



PREVENTIVE LAW SERIES

BANKRUPTCY



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WHAT IS BANKRUPTCY?

Bankruptcy is a federal legal proceeding which 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 usually turn over some of his or her property or income to creditors.

There are different types of bankruptcy. The two types used most by individuals are Chapter 7 and Chapter 13. 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 the creditors. These are explained more in detail below. In 2005, the law was rewritten to make it more difficult to file a Chapter 7 bankruptcy and restricted the relief available in a Chapter 13 bankruptcy. Chapter 11 bankruptcies are mostly utilized by businesses.

SHOULD I FILE FOR BANKRUPTCY?

Filing for bankruptcy is a serious decision that should be made only after consulting a bankruptcy expert and 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. A better first step is to speak to a consumer credit counselor. Other people declare bankruptcy because of large expenses such as medical care. Whatever your reason for thinking bankruptcy is the answer, you should first see a bankruptcy lawyer.

Seeing a bankruptcy lawyer and filing bankruptcy can be expensive. A typical bankruptcy case in San Diego might cost between \$700 and \$1,500, plus filing fees. That cost is slight when compared to the "other costs" associated with filing bankruptcy. These "other costs" could include bad credit ratings 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. Bankruptcy, or any failure to pay just debts, can also have significant impacts on a military member's security clearance, which could ultimately result in separation from the service.

However, in some cases, bankruptcy is an appropriate option. These instances usually occur when a person's debt outweighs his or her ability to repay the debt to such an extent that it will be near impossible to pay off. Bankruptcy helps give an overburdened debtor a fresh start.

ELIGIBILITY FOR BANKRUPTCY

Before a debtor can file for bankruptcy he or she has to obtain credit counseling, in an individual or group briefing, from a counseling agency approved by the U.S. Trustee. A list of government-approved agencies can be found at www.usdoj.gov/ust/eo/bapcpa/ccde/cc_approved.htm. Additionally, a debtor must show relief is necessary through a means test. The test identifies debtors who have the capacity to pay back some of their debts. Anyone with an income below a state's median family income is exempt from a means test and may then file a Chapter 7 bankruptcy. For debtors above the median family income of a state, the means test determines if the debtor is able to pay more than \$100 per month of a Chapter 13 plan.

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 5 years old unless the debtor shows undue hardship (11 U.S.C. §523(a)(8)).

- Debts on luxury items of \$650 or more or within 90 days of filing for bankruptcy (see 11 U.S.C. §523(a)(2)(A)).
- Cash advances aggregating \$925 or more taken on credit cards or within 70 days prior to filing for bankruptcy (see 11 U.S.C. §523(a)(2)(B)).
- Purchases made on credit cards within the last 60 days, except for necessities (food, gas, medicine).
- Debts incurred to pay non-dischargeable debts such as taxes or support, and some debts arising from divorce.

In exchange for discharging other debts, a Chapter 7 debtor must surrender all non-exempt assets. These assets are then sold and 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. For example, many states allow a debtor to exempt some or all of a home. IRAs are partially exempt. Certified retirement accounts under the 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. If your debt is discharged under Chapter 7, you must wait eight years before filing again. For a Chapter 7 bankruptcy, there is a \$245 filing fee, a \$75 administrative fee, and a \$15 trustee surcharge.

FILING CHAPTER 13 BANKRUPTCY

Under Chapter 13 bankruptcy a debtor reorganizes and consolidates his or her debts, usually may keep his property, and repays creditors based on a court-approved payment plan. Chapter 13 bankruptcy is an adjustment of debts for an individual with a regular income. A Chapter 13 bankruptcy cannot be filed if the debtor received a discharge under Chapter 7, 11, or 12 less than four years ago or the debtor received a discharge under Chapter 13 less than two years ago. The filing fee for a Chapter 13 bankruptcy can change annually, and can be found on the U.S. Courts website: <http://www.uscourts.gov/services-forms/fees/bankruptcy-court-miscellaneous-fee-schedule>.

To be eligible for Chapter 13 bankruptcy, a debtor must have:

- Less than \$383,175 in unsecured debts and less than \$1,149,525 in secured debts (total debts in a joint husband and wife chapter 13 case must be within the above limits) (**See 11 U.S.C. 109(e) as amounts may change**), AND
- A regular 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. A Chapter 13 bankruptcy'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 the creditors. The debtor pays the trustee (a person appointed by the court to administer the repayment plan) all of his disposable income each month. Disposable income is the amount left after all reasonable living expenses have been paid. The income that is used to pay back the debts need not be wages, but can include benefits, pension payments, investment income or receipts as an independent contractor. At the end of a three to five year period, the court will eliminate the remaining unpaid balance on the dischargeable debts.

FINAL TIPS

Some concerns many people have in filing for bankruptcy are:

- Can a debtor own property? Yes. A debtor can keep exempt property and any property received after the bankruptcy is filed.
- Can a debtor keep their home? It 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 the home and the exemption amount provided for by state law.
- Will a debtor's credit rating be adversely affected and if so, for how long? Yes, a debtor's credit rating will be affected and for up to 10 years. However, in some cases a debtor can seek to have the bankruptcy removed after less than 10 years.

RESOURCES

Federal Trade Commission: (877) FTC-HELP; www.consumer.ftc.gov/features/feature-0009-military-families
Consumer Information: www.consumer.ftc.gov; (877) FTC-HELP
Department of Justice: www.justice.gov/ust
U.S. Bankruptcy Courts: www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics.aspx