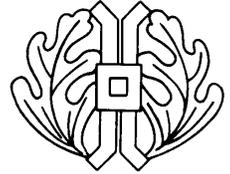


PREVENTIVE LAW SERIES

BANKRUPTCY



Prepared by:
Legal Assistance Department
Naval Legal Service Office Southwest
P.O. Box 357042
Naval Air Station, North Island
San Diego, CA 92135-7042
(619) 545-6278



BANKRUPTCY IS A SERIOUS decision that should be made only after consultation with a bankruptcy expert and only if you believe it is the **only** way to deal with your financial problems.

Some people declare bankruptcy because they have overspent on their credit cards and believe they have no way to pay them off. These people should first see consumer credit counselors before deciding to file for bankruptcy. For more information, contact Debt Counselors of America at www.getoutofdebt.org.

Other people declare bankruptcy because of large expenses such as for medical care that they cannot pay off.

Whatever a person's reason for thinking bankruptcy is the answer, he or she should first see a bankruptcy lawyer. This handout provides a general overview of bankruptcy law and should not be used as a substitute for getting expert advice from a bankruptcy lawyer.

WHAT IS BANKRUPTCY?

It is a federal legal proceeding that allows people to reduce or eliminate some or many of their debts and get a fresh financial start. In return, the person who files for bankruptcy must turn over some of his or her property or income to creditors.

There are different types of bankruptcy. Two examples used most by individuals are Chapter 7 and Chapter 13 bankruptcy.

In a Chapter 7 bankruptcy, or "straight" bankruptcy, a person's non-exempt assets are sold and the proceeds are used to pay off creditors. In a Chapter 13 bankruptcy, the person's debts are consolidated and the person provides a plan to pay creditors. These are explained more in detail below.

SHOULD I FILE BANKRUPTCY?

Seeing a bankruptcy lawyer and filing bankruptcy can be expensive. A typical bankruptcy case in San Diego might cost between \$1,000 and \$1,500, plus filing fees. But that cost is slight when compared to the "other costs" associated with filing bankruptcy. **These** "other costs" could include bad credit ratings that can be affected for up to 10 years, difficulty in renting apartments or getting car insurance, higher interest rates for home and car loans, having to disclose a bankruptcy on job applications, and the social stigma attached to being bankrupt.

However, in some cases bankruptcy is the only option. These are where a person's debts greatly outweigh his or her ability to pay them and it will be impossible to pay those debts off. Bankruptcy also helps give an overburdened debtor a fresh start.

WHAT ARE THE BENEFITS OF FILING FOR BANKRUPTCY:

- Discharge of most or all debts.
- Bankruptcy may also allow you to prevent your home from being foreclosed on, though it may not eliminate your mortgage or other liens on your property.
- It may prevent repossession of other property, including your car.
- It will stop creditors from harassing you for collections and prevent wage garnishment.

FILING CHAPTER 7 BANKRUPTCY

Under Chapter 7 bankruptcy, most debts are discharged, or forgiven. The exceptions to discharge include:

- Spousal support.
- Child support.
- The last three years of income taxes.
- Most student loans less than 7 years old.
- Debts on luxury items of \$1,000 or more.
- Cash advances taken on credit cards 60 days prior to filing for bankruptcy.
- Purchases made on credit cards within the last 60 days, except for necessities (food, gas, medicine).

However, a Chapter 7 debtor must surrender all non-exempt assets, which are then sold, with the proceeds distributed to creditors. This is called liquidation. Assets include such things as land, household goods, cash, jewelry, insurance policies, and retirement funds such as IRAs. Some assets are exempt, which allows the debtor to keep them, or partially exempt. Exemptions vary from state to state. Many states allow a debtor to exempt some or all of a home, for example. IRAs are partially exempt. Certified retirement accounts under federal ERISA law are exempt. Other assets may still be subject to liens by creditors, such as a car loan from a bank, and will not be exempt. These are called secured debts.

FILING CHAPTER 13 BANKRUPTCY

Under Chapter 13 bankruptcy, a debtor reorganizes and consolidates his or her debts, keeps assets, and repays creditors based on a court-approved payment plan. The person who administers the plan is a trustee (usually a bankruptcy lawyer) appointed by the court. To be eligible for Chapter 13 bankruptcy, a debtor must have; 1) Less than \$250,000 in unsecured debts and \$750,000 in secured debts, and 2) A steady income to pay off the debts over the next three to five years. Under Chapter 13, the creditors are supposed to receive as much from the debtor as they would under a Chapter 7 bankruptcy. A debtor's creditors can challenge a Chapter 13 filing. Chapter 13's principal benefit is that it allows a debtor to keep his or her assets. However, after a court-approved repayment plan is drafted, all of a debtor's "disposable" income goes to creditors each month to pay off debts.

FINAL TIPS.

Some concerns many people have in filing for bankruptcy are:

- Whether they can own any property. The answer is yes. A debtor can keep exempt property and any property received after the bankruptcy is filed.
- Whether they can keep their homes. The answer depends. Under Chapter 13, a debtor can keep a home if he or she agrees to continue making monthly mortgage payments as well as make up for past-due payments. Under Chapter 7, the answer will depend on the equity in it and the exemption amount provided for by state law.
- Whether a credit rating will be adversely affected, and for how long. The answer is yes, and for up to 10 years. However, in some cases a debtor can seek to have the bankruptcy removed after less than 10 years.

LEGAL ASSISTANCE APPOINTMENTS

For an appointment to see a legal assistance attorney, please contact the Legal Assistance Office, located in Building 610, Naval Air Station North Island, by telephone at (619) 545-6278.

RESOURCES

www.cornell.edu/topics/bankruptcy