

Understanding Bankruptcy Basics

What is bankruptcy?

Bankruptcy is a federal court process that helps individuals and businesses eliminate their debts or repay them under the protection of the bankruptcy court. There are two types of bankruptcy that individuals typically file, Chapter 7 and Chapter 13.

What is the difference between Chapter 7 and Chapter 13?

Chapter 7 bankruptcy -- also called "straight" or "liquidation" bankruptcy -- wipes out most types of debt, and in return the bankruptcy trustee sells (liquidates) your nonexempt property in order to provide partial repayment to creditors.

In a **Chapter 13 bankruptcy**, you use your income to pay some or all of what you owe to your creditors over time -- from three to five years, depending on the size of your debts and income. In return, you may keep your property. The repayment plan describes in detail how (and how much) you will pay for each of your debts. In order for your bankruptcy to go forward, the court must approve your repayment plan and also determine that you have enough income to meet your payment obligations under the plan.

There are a few striking differences between the two types of bankruptcy:

	Chapter 7	Chapter 13
Type of Bankruptcy	Liquidation	Reorganization
Who Can File?	Individuals and Business Entities	Individuals Only
How Long Does It Take to Receive a Discharge?	Typically 3 to 5 months	Upon completion of all plan payments (usually 3 to 5 years)
What Happens to Property in Bankruptcy?	Trustee can sell all nonexempt property to pay creditors	Debtors keep all property but must pay unsecured creditors an amount equal to value of nonexempt assets
Benefits	Allows debtors to quickly discharge most debts and get a fresh start	Allows debtors to keep their property and catch up on missed mortgage, car, and nondischargable priority debt payments
Drawbacks	Trustee can sell nonexempt property. Does not provide a way to catch up on missed payment to avoid foreclosure or repossession	Must make monthly payment to the trustee for 3 to 5 years. May have to pay back a portion of general unsecured debts.

What types of debts can be discharged in bankruptcy?

- ☒ **Credit Card Debt** – Since credit card debt is considered nonpriority unsecured debt, any outstanding balance remaining after you complete your repayment plan is discharged.
- ☒ **Medical Bills** – Medical debt is one of the main reasons people file for bankruptcy relief. If you had to incur debt because your medical care was not fully covered by insurance, you can discharge your medical bills.
- ☒ **Personal Loans** – Similar to credit card debt, any personal loans you took out also get discharged at the end of your bankruptcy. However, keep in mind that if you pledged an asset as collateral when you took out the loan, bankruptcy may discharge your personal liability on the loan but the creditor can usually repossess the collateral if you don't pay.
- ☒ **Older Tax Obligations** – Most tax obligations are nondischargeable priority debts. However, certain taxes (such as older income tax obligations) may be considered nonpriority debts and get discharged upon completion of your case if you timely filed your returns and did not commit fraud.

What bankruptcy cannot do:

- ☒ **Prevent a secured creditor from repossessing property** – A bankruptcy discharge eliminates debts, but it does not eliminate liens. So, if you have a secured debt (i.e., a debt where the creditor has a lien on your property and can repossess it if you don't pay the debt), bankruptcy can eliminate the debt, but it does not prevent the creditor from repossessing the property.
- ☒ **Eliminate child support and alimony obligations** – Child support and alimony obligations survive bankruptcy -- you will continue to owe these debts in full, just as if you had never filed for bankruptcy. And if you use Chapter 13, your plan will have to provide for these debts to be repaid in full.
- ☒ **Wipe out student loans, except in very limited circumstances** – Student loans can be discharged in bankruptcy only if you can show that repaying the loan would cause you "undue hardship," a very tough standard to meet. You must be able to show not only that you cannot afford to pay your loans now, but also that you have very little likelihood of being able to pay your loans in the future.
- ☒ **Eliminate most tax debts** – Eliminating tax debt in bankruptcy is not easy, but it is sometimes possible for older debts for unpaid income taxes. There are many requirements to be met, however.
- ☒ **Eliminate other nondischargeable debts** – The following debts are not dischargeable under either Chapter 7 or Chapter 13 bankruptcy:
 - debts you forget to list in your bankruptcy papers, unless the creditor learns of your bankruptcy case
 - debts for personal injury or death caused by intoxicated driving, and
 - fines and penalties imposed for violating the law, such as traffic tickets and criminal restitution.

Tips for considering bankruptcy:

- ☒ **Assess your finances** – Know what your expenses, income and total debts are.
- ☒ **Pull your free credit report** – Go to www.annualcreditreport.com to get an accurate list of all creditors you owe. Some people make the mistake of thinking that because debt collectors have stopped contacting them about a debt that it is no longer on their record or that if a bank has charged off the debt it is no longer valid. If you don't include all creditors on bankruptcy filings you run the risk of going through the entire process and still owing thousands in debt.
- ☒ **Inform all debt collectors and creditors** – Bankruptcy law requires that all debt collection calls, letters and efforts to reach debtors cease once a bankruptcy petition is successfully filed in court.
- ☒ **Get that credit counseling certificate sooner rather than later** – One of the pre-filing requirements involves obtaining a certificate of successful completion of credit counseling with a government-certified counseling agency. The counseling can take place up to six months prior to filing. If time is of the essence in filing for bankruptcy protection and you have not completed the counseling sessions, this can cause delays and problems.
- ☒ **Get an attorney** – The bankruptcy laws have become so complex that experts say consumers should not attempt to file by themselves.

How to find an attorney in your area:

- ☒ **Recommendations from friends, family, and colleagues** – The single best way to find a good bankruptcy lawyer is to get referrals from people you know and trust.
- ☒ **Referrals from other lawyers** – If you have used a lawyer for another matter, ask the lawyer if he or she know of any good bankruptcy attorneys.
- ☒ **Group legal plans** – Does your employer provide a group legal plan or do you pay a monthly fee for a legal plan? If so, check to see if the plan covers bankruptcies. At the very least, this should be your first stop for legal advice.
- ☒ **County or state bar lawyer-referral panels** – Many state bar or county bar associations maintain a lawyer-referral directory. Often you can find these on the Internet. Or you can call your local bar association. Usually, these directories will match you up with several attorneys that practice in your geographical area and have experience with your type of legal issue.
- ☒ **Internet directories** – Many private companies provide lists of bankruptcy lawyers on the Internet. A few places to start include:
 - o Nolo's lawyer directory at www.nolo.com/lawyers
 - o National Association of Consumer Bankruptcy Attorneys at www.nacba.org
- ☒ **Nonprofit legal services** – If you are low-income, you might qualify for help from a nonprofit legal services organization. Many legal aid organizations are partially funded by the Federal Legal Services Corporation. Others get funding exclusively from private foundations. Most legal aid offices do not provide bankruptcy representation, although a few do. Some won't represent you, but will guide you through the process on your own.
 - o Law Help at www.LawHelp.org
- ☒ **Law school legal clinics** – Many law schools sponsor legal clinics and provide free legal advice to consumers. Some legal clinics have the same income requirements as nonprofit legal services organizations. Others may provide information and services to people with slightly higher incomes.