

The Basics of Bankruptcy

[Bankruptcy](#) is a legal process meant to deal with debt that has become unmanageable. Under the U.S. Constitution, the federal government has authority to set uniform rules for bankruptcy, so when a person or business files for bankruptcy, they are dealing primarily with federal law.

Bankruptcy is designed to allow a person or business whose debts have become unmanageable to pay off their creditors to the extent possible, and then discharging (legally eliminating) the remainder of the debt. Bankruptcy should not be viewed as a “get out of debt free” card, and going bankrupt is not a magic wand that makes all of your financial troubles disappear. However, many people who are in dire financial straits find that bankruptcy’s benefits are worth its costs, and that bankruptcy can be one important step in getting one’s finances back on track. There are 3 main types (or “chapters”) of bankruptcy: chapter 7, chapter 13, and chapter 11. These names simply come from the chapters of the Bankruptcy Code in which they’re codified.

Chapter 7 Bankruptcy

[Chapter 7 bankruptcy](#) allows a person to discharge most of their debts – to relieve the debtors of their legal obligation to their creditors.

Chapter 7 is the main form of “liquidation” bankruptcy. The other form of bankruptcy is “restructuring.” Liquidation bankruptcy involves the debtor surrendering any excess assets, which are given to a bankruptcy trustee appointed to manage the debtor’s assets. They are then sold, and the proceeds given to the creditors.

However, federal and state laws provide that certain types of property are exempt from seizure and sale, up to a certain dollar amount in value. Exactly what type of property is exempt, and how much each exemption is worth, will vary widely from state to state. However, if a debtor does not have very much money or property, it’s not uncommon that the total value of all their assets will be well below the maximum exemption amount in their state, effectively meaning that they can keep everything they own.

The procedure for filing Chapter 7 bankruptcy is fairly simple. It begins with filling out a petition describing your debts, property, monthly income, monthly expenses, property claimed as exempt, among other things. This is usually faster and easier to do with the assistance of a bankruptcy attorney, who has likely dealt with hundreds, if not thousands, of similar petitions.

Once the petition is filled out, it is filed with the bankruptcy court in your area. Once bankruptcy is filed, there is an “automatic stay” during which creditors cannot engage in any attempt to collect debt from you, whether it’s a simple phone call, or a lawsuit. Violation of an automatic stay can carry severe consequences for creditors.

During this period, you cannot sell or transfer any of your assets without the court's consent. Once the trustee has finished reviewing your documents, and is satisfied that they are accurate, there will be a short meeting with the trustee. The trustee will ask you a few simple questions, which you will be under oath to answer truthfully. Then, any creditors who have questions for you will have an opportunity to ask them. In bankruptcy cases involving ordinary consumers, it's pretty rare for creditors to show up to these meetings, since the amounts of money involved are typically too small to be worth the effort.

Once this is done, any non-exempt assets are sold off, and the remaining debt is discharged.

If some of your debt is secured (has collateral attached to it; a car loan being the most common example), you will have to give up the security to the debtor if you wish to have that debt discharged.

If you like, however, you can choose to "re-affirm" the debt, if the property securing your debt is something you'd like to keep. For example, suppose you have a car which you have not completely paid off, and you depend on this car to get to work. Giving up the car might prove to be ruinous. Ordinarily, if you file for Chapter 7 bankruptcy, the company that financed your car purchase would be able to take possession of the car, in exchange for discharging the remainder of the car loan.

If you like, you can re-affirm the car loan. This will let you keep the car, but you must agree to keep current on your payments. If most of your other debts are discharged, making these payments will be much easier.

When you file for Chapter 7 bankruptcy, you will be unable to file for bankruptcy again for 8 years, and the bankruptcy will remain on your credit report for 7 to 10 years, where it will almost certainly have a negative effect.

Chapter 13 Bankruptcy

[Chapter 13 bankruptcy](#) is very different from Chapter 7 bankruptcy, in that it does not involve a discharge of most of your debts. Instead, it involves a *restructuring* of debt.

In short, when you file for Chapter 13 bankruptcy, you are able to restructure your payments for all of your debts, resulting in lower, more manageable, monthly payments. When you file, you will have to submit a debt repayment plan to a bankruptcy trustee. Once the trustee approves the plan, he or she will collect your payments, and then distribute the money to your creditors.

You cannot restructure your debts under Chapter 13 if you have more than \$250,000 in unsecured debt, and more than \$750,000 in secured debt.

What Option is Best For Me?

First of all, this question can only be definitively answered by your [bankruptcy attorney](#). As a general rule, however, if you have a large amount of assets you'd like to keep, and a steady income, restructuring under Chapter 13 might be the best option.

If you don't have a steady income, or have a very low income, and don't have a lot of non-exempt assets, Chapter 7 is usually the better option. Again, these are just general rules, no two bankruptcy cases are identical, and a general guide such as this cannot substitute for the advice of an expert.

How Does the New Bankruptcy Law Affect Me?

In 2005, Congress passed, and President Bush signed, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which made major alterations to consumer bankruptcy, particularly Chapter 7. Almost all of these changes have the intent, and result, of making it more difficult to be eligible for Chapter 7 bankruptcy. This law is often referred to simply as "the new bankruptcy law" or the "2005 bankruptcy reform law."

The biggest hurdle that it places in front of would-be Chapter 7 filers is the "means test." If your monthly income is higher than the median income for your state, this triggers a "presumption of abuse" – meaning that you now have an affirmative duty to prove that you cannot pay at least 25% of your debts. If you prove this, you can go ahead with the Chapter 7 process. If you cannot, your only option is to file for Chapter 13.

The law makes many other changes to the bankruptcy system, but this means test is the most fundamental. Other changes include:

- A requirement to attend a credit counseling class within 180 days before filing for bankruptcy
- A broader category of debts (including student loans, most taxes, criminal fines, child support, civil judgments resulting from drunk driving, and others) cannot be discharged in Chapter 7

Do I Need a Bankruptcy Attorney?

Filing for bankruptcy, especially when the effects of the BAPCPA are taken into account, can get pretty complicated.

For that reason, it's a very good idea to seek the advice and assistance of a bankruptcy [attorney](#), to ensure that you get your petition right the first time, helping you shed your debts and move on with your life.