

# BANKRUPTCY

**YOUR RIGHT TO  
A FINANCIAL  
FRESH START**

## **MONEY WISE**

**A CONSUMER ACTION AND CAPITAL ONE PARTNERSHIP**



Bankruptcy is a federal court process that can help consumers eliminate overwhelming debts or establish a plan to repay them. Depending on your income and circumstances, bankruptcy laws may give you a way to erase many financial obligations and start afresh. But bankruptcy may have a long-term negative impact on your ability to obtain credit, find a job, get insurance or rent a place to live.

### **Chapter 7 and Chapter 13**

Individuals may be able to file for one of two kinds of bankruptcy—Chapter 7 “liquidation” bankruptcy or Chapter 13 “repayment” bankruptcy.

In Chapter 7, the bankruptcy court forgives most debts that are not secured by assets or property (such as your house or car). In addition, you are allowed to retain certain “exempt assets.” Under Chapter 7, a court-appointed trustee takes possession of your non-exempt property, arranges for its sale or liquidation and is responsible for paying as many of your debts as possible with the proceeds. (Not all debts can be erased by bankruptcy.)

Chapter 13, sometimes referred to as “wage earner repayment plan” bankruptcy, may be your only choice if the court determines you have the income to repay your debts. Filing for Chapter 13 bankruptcy allows you to pay your debts in installments over an agreed-upon time period, usually three to five years. The court must approve your plan to repay all or part of the money you owe. Many people who want to keep property, such as a house or car, turn to Chapter 13.

### **Requirements for Filing**

Today, all bankruptcy filers are subject to a “means test” based on income and expenses to determine whether they are eligible for Chapter 7 or if they must file Chapter 13. You may be prevented from filing Chapter 7 if your income is above your state’s median and you can afford to pay a certain portion of your unsecured debt payments. The court also can require you to file Chapter 13 if it believes that you are abusing the system by filing for Chapter 7.

A means test is used to determine if a consumer may file for Chapter 7. The test considers your income in relation to the median income in the state where you live. Median incomes vary from state to state. For exam-

ple, 2005 median income for one person in New Mexico is \$31,652 while in New Jersey it is \$54,273. (The figures will be revised in late summer of 2006.) You can find current state median income statistics for individuals and families on the U.S. Trustee web site ([www.usdoj.gov/ust](http://www.usdoj.gov/ust)) under “Means Testing Information.”

If your income exceeds the state median and the test further determines that you can pay at least \$6,000 over five years (\$100 a month) toward your debts, you must file under Chapter 13. Internal Revenue Service (IRS) living standards are used as guidelines for determining allowable housing costs, food, clothing and other expenses and to determine how much money you have left over each month to repay your debts.

If you file under Chapter 7, you must provide a copy of your latest tax return or your case will be dismissed. For Chapter 13, you must provide tax returns for the past four years. If you have not submitted your income taxes, you must do so before you will be allowed to file bankruptcy. In addition, you must provide a number of other documents, including:

- ❖ A certificate of credit counseling.
- ❖ Evidence of earnings in the past 60 days.
- ❖ Monthly net income and any anticipated increase in income.
- ❖ A photo ID.

You cannot file for bankruptcy until you provide proof that you have participated in pre-bankruptcy credit counseling within the six months before you file. Before your bankruptcy case can be closed (discharged), you must complete mandatory post-bankruptcy money management training. You must pay the fees for these courses and the services must be provided by an agency certified by the U.S. Trustee. Visit the U.S. Trustee web site ([www.usdoj.gov/ust](http://www.usdoj.gov/ust)) for a list of agencies in your area. Approved credit counselors must provide the services free of charge to consumers who cannot afford the fees.

## A Personal Decision

Bankruptcy is a personal decision. Most people file bankruptcy because of crushing debts, often caused by financial hardships such as unemployment, lack of adequate insurance, catastrophic medical expenses, marital problems, overextended credit or, more rarely, out of control spending.

Bankruptcy laws were passed in order to give people a fresh start, and to

give debt-burdened consumers an organized, systematic way of paying back creditors. If you're over your head in debt and you can't see being able to repay all the money you owe, you may be interested in filing bankruptcy. Or, if you can pay back creditors but need to get out from under wage garnishments, repossession threats or a home foreclosure, you may want to consider bankruptcy.

People who are behind with bills but not overwhelmed by debt and collection calls may be able to get by without filing bankruptcy. Try these strategies:

- ❖ Find ways to earn more money. Ask your entire household to contribute from their earnings.
- ❖ Keep a budget. Track not only what you spend, but also upcoming expenses and regular bills you must pay.
- ❖ Downsize your life style. If your mortgage or new car loan is killing you, think about selling your home or car and living more simply for a while.
- ❖ "Freeze" your credit cards. Hide them, close them out or literally "freeze" them in a block of ice and use cash or your ATM or debit card to "pay as you go."
- ❖ Shop carefully. Compare prices on everything you buy and consider buying generic brands or in bulk.
- ❖ Start saving. Even low-income households can save regularly to build an emergency fund to fall back on when times get tough.

### Debts That Don't Disappear

When considering bankruptcy, it's important to know that certain debts cannot be erased. If you want to avoid foreclosure on your home or repossession of your car, you must bring your account up-to-date and continue paying your obligations.

While bankruptcy may be able to help you remove or repay many debts, these are some of the debts that generally can't be erased:

- ❖ Child support and alimony.
- ❖ Student loans.
- ❖ Debts you owe from a divorce decree or settlement.
- ❖ Income taxes from recent years.
- ❖ Fines and penalties such as traffic tickets, criminal fines, court-ordered

- repayments, income tax penalties and recent property tax assessments.
- ❖ Credit purchases of luxury goods or loans or cash advances of \$1,150 or more that occurred within 60 days of filing; debts owed to a single creditor of more than \$500 for luxury goods purchased within 90 days of filing; cash advances of \$750 made within 70 days.
  - ❖ Debts or judgments based on fraud or illegal activities you committed, such as drunken driving, malicious injury to a person or property, embezzlement or larceny.
  - ❖ Any debts you forgot to list in your bankruptcy filing.

### Exempt Assets

By federal and state law, certain things you own outright (assets) are protected during bankruptcy. These are called “exempt” assets because they do not need to be sold during the bankruptcy process. Everything else you own of value (all your non-exempt assets) must be sold to use to pay your creditors during a Chapter 7 bankruptcy filing.

Your exempt assets may include all or part of the value of your home that you own outright (your home equity). Other assets that you might keep despite filing bankruptcy are retirement accounts, autos, clothing, household furnishings, books and tools of your trade. (Assets such as your home or auto that serve as collateral for a loan, in most cases cannot be left out of the bankruptcy filing because you owe money on them.)

Your creditors cannot demand that exempt assets that you own outright be sold to pay your debts. Any part of your home you own outright—your home equity—is protected to varying degrees by federal and state law. State provisions that protect your home (homestead exemptions) are subject to these rules:

- ❖ If you haven't lived in a state for at least two years, you must use the homestead exemption for the state you lived in before the two-year period.
- ❖ You can exempt only up to \$125,000 of your home's equity, regardless of the state allowance, if the home was acquired less than 40 months before filing or if you have violated securities laws or been found guilty of certain criminal conduct.

### Before You Decide

Many people who file bankruptcy don't realize what an impact it will

have on their lives. It can affect your credit history for seven to 10 years, so you might have trouble getting new credit, a mortgage, a job, insurance or a rental dwelling. Some credit issuers might extend credit regardless of a bankruptcy, while others will extend credit only after several years or after bankruptcy filing is no longer on your credit report.

If bad spending habits have led you to bankruptcy, legal forgiveness of your debts might not change the way you handle money and credit. If you do not learn money management skills, you could fall into debt again, probably without the option of declaring bankruptcy. If you file Chapter 7 bankruptcy, you will have to wait eight years from the date you filed to file again. You can't file Chapter 13 if you obtained a bankruptcy discharge in the prior 2-4 years, depending on the kind of bankruptcy you filed.

Bankruptcy is a complex legal process—you go to court and hand over control of your financial affairs to strangers. Even if you file for Chapter 7, the bankruptcy judge must decide whether you have enough income to repay your debts in a Chapter 13 case, or if you are abusing the system by filing Chapter 7.

Are you considering bankruptcy because creditors are harassing you? Federal and state fair debt collection laws may be able to help you protect yourself from abuse and harassment by debt collectors.

### Assess the Damage

Before making a decision to declare bankruptcy, face your current financial situation and assess the damage.

Review your credit history. The three largest credit reporting companies are Equifax, Experian and TransUnion. Once per year, you are entitled to a free credit report from each agency from Annual Credit Report, a service run by the three agencies with oversight by the Federal Trade Commission. Order your free reports:

- ❖ Online ([annualcreditreport.com](http://annualcreditreport.com)).
- ❖ By calling 877-322-8228.
- ❖ By mail at Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. (You must first download an order form from the website.)

The reports will list most, if not all, of your debts. If you find inaccuracies in your report, call the company to file a dispute. The law requires

that the credit reporting company verify the information with the company that furnished it and remove inaccurate information from your credit report.

Speak with your creditors. Discuss your situation and explain that you are willing to pay off your debts. You may be able to arrange payment plans or negotiate a reduced settlement amount. Ask each creditor to agree to a voluntary plan for the repayment of your debts. See if they will reduce any interest or penalties that you owe. If you reduce your other expenses, it may be possible to pay off your debts in a reasonable time.

Consider credit counseling. If your creditors will not work with you, consider credit counseling. There are many reputable credit counseling organizations offering credit education, credit review, budgeting workshops and debt management plans. To find a credit counseling organization near you, contact the National Foundation on Consumer Credit (NFCC) online ([www.nfcc.org](http://www.nfcc.org)) or by phone (800-388-2227). Many NFCC-affiliated credit counselors (often known as “consumer credit counseling services” or CCCSs) have fees based on a sliding scale depending on your income. The counselors contact your creditors on your behalf. Sometimes creditors will waive interest charges and late fees when you enroll in an established debt management plan. Deal only with qualified credit counseling agencies—walk away from any offers that claim you can wipe out your debts.

Seek out loans or access your home equity. Explore the possibility of loans from family members or friends who might be willing to lend you funds if you repay them on a fixed schedule with a fair interest rate. If you are a homeowner, consider refinancing, a second mortgage or a home equity line of credit in order to pay off your debts. Be careful—if you miss payments on your home loans, the lender can sell your property and force you out.

Consumer debt is at an all-time high and many companies are preying on consumers looking for a solution. Be alert for companies offering an easy way out of debt—they may be for-profit counseling agencies (even if they say they are non-profits) or companies that promote bankruptcy as a quick and easy fix. Especially avoid any ads offering “debt consolidation mortgages.” Investigate any agency before meeting with it, and don’t sign agreements or pay money until you are sure that it’s the right thing.

## Do I Need an Attorney?

It is possible to file a bankruptcy case pro se (without the assistance of an attorney) but according to the U.S. Bankruptcy Court it is extremely difficult to do it successfully. Although the law requires bankruptcy attorneys to tell you that a lawyer is not required to file bankruptcy, professional advice can help protect your rights in this complicated legal proceeding. Your creditors almost certainly will have attorneys representing them. At the very least, consult with an attorney before making the decision to file on your own.

Ask friends and family if they can recommend a lawyer. If not, the National Association of Consumer Bankruptcy Attorneys (<http://nacba.org>) has an online directory of its members. On the home page, click on “Find a Bankruptcy Attorney Near You.” Look for a lawyer with expertise and more than a few years’ prior experience in personal bankruptcy. In many cases, lawyers don’t charge for a brief initial consultation, but to be safe ask about fees before setting up an appointment.

Bankruptcy attorneys must disclose all fees and can take your case only after you have signed a written contract. When you are billed, always ask for an explanation of charges you don’t understand. Bankruptcy lawyers can be held accountable, and may be subject to fines, if your filing contains any false information, so they must check the accuracy of the information you provide. In some cases, bankruptcy attorneys require clients to pay the cost of title searches and credit reports needed to verify information that will be contained in the filing.

If you cannot afford to pay a bankruptcy attorney, you may be able to find free or low-cost legal services. Call your local or state bar association or county courthouse or check the yellow pages under “Legal Aid” or “Legal Assistance.” To find legal aid services near you, visit the Legal Services Corporation web site ([www.lsc.gov](http://www.lsc.gov)) and use the “Find Legal Services” state-by-state directory.

## Bankruptcy Court

You must file bankruptcy in the U.S. Bankruptcy Court Division nearest to where you live. Look in the United States government section of your phone directory under Courts. If you have Internet access, you can find the appropriate court by using the Federal Courts Finder ([www.law.emory.edu/FEDCTS](http://www.law.emory.edu/FEDCTS)).

You can buy the forms you need at the bankruptcy clerk's office or download them for free from the Internet. The filing fee for Chapter 7 bankruptcy is \$274 and \$185 for Chapter 13. The court will need proof you have completed mandatory credit counseling, as well as past tax returns and paycheck stubs. You will have to provide information about your debts, creditors, income sources, loans, real estate, personal property and living expenses. The documents you may need include payment demands, mortgages, deeds, summonses, court judgments, credit card statements, medical bills, bank account statements, child support or alimony agreements, student loans and documentation of any past bankruptcy. If you hire a bankruptcy attorney to represent you, he or she will know what you need and how to pull it together.

Filing bankruptcy will stop—or “stay”—collection efforts by your creditors for the duration of the bankruptcy case. If your creditors continue to contact you, they could be cited for contempt of court and ordered to pay damages. However, if you miss any requirements after filing, your creditors can petition to have the stay lifted. If the court determines that there have been frequent bad faith or abusive filings, the stay will be voided and collectors will be able to seek payment from you.

A trustee will be appointed to review your forms and documents. You may be able to keep your home, car or other possessions that the court determines necessary, but if you owe money on these assets, you must continue to make payments. Secured debts must be paid in full and cannot be reduced, even if the value of the asset that secures the debt has fallen.

In a straightforward Chapter 7 case, you typically will be notified about the final outcome of your case within three to six months and, in most cases, debts that qualify will be discharged at that time.

Chapter 13 debts are discharged when the plan is completed—usually in three to five years.

Discharge does not mean your debts are forgiven, canceled or extinguished. It means that your creditors can no longer force you to pay the debt, but they still have the right to reclaim property in which they have a security interest.

## What If...

These are some of the most frequently asked questions about bankruptcy:

- Can my landlord kick me out? Bankruptcy cannot prevent or halt eviction if you fail to pay your rent after filing bankruptcy.
- Will I lose my job? Your current employers won't necessarily find out about your bankruptcy, unless the conditions of your employment call for regular credit checks. In any case, you probably would not be fired just for filing bankruptcy—however, the stress caused by being in debt may have caused a decline in your work, which could be used as a reason to dismiss you.
- Will I go to jail? No. There is no debtor's prison in the U.S.
- Does my spouse have to file? In most cases, no. However, your spouse will be obligated to continue paying the full amount of any joint obligations you have, even if your responsibility for paying them is discharged by the bankruptcy.
- What will happen if I list a co-signed debt in my bankruptcy filing? Your responsibility to pay will be removed, but the co-signers will be held responsible for the entire debt. If the co-signed debt is not delinquent, you may be able to "reaffirm" it as part of your bankruptcy filing. (This means that, with permission from the trustee, you waive any right to protection from the creditor if you default on the debt in the future.)
- Do I have to give back my credit cards? This depends on the companies you do business with. If you reaffirm your liability for the debt during the bankruptcy filing, you may be able to keep the cards. However, the credit card companies can close your accounts if they wish to do so.
- Do I have to pay my back taxes? Yes. You still are responsible for all taxes, and you must file all outstanding tax forms within 45 days of filing bankruptcy or the case will be dismissed.

## Re-Establishing Credit

Filing for bankruptcy will negatively affect your credit history. You may find it difficult to get a new credit card. However, you might be able to obtain a secured credit card when your bankruptcy is final. Even people with damaged credit may be able to obtain a secured credit card by

depositing money in a savings account. Your line of credit on a secured card usually is the same as the amount of money you deposit.

In recent years, some credit card companies have started to offer new credit cards to people who recently filed for bankruptcy because they know that people who have filed for bankruptcy cannot file again for several years. These offers are likely to be for credit cards with very poor terms, such as high interest rates and penalty fees. Be very careful about responding to such offers.

### For Further Information

#### **Cornell Law School – Legal Information Institute**

**Web site:** [www.law.cornell.edu](http://www.law.cornell.edu)

Click on “Law About...” to find information about many legal topics, including bankruptcy.

#### **The National Association of Consumer Bankruptcy Attorneys**

**Web site:** <http://nacba.org>

Click on “Find a Bankruptcy Attorney Near You” for a directory of member attorneys.

#### **The National Foundation for Credit Counseling (NFCC)**

**Web site:** [www.nfcc.org](http://www.nfcc.org)

**Phone:** 800-388-2227

Call or visit the web site to find a credit counseling agency near your home. (If you need pre-bankruptcy credit counseling, find a certified agency on the U.S. Trustee site.)

#### **Nolo Press**

**Web site:** [www.nolo.com](http://www.nolo.com)

**Phone:** 800-728-3555

Publisher of excellent legal background guides for consumers on many topics including debt, collections and bankruptcy.

#### **U.S. Trustee**

**Web site:** [www.usdoj.gov/ust](http://www.usdoj.gov/ust)

Find agencies certified to provide pre-bankruptcy credit counseling and post-bankruptcy money management education as well as guidelines for bankruptcy means testing.

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