

In Over Your Head—Life-Saving Strategies for Financial Crisis

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Section 6: Bankruptcy

For most people, there are two personal bankruptcy options:

Chapter 7—Liquidation of Debts (sometimes referred to as "straight bankruptcy")

Chapter 13—Adjustment of Debts of an Individual with Regular Income (sometimes known as "reorganization", "debt-adjustment" or the "wage-earner plan")

When you've done everything you can to pay your debts and you are still totally overwhelmed by the amount you owe, your final resort may be personal bankruptcy. If you are looking for more information about bankruptcy and how to file, you are not alone. In 1970 there were less than 100,000 personal bankruptcies in the United States. In 1998, a record 1,442,549 were filed! But is bankruptcy the right decision for you?

Filing personal bankruptcy involves a U.S. District Court proceeding in which the obligations of the debtor (the person who owes the debt) are balanced against the claims of the creditors (the individuals or companies to whom the debt is owed). The objective of the debtor is to reduce debt or eliminate it completely. The objective of the creditor is to collect as much of the debt as possible. The bankruptcy proceeding is the legal process to help the debtor and creditors resolve their differences.

Bankruptcy—is it right for me?

You should thoroughly explore other debt payment options prior to considering bankruptcy. You may be able to settle your debts through debt consolidation, with the help of a financial counselor, by generating more income or spending less. The previous sections of this booklet will help you explore these options before you consider filing bankruptcy.

Your debts will either be secured or unsecured. A secured loan has an established installment payment required on a regular schedule. When you agree to a secured loan, you pledge to give up something of greater value, such as your house or car, if you can't repay. The property that the creditor may seize according to the loan agreement is called collateral. Secured loans also allow the seller to repossess the merchandise purchased when payments aren't made on time.

Unsecured debt is not tied directly to a written repayment plan and the creditors have no collateral against the debtor. Common unsecured debt includes medical bills and most credit cards. Interest for an unsecured debt is often much higher than secured debt because the creditor may not be able to collect without taking the debtor to court.

If your primary debts are loans for secured items such as a house or car, you may lose them even if you file for bankruptcy.

Weigh carefully the consequences of filing bankruptcy. If creditors are not beating on your door for payments and your property and wages are not being affected, don't be too quick to file bankruptcy. You may also want to rethink filing if doing so means you will lose assets that have family or sentimental value.

When bankruptcy is the best choice:

Bankruptcy is governed by federal law and will be handled through the federal court in your area. You will find bankruptcy courts listed in the phone book in the U.S. Government Offices section under Bankruptcy Court. Calling the district Bankruptcy Court may help you gather some helpful information, but their office staff normally deals directly with attorneys who are familiar with the process and have specific questions regarding cases on which they are working. Court clerks cannot give legal advice and therefore don't want to be asked. General information is best obtained through an attorney who is experienced with the federal Bankruptcy Code.

The bankruptcy process normally includes consulting an attorney, filing a petition, filing "schedules" which describe your financial situation, meeting with your creditors, and establishing a liquidation or repayment plan.

A trustee will be assigned to oversee your case. The trustee collects nonexempt property and distributes it to creditors as determined by court order. The trustee works for the Department of Justice and is responsible for checking the required paperwork, reviewing the listing of assets and liabilities and reviewing claimed exemptions. In Chapter 13, the trustee must also meet with you to review your repayment plan, accept your monthly payments and distribute repayment to your creditors.

Filing for bankruptcy is a matter of public record and names of individuals filing are sometimes published in the newspaper. Do not be too eager to accept offers for counseling assistance. There are unscrupulous "counselors" who may see your name and contact you to offer assistance at a price. They will charge fees for their "services" to help you reestablish "good credit" and offer high interest, high-risk loans. "Rip-off" lenders know the bankruptcy laws well and use them to their advantage. They prey on people who have filed bankruptcy because they know that the bankruptcy filer can't file again for six years. They will get their money from you through harassment if need be. Remember, no one but you can reestablish good credit.

Advantages of filing bankruptcy:

- Provides a manageable, court-ordered process to settle with creditors.
- Provides an "automatic stay" that freezes actions by creditors to seize your assets. In Chapter 13, the automatic stay protects your home from foreclosure and prevents repossession of your car. It prevents eviction, wage garnishment, harassment by creditors, and termination of utilities. Utility services are restored in both Chapters 7 and 13.
- Prohibits the IRS from seizing your property for back taxes although you still have to pay those taxes.
- Suspends additional interest or finance charges on debts.
- Generally speaking, filing bankruptcy will not make your credit record any worse.
- Provides opportunity to start fresh and usually provides relief from stress.
- May be faster and easier than other options for getting out of debt.
- Government programs can't discriminate against you for filing bankruptcy.

Disadvantages of filing bankruptcy:

- The "automatic stay" is only temporary. It cannot provide long-term relief from foreclosure or repossession.
- Filing bankruptcy involves a lot of paperwork, is time consuming, and can be very confusing.
- Any property you transferred to someone else within the past year is subject to ownership review. If you sold something, you must have received something equal to its value in return. People faced with bankruptcy are often tempted to hide assets because they fear losing them to creditors. Don't try to hide assets; a judge may see such an attempt as fraud.
- Bankruptcies are a matter of public record. Your personal financial history will be open to the scrutiny of others including potential employers, landlords and insurance companies. Emotional stress and embarrassment may result.
- Private businesses can discriminate against you by denying you credit.
- Although it is illegal for a potential employer to discriminate against individuals who have filed for bankruptcy, it happens. Potential employers may have job applicants sign a release to gain access to credit reports and may choose another candidate if they discover a bankruptcy in your report.
- Secured creditors are entitled to the belongings for which you are unable to pay and/or the money you owe. They may have to accept lower payments over more time than was originally agreed upon (Chapter 13), but you will either pay them or return their property.
- There are filing fees and other costs. The fees are at least \$200 for Chapter 7 and \$185 for Chapter 13. For current fees, call the Bankruptcy Court in your area listed under U.S. Government. Fees can be paid in installments, but if fee payments aren't made, the case will be dismissed. The attorney will also charge for his/her services. Attorney fees range from \$400–\$575 for an individual Chapter 7 and from \$450–\$1000 for an individual Chapter 13. Joint filing fees are more. Attorneys usually expect around one fourth of their fee to be paid "up front".
- Although the debt forgiven is not considered personal income after bankruptcy, the amount of the discharged debt may appear on your 1099 income form. This, and the fact your finances are now more involved, will make filing personal income tax forms more difficult.
- Renting a home or obtaining a home loan may be difficult because of your damaged credit.
- Legally, both Chapter 7 and Chapter 13 can be on your credit report for 10 years from the day you filed for bankruptcy. The major three credit bureaus usually remove successfully discharged Chapter 13 bankruptcies after 7 years.
- You may be denied credit or be charged higher interest rates in the future. Without a credit card, it is difficult to rent a car, cash a check or make reservations for a flight or a hotel room.
- Utilities cannot deny you service because you've filed bankruptcy in the past; however, they may require a deposit prior to reestablishing service.
- Bankruptcy requires you to place your affairs under court scrutiny. A creditor or the trustee can therefore intrude into your life to be certain you are legally entitled to the relief you are seeking.

Chapter 7

Chapter 7 allows you to eliminate nearly all personal debt. In simple terms, you list your assets and liabilities and give control of your property to the court. Much of it is sold to repay your debt.

Eligibility for Filing Chapter 7:

Any person who lives in and has property or a business in the U.S. may file Chapter 7 bankruptcy. There is no maximum debt restriction, however there is a time restriction. You cannot file for Chapter 7 if either your debts were discharged in a previous Chapter 7 or if you filed a Chapter 13 where you paid less than 70 percent of your debt within the past 6 years.

Advantages of Chapter 7:

- It can permanently wipe out your obligation to pay back many unsecured debts. These generally include: credit card debt, medical bills, and past-due utility payments.
- It is possible to get credit approval because some lenders see bankrupts as a good risk. A bankruptcy filer cannot file another bankruptcy for at least six years and has no outstanding debt. Credit terms for previous bankrupts are, however, strict and very costly!
- It takes a few weeks to complete the paperwork and about 4–6 months to close the case after one or two trips to the courthouse. Chapter 7 is quicker and less complex than Chapter 13.
- In Ohio, you may keep \$5,000 of equity in your home for each debtor, \$1,000 of value in a car, standard household goods, \$500 worth of jewelry, tools used for work, life insurance policies, and prescription health related equipment. The amount of equity you retain in your house or other property varies widely from state to state. All other assets are sold. Money generated after paying court costs will be distributed to your creditor(s).

Disadvantages of Chapter 7:

- You may lose some personal assets.
- Some debts (taxes, student loans, alimony, child support, divorce/dissolution debts, property settlements, criminal fines and claims for punitive damages or court restitution orders) may remain.
- You cannot file Chapter 7 if you were discharged from your debts under Chapter 7 or 13 within the past 6 years (filing date).
- Debts incurred within 40 days of filing and additional debt you take on after your filing date are NOT discharged - you must pay them.
- Although co-signers are protected when you first file bankruptcy, creditors will likely contact them to pay your debt. The co-signer may have to pay all or part of your loan even if you are discharged from paying because of filing bankruptcy. This may cause friction in your relationship - if you still have one.
- You will have failed to meet an obligation to pay for goods and services someone provided to you because they trusted you to pay for them later. You've betrayed that trust. This may be seen by some creditors as an unwillingness to take responsibility for your debts.

Chapter 7 is a better choice than Chapter 13 if:

- Most of your property is exempt from being seized and sold.
- Nonexempt property can be exchanged for exempt property.
- Debts causing the difficulties can be discharged under Chapter 7.

Chapter 13

In Chapter 13, you keep your property. A repayment schedule is established that requires you to repay your debts over several years. Past-due mortgage payments are expected to be paid off in three years, but this can be extended to five years if there is a good reason. You may be expected to pay interest on the debt as well as the debt itself. The repayment plan is court-approved and the court-appointed trustee oversees payment to your creditors. Chapter 13 does not eliminate your debt but it can keep creditors from harassing you until a repayment schedule is worked out in the courts.

Advantages of Chapter 13:

Eligibility for Filing Chapter 13:

You or your spouse must have a stable job or other source of regular income. The income must be high enough to meet the obligations of the repayment plan with enough left to meet basic living expenses. To determine if

you can meet these requirements, you will be required to develop a workable budget. You may not qualify to file Chapter 13 if your debts are too high. Limits vary from state to state, but in Ohio your debts are too high to file Chapter 13 if your secured debt exceeds \$807,750 and your unsecured debt is more than \$269,250.

- Unlike Chapter 7, you keep your property as long as you make the monthly payments the court arranges for you.
- You will meet an obligation to pay for goods and services someone provided to you, trusting you to pay later.
- You have 3–5 years to completely pay your debts. Your creditors must accept the terms of the court-approved repayment agreement.
- The interest rates established in the pay back plans are often less than the original loan. If you have a car loan, you may only be required to pay the true value of the car itself.
- You may file Chapter 13 anytime, even if you recently filed for Chapter 7 or Chapter 13.
- It may be easier for you to reestablish good credit because you will have paid your debts rather than filing Chapter 7.
- Chapter 13 may legally be kept on your credit report for 10 years. (That's not good news.) However, the three major credit bureaus often remove Chapter 13 from their records if the debts have been paid off within 7 years from filing date. (That's not "good" news either, but 7 years is better than 10 years.)

Disadvantages of Chapter 13:

Chapter 13 is a better choice than Chapter 7 if:

- The delinquent debt is on secured loans - normally the house and/or car.
- More than one secured creditor exists.
- You want to protect unsecured assets from being sold to pay your debts.
- You usually have only three years to pay back past due mortgage payments.
- You may have to pay additional interest on the debt you pay back.
- Attorney fees may be higher for Chapter 13 because it is more complex and requires more time than Chapter 7.
- Nationwide, about 49 percent of Chapter 13 plans are dismissed, 14 percent of the debtors eventually file for Chapter 7, and 36 percent are discharged (completed).
- You cannot file for Chapter 13 if your unsecured debt exceeds \$269,250 or your secured debt is over \$807,750.
- If you want to sell your house after filing Chapter 13, the court may need to approve your choice of Realtor. The court will stay involved in the sale process and will demand additional paperwork and procedures.

Handling bankruptcy yourself

Bankruptcy is complicated and will have a long-term impact on your life. Most people are therefore advised to seek the help of an attorney. But the law does not require that you retain an attorney to file bankruptcy. "Do-it-yourself" bankruptcy kits are available to help you understand the bankruptcy process, the records you must gather, the paper work required and the consequences of filing for bankruptcy. Kits normally focus on Chapter 7 because other types of bankruptcy are a bit more complex and fewer consumers file Chapter 13. A word of caution - the kits tell you that filing for Chapter 7 is a relatively simple matter. You will need to be very well organized, detail-minded and patient to successfully file bankruptcy without the assistance of an attorney. An attorney will assure that the bankruptcy paperwork is in order and will help steer you through the entire legal process.

There are a number of books available to help prepare for filing bankruptcy:

How to File for Chapter 7 Bankruptcy (8th Edition) by Stephen Elias, Albin Renauer, Robin Leonard (Nolo Press) Feb. 1999. ISBN#: 0873375025.

How to File Your Own Bankruptcy (Or How To Avoid It) (4th Edition) by Edward A Haman (Sourcebooks Trade) Oct. 1997 ISBN#: 1570712239.

Debt Free - Your Guide to Personal Bankruptcy Without Shame by James P. Caher and John M. Caher (Henry Holt) June 1996 ISBN#: 0805042768.

Chapter 13 Bankruptcy: Repay Your Debts (4th Edition) by Attorney Robin Leonard, (Nolo Press) 1999 ISBN#: 0873375017.

Bankruptcy: Is It The Right Solution To Your Debt Problems? by Attorney Robin Leonard, (Nolo Press) 1999.

Dealing with Debt, Your Guide to Bankruptcy and Other Options by Mary Trimble (part of the American Bar Association's "Practical Law Series") 1995. ISBN#: 1-57073-242-6 Telephone 312-988-5522.

Finding legal assistance:

Hiring an attorney to help you sort through the bankruptcy process will incur more debt but it may be a comfort to know that someone who understands the complexities of the system is in charge of your case. If you are married, an attorney can advise you if a single or a joint petition is best. An attorney will be able to explain the legal issues involved in transferring assets to avoid criminal prosecution for fraud. Many problems can be prevented if you are honest and thorough with your attorney and the court.

The Legal Aid Society

In some communities the Legal Aid Society may provide bankruptcy filing assistance to individuals or families that qualify under certain income limits. Qualifications and services vary from county to county. Contact your local office for information.

An attorney:

Finding a competent, dependable attorney who will charge a reasonable fee for services may seem overwhelming. Keep the following in mind:

- Understand that you are in a crisis and are under emotional stress. You may not be able to make wise choices at this time. Consider asking a trusted friend to help you select an attorney.
- Go through the phone book and examine the ads. Are there ads that list bankruptcy? Do the ads use fear, stress or revenge gimmicks? Is the office location convenient? Do you want an attorney from your hometown? Do the office hours fit your schedule?
- Check with the local American Bar Association for a referral or advice in your search.
- Be leery of television and radio ads that promise a quick fix to your financial problems.

When you call the attorney's office the first time, ask the following questions:

- Is there a fee for the first visit? If so, how much is it and when is it paid? If you decide not to use the services, is this fee returned?
- What is an estimated cost for their services? How much of their fee do they expect "up front" and do they use an installment plan for payment of the rest of their fee?
- Is the attorney a member of the American Bankruptcy Law Forum, the American Bar Association, or a county or state Bar committee? Membership may indicate a higher level of training and professionalism.
- How many bankruptcy cases have they handled?
- Will you be assigned to one attorney, or will your case be handled by several?
- What paperwork, if any, is required for the first visit? Ask for forms that you complete prior to your first visit.

Contact several attorneys by telephone and record how they responded to your questions. Filing bankruptcy is an emotional experience. You need an attorney whom you trust and with whom you feel comfortable. Review your findings and set an appointment for a meeting.

Ask yourself:

- Can I relate to this person? Do I feel comfortable asking for more information if I don't understand something?
- Is it clear how, when, and how much the attorney is to be paid? How are the legal fees determined? If you pay in installments, how much more expensive will the total cost be?
- Do you understand what the attorney will do and what you will have to do?
- Do you fully understand the separate steps in the bankruptcy process?

When you meet with the attorney:

- Ask a friend to go with you to the first visit. You are understandably anxious to get the bankruptcy process started. A friend may be more objective and less likely to rush into decisions.
- Complete any paperwork provided prior to the first visit. Take your completed [Know what you owe form](#) (pdf) with you. This will minimize the amount of time spent and should lower attorney fees.

Bankruptcy is intended as a fresh start and may be the best way to handle overwhelming debt.

References

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