan and schedules.

Working with a Lawyer

Q. How would I find a lawyer to represent me in a bankruptcy action?

A. There are a number of ways.

- The American Board of Certification has certified some 1,000 lawyers specializing in bankruptcy. You can get their names and locations from the ABI website at: www.abiworld.org.
- In addition, some states certify lawyers as bankruptcy specialists when they have had significant experience in the field. Access an ABA website,

<http://www.abanet.org/legalservices/specialization/source.html>, for a list of state certification programs, some of which encompass bankruptcy law.

- You could also ask a lawyer who you know well to recommend a specialist.
- Suggestions from a friend, relative, neighbor, or associate who has had a good experience with a particular lawyer also may help.
- Bar associations and groups operated for people with special needs, such as the elderly or persons with disabilities, often provide referral services. For a list of bar association referral programs, access an ABA website, <http://www.abanet.org/legalservices/lris/directory.html>
- You might also find a lawyer by looking in the yellow pages of your telephone directory and advertisements in your local newspaper. If you hire from the phone book or a direct mail solicitation, be sure and check the references of the lawyer. Remember that phone book ads and direct solicitation ads do not ensure you will receive good service.

Chapter One contains more information about finding and hiring a lawyer.

Do It Yourself?

Of course, it is legal and proper to file your own bankruptcy petition, though the more complicated your debt situation, the more risky it is to represent yourself. It is not advisable to hire a non-lawyer to help you file bankruptcy.

Q. How would I evaluate lawyers who might represent me in a bankruptcy action?

A. Be careful in your selection and make sure that your lawyer is familiar with bankruptcy law and procedures, and has a good reputation. When you have an initial talk with a prospective lawyer, does he or she seem to understand your problems and have solutions or are you in a “factory” that merely processes paper?

Q. How can I learn about fees?

A. You can, and should, discuss your lawyer’s fees in advance and understand what procedures are included in the fees. This will give you as clear an idea as possible of what the bankruptcy procedure will cost. For more details, see the first chapter in this publication, “When and How To Use a Lawyer.”

Discuss whether a lawyer will charge additional fees if there are proceedings other than filing the case. The basic case will include preparing and filing the petitions and additional schedules and attending the creditors' meeting. In some states, it may also include preparing and filing a homestead deed. In a Chapter 7 bankruptcy, there may be reaffirmation agreements to negotiate and sign, objections to exemptions or objections to the discharge of some or all of your debts. In a Chapter 13 case, there may be objections to your repayment plan or the way you value your assets. In either chapter, creditors may file **motions for relief from the automatic stay**, seeking court approval to repossess property or foreclose on real estate.

Under some Chapter 13 cases, you can pay the lawyer from the assets of your estate administered by the court in the bankruptcy case. Depending upon the complexity of your case, your legal fees might range from \$400 to \$5,000. Generally, Chapter 13 is usually more expensive than Chapter 7, though it helps that the costs may be included in your repayment plan.

World At Your Fingertips

- Myvesta.org, formerly known as Debt Counselors of America, offers an interactive website focusing on nonbankruptcy remedies such as debt consolidation. Access <http://www.myvesta.org>.
- Debt Advice is a major non-profit site, affiliated with the National Foundation for Credit Counseling and offering much information for consumers: <http://www.debtadvice.org/index.html>.
- Another non-profit site is American Consumer Credit Counseling: <http://www.consumercredit.com/>.
- DebtReliefUSA.net is a for-profit site that can help you reduce your debt: <http://www.debtreliefusa.net/>.
- To find a certified bankruptcy lawyer, access the American Board of Certification: <http://www.abworld.org/abchome.html>.
- To understand more about bankruptcy, access the U.S. Bankruptcy Code and bankruptcy rules: http://www.thebankruptcysite.com/bankruptcy_law.htm.
- For bankruptcy basics and forms, access the site of the U.S. Bankruptcy Courts:

Remember This

- You may try negotiating directly with creditors to obtain some financial relief. The creditors may reduce their interest rates or allow a longer payment plan.
- You may seek help from a local financial counseling program or a consumer credit counseling service. They may be able to help you consolidate (and reduce) your debt.
- Remember that not all for-profit and non-profit credit counseling services are equal. Some are better than others. Contact the Better Business Bureau before dealing with such a service.
- Bankruptcy is a legal process through which people and businesses can obtain a fresh financial start. It is for people who are not in a financial position to repay their debts.
- Bankruptcy could be your only realistic option. If you think it may be, consult a lawyer for advice.
- Select a bankruptcy lawyer with care. Do not rely solely on advertisements. Contact your local bar association or refer to the American Board of Certification. Do not hire a non-lawyer to file your bankruptcy.
- During bankruptcy, creditors cannot call you to collect debts. Once a bankruptcy petition is filed, an automatic stay prohibits most collection activities.
- Bankruptcy cases begin with the filing of a petition to U.S. Bankruptcy Court.
- Use bankruptcy with caution; it remains in your credit files for as long as 12 years.
- There are different types of bankruptcy. Two major types for consumers are Chapter 7 (straight/liquidation bankruptcies) and Chapter 13 (wage-earner bankruptcies).
- Most consumer debts are unsecured. Some creditors are called secured creditors because they have the right to seize and sell the collateral for a loan, such as a car or your home, if payments are missed. Secured creditors have more protection in a bankruptcy than unsecured creditors.

Straight Bankruptcy: Chapter 7

Mr. Smith makes a modest income and has few significant assets. He rents an apartment. He is struggling to pay his rent because of his mounting credit card bills and other debt. He defaults on payments to many creditors. He receives phone calls every day at home and on the job from creditors. He has consulted with a credit counseling service. They have told him his best option is to file bankruptcy. What type should he file?

Bankruptcy law, like much of the legal system, can be quite complicated. It is intimidating to the average consumer who simply knows he cannot pay his bills. You hear lawyers talk in legal jargon about Chapter 7, Chapter 11, and Chapter 13. What do they mean? The following section explains the most common type of bankruptcy for the average consumer—Chapter 7. It is the type of bankruptcy for a person with few assets and comparatively high debt.

Q. What is Chapter 7 bankruptcy?

A. Straight bankruptcy under Chapter 7 is available if less drastic methods will not solve your financial problems. It allows you to discharge (eliminate) most debts.

Q. Am I eligible to file for bankruptcy under Chapter 7?

A. It used to be possible for anyone to file for bankruptcy under Chapter 7. However, a new bankruptcy law—the **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005**—came into effect on October 17, 2005. Under the new bankruptcy law, you are eligible to file for bankruptcy under Chapter 7 if you earn less than the median income in your state. If you earn more than the median income in your state, then you will only be eligible to file for bankruptcy if you pass a “**means test**” to determine whether you are eligible.

Discharge under Chapter 7 is not available if you filed for bankruptcy and were granted a discharge under Chapter 7 within the past eight years.

Q. How does the means test work?

A. If you earn more than the median income in your state, then the state applies a means test to determine whether you are eligible to file for bankruptcy under Chapter 7. In the means test, the court applies a complex formula (subtracting costs of food/rent/mortgage etc, calculated under IRS guidelines) to determine whether your monthly income after expenses have been subtracted is less than \$100.

- If your income is less than \$100 per month, then you can file under Chapter 7
- If your income is between \$100-\$166 per month, then the court will determine what percentage of your unsecured debt they could pay off using disposable

income over a 5-year period and decide whether you should file under Chapter 7 or 13

- If your income is more than \$166 per month, then you must file under Chapter 13

A bankruptcy lawyer can help you calculate whether or not you will be eligible to file for bankruptcy under Chapter 7.

Q. What steps do I need to take before filing for bankruptcy?

A. Under the new bankruptcy law that came into effect on October 17, 2005, you must undergo credit counseling at an “approved non-profit budget and credit counseling agency” within 180 days before filing for Chapter 7 or Chapter 13. Credit counseling can take place individually or in a group, in person, on the telephone, or over the Internet. Section 111 of the new Bankruptcy law provides that the bankruptcy court clerk shall maintain a publicly available list of approved credit counseling agencies. So, if you are considering bankruptcy, contact your local bankruptcy court to find a credit counseling agency near you.

Q. May I use bankruptcy to get rid of all my debts?

A. No, bankruptcy does not discharge all types of debt. If a debt is excepted from discharge you remain legally responsible for it. Exceptions include

- tax claims,
- alimony,
- child support (including past-due support arrearages),
- property settlement obligations from a divorce or separation,
- most student loans,
- fraudulent debts (there is a presumption of fraud in last minute credit card binges involving more than \$1150 in either cash advances or luxury purchases within 60 days before a bankruptcy filing),
- criminal obligations such as fines, and
- a court-ordered judgment from a drunk driving incident

Chapter 7 bankruptcy also will not release you from damages for “willful and malicious” acts such as assaulting another person.

Q. How does a Chapter 7 bankruptcy case begin?

A. It starts when you file a petition with the U.S. Bankruptcy Court asking it to relieve you (or, if you both file, you and your spouse) from your debts. As of the date you file the petition, your assets will be under the protection of the court. In addition, the law imposes an **automatic stay**, which prohibits most collection efforts against you. However, if someone has co-signed a loan for you, the automatic stay does not stop creditors from seeking payment from your co-signer.

When you file the petition, you also must file a **Statement of Financial Affairs** and **schedules** that, among other things, describe your financial history and list your income, all of your debts and all of your assets. If you are self-employed, your business affairs must be included. These schedules are quite detailed, and the information you provide must be complete and accurate.

Q. What is included in the liabilities portion of your schedules?

A. Typically, liabilities include:

- your priority debts (such as taxes and past due support payments);
- your secured creditors (auto and furniture dealers, home mortgages, and so on);
- your unsecured creditors (department store credit cards, medical bills and the like).

Be sure that you list all your creditors and their correct names and addresses. Even if you are current on your bills, if you omit some, or provide incorrect addresses, you might not be discharged from those debts. It may be very helpful to access your credit report before filing in order to discover what debts are outstanding (the chapter on Consumer Credit explains how to do that.) Also, make sure to give your lawyer copies of all your bills and collection letters.

Q. What should be listed in the assets portion?

A. You would generally include:

- all your real property, including any you own together with your spouse or other persons;
- all your personal property (such as household goods, clothing, cash, retirement funds, accrued net wages and tax refunds to which you may be entitled);
- Any lawsuits in which you are a plaintiff or potential plaintiff (e.g. worker's compensation claims and/or personal injury claims).

From the above, you will designate the real or personal property you want to claim exempt from creditors. Note that your post-petition earnings are not part of the bankruptcy estate.

Q. Will I lose some of my assets if I file for Chapter 7?

A. Under Chapter 7, you might well have to turn over many, if not all, of your nonexempt assets to the trustee, who is appointed to supervise your case. What happens depends upon the classification, or value, of the asset and state or federal law exemptions.

Encumbered Assets

Assets pledged as collateral on a loan are known as **encumbered assets**. When you have borrowed money to buy a car, boat, household furniture, appliance, or other durable item, the lender commonly has a **lien** (legal claim) on that property to secure the debt until the loan is fully repaid. You may also have given a lien on property you already owned to obtain a new loan, such as a second mortgage to finance home improvements. Some creditors may obtain liens without the debtor's agreement, either because they have won a lawsuit against the debtor or because the law automatically provides a lien for certain claims, such as for duly assessed taxes or purchases that haven't been paid for in full.

Q. What happens to encumbered assets during a bankruptcy?

A. In bankruptcy a claim is secured to the extent that it is backed up by collateral. Often the collateral is worth less than the amount of the debt it secures, such as a \$1200 car securing a loan balance of \$3000. In that case, the lender is **undersecured** and is treated as holding two claims, a \$1200 secured claim and an \$1800 unsecured claim. On the other hand, sometimes a debt is secured by collateral having a value that exceeds the loan balance at the time of bankruptcy, such as a \$65,000 home subject to a \$30,000 mortgage. In that case, the lender is **oversecured**. The lender is entitled to no more than the \$30,000 it is owed. The excess value of \$35,000 is referred to as the debtor's equity.

If you cannot make the required payments on a secured claim (and also catch up on any back payments), the creditor has a right to take back the collateral after having the automatic stay lifted or after the discharge. However, you may be able to keep your car, boat, or other encumbered item by redeeming it or reaffirming your debt (as explained later in this chapter).

Generally, the value of an asset is its **liquidation value**. This refers to what the asset would bring at an auction, yard sale or pawn shop.

Q. What is the situation with unencumbered assets?

A. Unencumbered assets include (1) assets on which there is no lien at all and (2) the debtor's equity in assets that are collateral for oversecured claims. The debtor retains unencumbered assets to the extent that they are exempt; otherwise they must be surrendered for distribution among those creditors holding unsecured claims, or the equivalent value must be paid to the trustee. However, if your unencumbered assets are worth less than a certain amount, or would be difficult to sell, the trustee might abandon them, if he or she decides it would not be cost effective to sell those assets and distribute the money to the creditors.

Q. What are exempt assets?

A. Exempt assets are assets that you must list on your schedules (specifically **Schedule C**) and that you may shield from your unsecured creditors. Federal and state law define the assets that you may protect in this way.

Which Law Applies?

In about 10 states you may elect to exempt assets under either federal or state law. In most states, however, you may use only the state exemptions.

Q. Do the exemptions vary much by state?

A. Yes, they vary widely. For example, under the federal statute a person can exempt up to \$17,450 of the equity in a home. A couple filing jointly may exempt twice this much—a total of \$34,900—in equity in their home. This is called their **homestead exemption**. Thus, if the home is worth \$65,000 and has a \$25,000 mortgage, creditors can claim only \$5,100 (the difference between the equity of \$40,000 and the \$34,900 exemption). As a matter of practice, the couple would probably keep their home—perhaps at the cost of paying that \$5,100 in nonexempt equity to the trustee—rather than have it sold for the benefit of the creditors. The couple may also be able to exempt the equity under another category.

Florida, along with six other states, has no dollar cap on homestead exemptions. Florida allows a homestead exemption that protects from creditors a debtor's home and property so long as it does not exceed half an acre in a municipality or 160 acres elsewhere. So investment bankers and Hollywood stars who file bankruptcy could retain beachfront homes valued in the millions. A number of other states have high caps on homesteads, in effect enabling debtors to shield a considerable amount of money from creditors under the right circumstances. In Georgia, in contrast, the homestead exemption is limited to \$5,000.

However, under the new federal bankruptcy law, if you bought your home within 40 months of filing for bankruptcy, then you can exempt no more than \$125,000 of its value (unless you rolled over an interest from another house you owned in the same state). If the homestead exemption in your state is lower, then the lower exemption applies.

Q. How do the exemptions work if you're married?

A. In cases involving an individual married debtor or joint debtors, several specific points about exemptions are worth noting.

- First, in joint cases, each spouse must claim exemptions under the same law, either both relying on state law or both relying on federal law. If they each want to claim exemptions under different law, they need to file separate cases.
- Second, when married debtors elect to apply federal exemptions (and often as well when state law applies,) each spouse can claim the full exempt amount on his or her own behalf, in effect doubling the amount of exemptions that a single person would be entitled to.
- Third, in some cases, such as when one spouse has debts and the other is debt free and has assets, it might be preferable for only the one with debts to file. In more than fifteen states, creditors of only one spouse are barred either completely or in large part from reaching real and/or personal property owned by the debtor with a non-debtor spouse as joint tenants or tenants by the entirety. Those bars generally apply in any bankruptcy case where state law exemptions govern. The way your property is titled may determine the exemption. Give your lawyer copies of your deeds, bank account statements and car titles.

Q. How do the exemptions apply if the lender has a security interest in the property?

A. As mentioned above, exempt assets are beyond the reach of *unsecured* creditors. Exemptions do not ordinarily affect the rights of creditors to assets over which they have liens. For example, homestead exemptions generally do not affect the rights of a mortgage lender to foreclose on the debtor’s home. Furniture bought on store credit may be subject to a **purchase money security interest**, and some credit cards attempt to create liens. Under some specific circumstances, the Bankruptcy Code may permit the debtor to undo a lien and then assert exemption rights. This is a matter about which it is probably best to consult a lawyer.

What the Trustee Can Liquidate

The Bankruptcy Code requires that you give all nonexempt unencumbered assets to the bankruptcy trustee—that is, all the assets that aren’t exempted by the law and aren’t secured as collateral to a loan. Unless it would be too costly, the trustee will then liquidate (sell off) these nonexempt assets to pay your creditors.

In actual practice, over 85 percent of Chapter 7 filings are “no-asset filings”—that is, there are no assets with value left for unsecured creditors after the exempt assets have been claimed and the secured assets returned to the creditors.

Chapter 7 in Action

Q. How may I keep certain possessions that I do not want the trustee to sell?

A. If you are required to surrender some nonexempt property that you wish to keep—for example, a car—you may under certain circumstances arrange to **redeem it** (buy it back) for a price no greater than its current wholesale value. For example, if you owe \$3,000 on your car, but its wholesale value is only \$1,200, you can recover the car by paying \$1,200 to the creditor who has a lien on it.

In the real world, of course, it may be very hard to come up with \$1,200, which must be paid from the debtor’s personal assets, not property that has been set aside for the distribution to creditors. Possible sources of funds would include the debtor’s post-petition salary, proceeds from the voluntary sale of exempt assets or loans from relatives or friends.

Q. Is redeeming the property the only way to keep it?

A. No. You may **reaffirm** some debts, if the creditor is willing. By reaffirming debts, you promise to pay them (usually, but not always, in full), and you may keep the property involved, so long as you keep your promise. But, if you later default, the creditor can repossess the property and the remaining balance is not discharged.

You have the right to cancel a reaffirmation agreement within 60 days after it is filed with the court or prior to the discharge, whichever occurs later. Reaffirmation is not always in the best interest of the debtor, especially when the reaffirmed debt relates to property worth far less than the debt being reaffirmed. Most reaffirmations relate to mortgage loans and personal property especially valued by the debtor, for example a car or a boat. Under the new bankruptcy law, creditors must provide extensive closures to debtors about the risks of reaffirmation.

If you can, it is a good idea to take reaffirmation negotiations as an opportunity to re-negotiate the loan, especially on personal property that has **depreciated** (i.e., decreased in value). If there are items that are worth less than the secured debt against them and the debtor wishes to retain them, a Chapter 13 reorganization may make more sense.

After discharge, it is too late to reaffirm, and the creditor may repossess the property, but cannot collect the balance due.

Your Intentions

Within 15 days of filing, and usually as part of the papers you file, you must advise your secured creditors on a court form whether you intend to surrender or redeem any collateral, or reaffirm any debt. You can address the issue of reaffirmation at the creditor's meeting.

Q. Can I protect some assets, such as a vacation home, by transferring title to relatives prior to filing for bankruptcy?

A. Not if you just transfer them in return for nothing, or in return for an insufficient amount of money. You will be asked whether or not you have transferred property within a year prior to filing. If you have transferred property without getting enough in return, the trustee can cancel the transfer and recover the property for your bankruptcy estate. Moreover, if the trustee discovers that you made the transfer with the intention of defrauding any creditor, you may be denied discharge and face federal criminal charges of committing a fraudulent transfer.

The bottom line is that you cannot keep any debts or assets out of bankruptcy, and if you do not disclose everything you may face criminal charges or loss of your discharge, even after liquidation.

The greater the period of time between the transfer and the bankruptcy filing, the less likely it is that the transfer will be perceived as fraudulent.

Q. What happens after I submit all the required financial information to the court?

A. The bankruptcy court clerk will notify your creditors that you have filed a bankruptcy petition. Creditors must immediately stop most efforts to collect the debts you owe. A trustee will be appointed, usually a local private lawyer approved by the court who does this kind of work in the normal course of practicing law. Your bankruptcy case is a federal court action.

Q. What will I have to do?

A. The procedures may vary greatly by state, but you might be required to take the following steps:

- In some states, you may have to file your homestead deed for exempt property in the appropriate state court; there are deadlines for this that must be met. A **homestead deed** is a document intended to protect the property from your creditors. Generally, it describes the property and assigns an approximate value to it. The document may also have to be recorded in the appropriate office (such as a land record office) in the county in which you live. (In some states, you may be required to take this step *before* you file for bankruptcy.)
- You probably will be required to appear at a first meeting of creditors, where the trustee will examine you under oath about your petition, Statement of Financial Affairs, and schedules. Creditors can also question you about your debts and assets, and often attend this meeting to discuss reaffirmation, surrender of property and related issues. Later the trustee will determine whether to challenge any of your claimed exemptions or your right to a discharge.
- If you disagree with the trustee's decision, you may protest to the court, which will make the final decision.

Q. The trustee is obviously a key person. What are some of the options that the trustee has?

A. The trustee might “abandon” property that would bring no value to the unsecured creditors. This will include nonexempt assets and those with minimal resale value.

Also, encumbered assets with no equity will be “abandoned” to the secured creditor, because there would be no value from the sale to help pay off the unsecured creditors.

Q. How does the trustee go about wrapping up the bankruptcy?

A. After determining your exemptions, the trustee will assemble, liquidate and distribute the value of your nonexempt assets (if there are any). The trustee will first distribute to secured creditors the value of their collateral, or the collateral itself. Next, the trustee will pay unsecured priority claims, such as most taxes and past due support such as alimony and child support. If any funds are left, the trustee will make a distribution among your general unsecured creditors on a *pro rata* (proportionate) basis.

Say, for example, that after the payment of secured and priority claims, the proceeds from the sale by the trustee of your nonexempt assets equal 20 percent of your remaining debts. Then the trustee will pay each general creditor 20 percent of what you owe. In return, the court will discharge you from paying any remaining balance on your general unsecured debts.

The trustee will also pay the administrative claims such as his or her commission (ranging between 3 percent and 25 percent depending on the value the trustee recovers) and professionals, such as lawyers and accountants.

Should Husbands and Wives File Jointly for Bankruptcy?

They are permitted to, but whether it is to their advantage depends on many factors, such as how closely entwined their finances are and whether they live in a community property or separate property state (see this book’s chapter on Family Law). They’re best advised to seek the counsel of a bankruptcy lawyer well versed in the law of their state. If they both file for bankruptcy at the same time, only one case-filing fee with required charges (in all about \$200) will have to be paid to the court in a Chapter 7 or 13 case. State law may require separate homestead deeds. You should be wary of a joint filing if there are already marital problems that appear to be leading to divorce court.

The World at Your Fingertips

- Access the site below for the Statement of Financial Affairs form:
<http://www.uscourts.gov/rules/comment2002/b7.pdf>.
- Access the site below for a list of exemptions in different states, from BankruptcySite.com: http://www.thebankruptcysite.com/what_do_i_keep.htm.
- The Nolo website has information on states with large homestead exemptions. Go to <http://www.nolo.com/lawcenter/index.cfm>, and search “Keeping Your Home During Tough Times.”
- For a Q & A on bankruptcy debts, access <http://www.debtwipeout.com/bk-QandA.htm>.
- For a Q & A on what debts are dischargeable and what are non-dischargeable, access http://www.bankrupt-law.com/faq/faq_debts.htm.
- For a discussion of reaffirmation of debt in bankruptcy case, access <http://www.mauilaw.com/article5.htm>.
- You can download the official bankruptcy forms for all types of bankruptcy from the U.S. Courts website at: <http://www.uscourts.gov/bankruptcycourts.html>. The forms are long and detailed, and you may need a lawyer to help you complete them.

Comment [RH1]: The URL is really too long to be useful – doubt anyone would type this in. just [nolo.com/lawcenter?](http://www.nolo.com/lawcenter?)--OK

Comment [RH2]: Provide source for Chapter 7 forms?—OK – US Courts site provides forms for all kinds of bankruptcy. Might be an idea to put this information in a “key information” sidebar in Bankruptcy Basics?

Remember This

- Chapter 7 allows debtors to discharge most of their debts. It is the most common form of bankruptcy by individual consumers. In a Chapter 7 bankruptcy case, a trustee is appointed to supervise your case.
- If you earn less than the median income in your state, you are automatically eligible to file for bankruptcy under Chapter 7. If you earn more than the median income in your state, the court will impose a means test to determine whether you are eligible to file under Chapter 7. If you earn too much to use Chapter 7, the court will convert your filing into Chapter 13.

- When you file a Chapter 7 bankruptcy, you must file schedules and a statement of financial affairs. This includes your financial history, income, debts and assets. They are quite detailed.
- On your schedules, list all your debts, including priority debts, secured creditors and unsecured creditors.
- Some of your assets may be exempt from creditors during bankruptcy under either federal and/or state law. States have different exemptions. Exempt assets are beyond the reach of unsecured creditors.
- The Bankruptcy Code requires that debtors give all nonexempt, unencumbered assets to the trustee. If these assets have sufficient value to make a sale worthwhile, the trustee will then liquidate them to pay creditors.
- Debtors may be able to reaffirm some debts—that is, promise to pay them—in order to keep certain assets. Creditors must provide lengthy disclosures to debtors who wish to reaffirm debts.
- You cannot avoid the reach of creditors during bankruptcy by transferring title of property you own in the 12 months before you file for bankruptcy. Generally, the period for transfers is within one year of the filing, but, depending on the circumstances and state law, transfers done more than a year before the bankruptcy may also be undone.
- You cannot keep any debts or assets out of the bankruptcy, and if you do not disclose everything you may face criminal charges or loss of your discharge, even after liquidation.
- Depending on state law, you may be required to file your homestead deed in the appropriate state court (this is a document that shields certain assets from creditors).
- You must attend a creditors' meeting during which creditors can question you about your debts and assets.
- Bankruptcy does not discharge all debts. You are still liable for tax claims, alimony, child support, property settlements, fraudulent debts, student loans and criminal obligations.
- Husbands and wives, depending on state law and the status of joint debt, may want to file jointly for bankruptcy.

Chapter 13

Mr. and Mrs. Jones make an excellent combined salary. Unfortunately, they underestimated the effect of the declining stock market, costs of college for their children, extreme and unexpected medical costs and other expenses. They have substantial assets that they don't wish to see swallowed up by creditors. They want to discharge some of their debt but can still afford to make payments. They just need some relief in the form of reduced payment plans.

The Joneses might find that a Chapter 13 bankruptcy suits them better than a Chapter 7 filing. Chapter 13 allows individuals with regular incomes to pay a portion of their debts under a court-approved payment plan. The following section explains the basic features of a Chapter 13 bankruptcy plan.

Chapter 13 in Action

Q. What is Chapter 13 bankruptcy?

A. Chapter 13 allows individuals who have steady incomes to pay all or a portion of their debts under protection and supervision of the court. Under Chapter 13, you file a bankruptcy petition and a proposed payment plan with the U.S. Bankruptcy Court. An important feature of Chapter 13 is that you will be permitted to keep all your assets while the plan is in effect and after you have successfully completed it.

Q. Who is eligible for Chapter 13 bankruptcy?

A. Chapter 13 is available to almost everyone who has a regular income. The only other requirement is that debtors have less than \$290,525 in unsecured debts (such as credit cards) and less than \$871,550 in secured debts (such as mortgages and car loans). These figures are subject to periodic adjustments. Anyone with greater debts usually must declare bankruptcy under Chapters 7 or 11 of the Bankruptcy Code. In a joint Chapter 13 case those limits are not doubled, but instead are applied to the total amount owed by the debtors.

Q. How does Chapter 13 differ from Chapter 7?

A. The major difference is that in Chapter 7 you pay debts out of your *assets*; in Chapter 13, you pay debts out of your *income*. So a repayment plan under Chapter 13 normally extends your time for paying debts and usually involves your paying off more of your debts. The permitted repayment period usually is three years or, with special permission of the court, up to five years.

If you earn more than the median income in your state, you may not be eligible to file for Chapter 7 bankruptcy, and will have to file under Chapter 13.

Typically, the amount that you repay under a Chapter 13 plan is determined by the total of your planned monthly payments over three years, given your good faith effort to do the best that you can. Your payments represent either (1) full satisfaction of your debts or (2) all of your disposable income for a three-year period. **Disposable income** consists of whatever is left over from your total income after you have paid for taxes and necessary living expenses (determined on a monthly basis). The plan must also pay secured creditors the value of their lien, over time, and cannot change the terms of the loans secured by your home.

A Chapter 13 repayment plan often results in your repaying less than you owe. If you are unable to pay a secured creditor the value of its collateral, it can choose to obtain relief from the automatic stay to repossess the collateral.

Q. What steps do I need to take before filing for bankruptcy?

A. Under the new bankruptcy law that came into effect on October 17, 2005, you must undergo credit counseling at an “approved non-profit budget and credit counseling agency” within 180 days before filing for Chapter 7 or Chapter 13 bankruptcy. Credit counseling can take place individually or in a group, in person, on the telephone, or over the Internet. Section 111 of the new Bankruptcy law provides that the bankruptcy court clerk shall maintain a publicly available list of approved credit counseling agencies. So, if you are considering bankruptcy, contact your local bankruptcy court to find a credit counseling agency near you.

Q. Can I save my home and other assets by filing under Chapter 13?

A. Your home will be preserved under Chapter 13 if there is not substantial non-exempt equity in the home, and you successfully complete the payment plan.

If not preserved in this way, home may be preserved under homestead exemption or marital ownership law. However, the new bankruptcy law provides for a homestead exemption of no more than \$125,000 if the home was acquired in the 40 months before filing, or if the debtor engaged in certain fraudulent conduct.

The vehicle will be preserved if plan is successfully completed and appropriate payments are made. If not, it might be taken by creditors (unless arrangements are made to pay off lien).

All other non-exempt assets can be kept by the debtor if the plan is successfully completed. If the plan is not successfully completed, the non-exempt assets will be sold to pay creditors, as in Chapter 7 bankruptcy.

Q. What are the mechanics of a Chapter 13 filing?

A. You submit your plan to the court and a Chapter 13 trustee, who is appointed by the United States Trustee to handle Chapter 13 cases. The trustee will verify the accuracy and reasonableness of your plan. The plan will then be distributed to the creditors. They will have the opportunity at a hearing to challenge your proposal if they believe that it doesn't meet specific requirements of the Bankruptcy Code.

With that in mind, the trustee will want to be sure that your plan provides enough for you to live on, but will also challenge expenses that are unreasonably high. The issue is whether you are making a "good faith" effort to repay your debts, even if it means a reduction in your living standards such as cutting your entertainment expenses down from five hundred dollars per month. Since the trustee's recommendation will carry considerable weight with the court, it pays to be honest and open with the information that you provide.

Q. How is secured collateral valued for the purposes of a bankruptcy?

A. Secured creditors will have the chance to object to the value you place on the collateral and the rate of interest you propose. In some jurisdictions, you should use the "Blue Book" retail value for cars, unless you show something that would affect value, such as damage. The interest rate does not have to be as high as in the contract, but you will prompt objections if you go too low.

If You're Self-Employed

If you are self-employed and filing under Chapter 13, you will show your average monthly business expenses and income. You would also include incidental income, such as part-time wages for baby-sitting, alimony/support income, and rental income.

Q. What is this proposed payment plan?

A. If there is no objection to your proposed plan, it may be somewhat flexible. The plan that you prepare for review by your lawyer should take into account your income from all sources and

your reasonable necessary expenses. Your plan should anticipate any known future changes in your income or expenses, such as retirement or a rent increase. What is left from your income after paying living expenses will be available for disbursement to your creditors. **[is this still correct?]**

Your plan must provide for payment in full of all **priority claims**. These are certain taxes, fraudulently incurred credit card debt, family support obligations (including overdue child support and alimony), and most student loans. You can arrange to pay such overdue debts over the life of the plan.

Q. What if there is an objection to the plan?

A. Under Chapter 13, a creditor or the trustee might object to your plan. If this happens, you must re-draft your plan to address the objection.

Q. What happens once the plan is approved?

A. Once the court holds a hearing and approves your payment plan, you make regular monthly payments to the trustee. These payments begin within a month of the filing. The trustee distributes the money among your creditors according to the plan. A Chapter 13 discharge is granted after completion of the payments in the plan (this is three to five years later). If the payments are not completed, there are some circumstances under which a more limited discharge may be granted, or the case may be dismissed or converted to Chapter 7, particularly if there is significant equity in non-exempt assets.

Chapter 13 Trustee

The role of Chapter 13 trustees varies among judicial districts. Some trustees work with debtors to help them learn to manage their finances, and may arrange for (or require) automatic payroll deductions of the monthly payments to be credited directly to the trustee's account for disbursement to the various creditors. A small part of the monthly payments goes to the trustee for these services.

Q. What happens if I can't keep up the payments under my Chapter 13 plan?

A. There are several possibilities depending on the circumstances. For example, if you have an accident that causes you to lose time from work temporarily, you may be able to arrange a **moratorium**, which means that you can miss a payment and catch up later. Further, if there is a major permanent reduction in your income, for example, from lost hours due to a chronic illness, your trustee may support a **modification** in the plan if you meet certain legal requirements. This might involve either stretching payments out over a longer period and accordingly reducing the amount of each payment or perhaps giving up some asset for which you had planned to make payments. If you complete performance of your modified plan, you are entitled to a full Chapter 13-type discharge, described below.

Q. What happens if I can't keep up with my Chapter 13 plan but just don't do anything?

A. Bad things happen. If you fail to take the initiative in dealing with defaults under your Chapter 13 plan—whether by modification, hardship discharge or conversion—a creditor or the trustee may seek to have your case either converted to Chapter 7 or dismissed outright. If the case is dismissed, the collection calls will begin again and you may have your car repossessed or your home foreclosed upon as if there had been no bankruptcy.

The World at Your Fingertips

- The forms for Chapter 13 bankruptcies are available at: <http://www.uscourts.gov/bankruptcycourts.html>.
- You can find more information and FAQs at the www.nolo.com website. Just click on bankruptcy and follow the links for more information on Chapter 13.

You Must Remember This

- Chapter 13 allows individuals with steady incomes to pay all or a portion of their debts under protection and supervision of a court. Under Chapter 13, you file a bankruptcy petition and a proposed three to five year payment plan with the U.S. Bankruptcy Court.

- The bankruptcy trustee or court clerk will take your proposed payment plan and distribute it to your creditors. Creditors will have a chance to challenge your proposals. Once the payment plan is approved, you make monthly payment plans to the trustee, who then disperses the money amongst the creditors.
- If you cannot make payments under a Chapter 13 plan, you may be able to convert your case to a Chapter 7.

Chapter 13 or Chapter 7?

Choosing the best form of bankruptcy for a particular situation is often difficult. This section tries to help by contrasting Chapters 7 and 13, and gives specific information on the factors you may wish to consider if you want to save your home.

Q. Compared with Chapter 7 (straight bankruptcy), what advantages may there be to filing for Chapter 13?

A. There may be several advantages. The most important, probably, is that you will be able to retain and use all your assets as long as you make payments to the trustee as agreed in your Chapter 13 plan.

Keep Those Payments Up

What happens to your home and home loan in Chapter 13? To avoid losing your home, you must make your regular monthly payments to the Chapter 13 trustee *and* make your monthly future mortgage payments on your home as they become due after the filing. If you've skipped some mortgage payments before you filed your Chapter 13 bankruptcy, you can put the delinquent mortgage payments (with interest to account for your delay) under the Chapter 13 plan. In other words, you can spread them out. However, to be sure of keeping your house, you must also make the *future* monthly payments on your home mortgage loan as they come due. If you don't, you may have to turn your home over to the lender.

Q. Can you discharge more debts under Chapter 13 than under Chapter 7?

A. Yes. The discharge of debts under Chapter 13 is broader than it is under Chapter 7. Once you successfully complete a repayment plan under Chapter 13, individual creditors cannot require you to pay them in full, for example, even if you gave them false financial information when you applied for the credit, or if you used some other fraudulent means to get credit. You can discharge debt arising from embezzlement or intentional injury to others or their property, and debts for cash advances or luxury purchases made shortly before bankruptcy.

The story is different if you file for straight Chapter 7 bankruptcy. In chapter 7, any creditor to whom you gave false or fraudulent information may object to discharging you from repaying the debt you owe.

Q. What is the situation with co-signers under Chapter 13?

A. Better than under Chapter 7. Under Chapter 13, if you had people co-sign any of your loans or other credit representing consumer debts, and you have the collateral, your creditors cannot collect from these co-signers until it is clear that the Chapter 13 plan will not pay the entire amount owed to the creditors. In contrast, if you file a straight bankruptcy (Chapter 7) petition, your creditors have the right to demand payment from your co-signers immediately.

Q. Can I use Chapter 13 more often than Chapter 7?

A. Yes, this is another advantage. You may discharge debts under Chapter 13 more often than under Chapter 7. The law forbids you from receiving a discharge under Chapter 7 more than once every six years. However, Chapter 13 allows you to file every two years, although each filing will appear on your credit record and all Chapter 13 plans have to be filed in good faith.

Note, however, that after you have been discharged under Chapter 13, you must wait six years before you are eligible for Chapter 7 discharge. That six-year rule does not apply if your Chapter 13 case paid your unsecured creditors at least 70 percent of their allowed claims and your plan was proposed by you in good faith and was your best effort. **[is this still the case?]**

Q. I see the advantage of Chapter 13, but why might some debtors fare better in Chapter 7?

A. There are several circumstances in which straight bankruptcy may be preferable.

First, there are many debtors for whom the advantages of Chapter 13 do not matter: debtors with no nonexempt assets they particularly wish to keep, no debts excepted from discharge in Chapter 7, no history of receiving any bankruptcy discharge within the last six years and no co-signers on their consumer debt loans.

Second, the benefits of Chapter 13 may come at the price of committing the debtor's disposable income to creditors for as long as three or even five years. In Chapter 7, the debtor can keep post-petition earnings free and clear from discharged pre-bankruptcy debts.

Third, some debtors are legally ineligible for Chapter 13, either because their income is not sufficiently regular to fund payments under a plan or because the amount of their debt exceeds the limits mentioned above. **[is this still the case?]**

Fourth, the bankruptcy may be off of your credit report sooner with a Chapter 7 case than a Chapter 13 case. This is because, in a filing under either chapter, the bankruptcy is noted when the case is filed, but the time for when it comes off differs because the bankruptcy does not come off your credit until discharge. So even though the seven-year clock (time on the credit report) for Chapter 13 cases is far shorter than the 10-year clock for Chapter 7 cases, the clock runs from discharge, and that can be three to five years *later* for a Chapter 13 case than for a Chapter 7 case. This makes the outer limit that a Chapter 13 bankruptcy can be on your credit report 12 years, while the outer limit of a Chapter 7 case is 10 years.

Saving Your Home

Q. It is very important that we keep our home. What's the most important step we can take?

A. First, under either Chapter 7 or Chapter 13, you will be able to keep your home only if you continue to make the required monthly payments on your mortgages.

If you've fallen behind under Chapter 7, you must make arrangements acceptable to your mortgage lender to catch up on any delinquent payments, and it's up to the mortgage company to decide whether to work with you. Under Chapter 13, you may be able to include the delinquent payments in the payment plan and pay those off over, for example, three years, while maintaining ongoing monthly mortgage payments. So you must have sufficient cash flow to cover the payments to the Chapter 13 bankruptcy trustee and the regular on-going mortgage payments.

As will be seen below, a willingness to make monthly payments on the mortgage will not ensure that you can keep your home. But *not* making monthly payments in the future will make it likely that you will *not* keep your home.

Q. We think we'll have to file under Chapter 7—what will become of our house?

A. Even if you're willing to continue making the agreed monthly payments you can still lose your home if you file for Chapter 7.

Under a Chapter 7 filing, if you have no equity and are in default, the creditor can foreclose, even if your unsecured debts are discharged.

But if you have equity, your unsecured creditors may also have an interest in your home, especially if it is worth more than the total of the mortgage debt and any applicable homestead exemption. In that case, the trustee may take possession of your home and sell it for the benefit of the unsecured creditors; that is, it may become part of the collection of your assets taken by the trustee.

Q. Under what circumstances would the trustee take our home?

A. Whether the trustee will actually take your home will depend upon two basic factors: how much equity is in the home and how much of the home's value is sheltered by law from creditors.

The homestead exemption is the amount of your home's value that the law puts out of the reach of creditors. In general, the lower the exemption, and the higher the equity, the better the chance that the trustee will take your home.

Q. Can you give an example?

A. Assume that the market value of your home is \$90,000, and you have a mortgage of \$55,000. Your equity is the difference between those two figures, or \$35,000. If your homestead exemption were \$30,000 (as in Colorado), the creditors could seek to claim the \$5,000 left over from your exemption. As a practical matter, the trustee would probably not go to the expense and trouble of taking over the property and selling it for the benefit of the unsecured creditors, but you could be called upon to pay the \$5,000 to the trustee.

Of course, if the homestead exemption were \$10,000 (as in Georgia and a number of other states), then \$25,000 might be realized through a sale, which would make selling the home a more attractive option for the trustee.

Sidebar: Warning

What if the Foreclosure Isn't Enough?

A lender who recovers less from the sale of the house than the amount that you owe will have an unsecured claim for the difference, which may be asserted and usually discharged in your bankruptcy case. In some states, a confirmation action in state court is required to verify the foreclosing mortgage company's entitlement to such a deficiency claim.

Q. What's an example of a case where taking the home could pay a great deal to the unsecured creditors?

A. The greater the difference between the market value of your home and your mortgage debt, the more likely is it that the trustee will find it worthwhile to take over your home and sell it for the benefit of creditors. Take the example of the house in Colorado given above, but assume that the market value is \$190,000, not \$90,000. Now, if the house is taken over by the trustee and sold for the benefit of the bankruptcy estate, the funds available for unsecured creditors would amount to \$105,000:

Selling price	\$190,000
Less: Mortgage loan	<u>\$55,000</u>
Value of your equity	<u>\$135,000</u>
Less: Homestead exemption	<u>\$30,000</u>
Available for unsecured creditors	\$105,000

In some jurisdictions, to determine equity, you would also deduct the costs of sale, such as a typical realtor's fee. Alternatively the value may be determined by typical foreclosure results (such as 80percent of retail,) or by reference to tax assessed value.

Q. Are there any states that shield all of a home's value from creditors?

A. In a few states, such as Florida, there is no dollar limit on the homestead exemption, only a limit on the acreage that can be shielded from creditors. In Texas unsecured creditors cannot seek payment from a homestead, so long as it is not more than one acre in a city or 200 acres elsewhere, *regardless of the value of the property.*

However, the homestead owner will still have to make the required monthly payments to the bank that is financing his \$2 million townhouse in downtown Dallas or his home in Palm Beach.

In addition, if the home was purchased within 40 months before the bankruptcy, then you can exempt no more than \$125,000 of its value (unless you rolled over an interest from another house you owned in the same state). If the homestead exemption in your state is lower, then the lower exemption applies.

If One Spouse Owes a Lot...

Another factor in whether you'll keep your home is whether you own the property with your spouse. Let's say you have plenty of debt, but your spouse has little or none. Many states completely block or seriously limit your unsecured creditors from reaching property that you own together with your non-debtor spouse. Much may depend on how you hold the home (i.e., in what form of joint ownership).

Q. How can we preserve our home if we file under Chapter 13?

A. Under a Chapter 13 plan, your basic choice is either:

- to agree to continue your lender's lien on your home and to make the required ongoing monthly payments, in addition to agreeing to pay any skipped payments (defaults) through your payment plan, or
- to turn the property over to the lender.

It is possible that if housing values are greatly depressed, a lender might be willing to lower the monthly payments in order to gain some income and keep the house occupied. But don't count on it.

An Alternative for Farmers: Chapter 12

Family farmers have the option of a special type of bankruptcy under Chapter 12 of the Bankruptcy Code. It is one of a series of special farm-aid provisions enacted to help farmers survive periodic economic slumps.

Chapter 12 allows family farmers with regular income to avoid foreclosure on their farms by pledging part of the profits from their future crops to pay off the debts, particularly those secured by the farm.

Only farmers acting in good faith have the right to adjust their debts under Chapter 12. In order for a petition to proceed quickly, as in other chapter filings, the debtor must submit to the bankruptcy court a list of creditors, a list of assets and liabilities, and a Statement of Financial Affairs. The farmer-debtor usually will require legal help. The process is similar to a Chapter 13 case but the discharge that is issued is that granted in a Chapter 7 case (subject to the same exceptions).

The Bankruptcy Code specifically defines who can qualify as a “family farmer” under Chapter 12, and you must meet this definition. Further, this Chapter has expired in the past and may or may not be available at the time you need it.

The World At Your Fingertips

Good overall information on bankruptcy can be found at the following sites:

- The American Bankruptcy Institute website has particularly useful areas such as the Consumer’s Corner, links to lists of lawyers who are certified bankruptcy specialists and highlights of recent legislative developments: <http://www.abiworld.org/>.
- In print, consider *Surviving Debt: A Guide for Consumers* (2002), by the National Consumer Law Center (NCLC). It is available for approximately \$19.00 at bookstores or directly from the NCLC, 18 Tremont Street, Boston, MA 02108-2336. You can also order it online at http://www.consumerlaw.org/publications/guides/surviving_debt.shtml. The website has some samples from the book.

You Must Remember This

- There may be several advantages to filing Chapter 13 instead of Chapter 7. A main reason is that under Chapter 13 you will be able to retain and use all of your assets as long as you make the promised payments. The discharge of debts is broader under Chapter 13 than Chapter 7.
- There may also be advantages to a Chapter 7 bankruptcy. For instance, Chapter 13 debtors have to keep making payments for at least three to five years. In Chapter 7, a debtor can keep post-petition earnings free and clear from discharged pre-bankruptcy

debts. However, under the new bankruptcy law, not all debtors are eligible to file under Chapter 7.

- Under either Chapter 7 or Chapter 13, you will not be able to keep your home if you don't make the required monthly payments on your mortgage after the filing.
- Often, there is a homestead exemption with a dollar amount that is shielded from creditors, but don't assume that you will be able to keep your home simply because you file bankruptcy. In addition, if you bought your house within 40 months of filing for bankruptcy, you will not be able to exempt more than \$125,000 of its value, even if the homestead exemption in your state is higher.