

Client Handout Answering Common Bankruptcy Questions

A decision to file for bankruptcy should be made only after determining that bankruptcy is the best way to deal with your financial problems. This handout cannot explain every aspect of the bankruptcy process. If you still have questions after reading it, you should speak with an attorney familiar with bankruptcy or a paralegal working for such an attorney.

What Is Bankruptcy?

Bankruptcy is a legal proceeding in which a person who cannot pay his or her bills can get a fresh start. The right to file for bankruptcy is provided by federal law, and all bankruptcy cases are handled in federal court. In Vermont there is only one Bankruptcy Court located in Rutland and one Bankruptcy Judge, Honorable Colleen A. Brown. Filing bankruptcy immediately stops all your creditors from trying to collect debts from you, at least until your debts are sorted out according to the law.

What Can Bankruptcy Do for Me?

Bankruptcy may make it possible for you to:

- Eliminate the legal obligation to pay most or all of your debts. This is called a “discharge” of debts. It is designed to give you a fresh financial start.
- Stop foreclosure on your house or mobile home and allow you an opportunity to catch up on missed payments. (Bankruptcy will usually not, however, automatically eliminate mortgages and other liens on your property without payment.)
- Prevent repossession of a car or other property, or force the creditor to return property even after it has been repossessed.
- Stop wage garnishment, debt collection, harassment, and similar creditor actions to collect a debt.
- Restore or prevent termination of utility service.
- Allow you to challenge the claims of creditors who have cheated you or who are otherwise trying to collect more than you really owe.

What Bankruptcy Cannot Do

Bankruptcy cannot, of course, cure every financial problem. Nor is it the right step for every individual. Although bankruptcy can eliminate and reduce debt, it cannot increase your income. In bankruptcy, it is usually not possible to:

- You cannot eliminate certain rights of “secured” creditors. A “secured” creditor has taken a mortgage or other lien on property as collateral for the loan. Typical examples are car loans and home mortgages. You can force secured creditors to take payments over time in the bankruptcy process and bankruptcy can eliminate your obligation to pay any additional money if your property is taken. Nevertheless, you generally cannot keep the collateral (the property securing the debt) unless you continue to pay the debt.
- You cannot discharge types of debts singled out by the bankruptcy law for special treatment, such as child support, alimony, and most other debts related to divorce, most student loans, court restitution orders, criminal fines, and most federal and state taxes.
- You cannot protect co-signers on your debts. When a relative or friend has co-signed a loan, and the borrower discharges the loan in bankruptcy, the co-signer may still have to repay all or part of the loan.
- You cannot discharge debts that arise **after** bankruptcy has been filed.

What Different Types of Bankruptcy Cases Should I Consider?

There are four types of bankruptcy cases for individuals provided under the law:

- Chapter 7 is known as “straight” bankruptcy or “liquidation.” It requires a debtor to give up property that exceeds certain limits called “exemptions,” so the property can be sold by a Trustee to pay creditors.
- Chapter 11, known as “reorganization,” is used by businesses and a few individual debtors whose debts are very large.
- Chapter 12 reserved for family farmers and fishermen.
- Chapter 13 is called “debt adjustment.” It requires a debtor to file a plan to pay debts (or parts of debts) from current income over three to five years.

Most people filing bankruptcy will want to file under either chapter 7 or chapter 13. Either type of case may be filed individually or by a married couple filing together (jointly).

Chapter 7 (Straight Bankruptcy)

In a bankruptcy case under chapter 7, you file a petition asking the court to wipe out (“discharge”) your debts. The basic idea in a chapter 7 bankruptcy is to discharge your **unsecured** debts in exchange for your giving up property, except for “exempt” property that the law allows you to keep. In many cases, **all** your property will be exempt. Property that is not exempt is sold, with the money distributed to the creditors.

If you want to keep property like a home or a car and are behind on the payments on a mortgage or car loan, a chapter 7 case probably will not be the right choice for you. That is because chapter 7 bankruptcy does not eliminate the right of mortgage holders or car loan creditors to take your property to cover the debt.

Chapter 13 (Debt Adjustment)

In a chapter 13 case you must file a “plan” showing how you will pay off some of your past-due and current debts over three to five years. The most important thing about a chapter 13 case is that it allows you to keep valuable property – especially your home and car –that might otherwise be lost, if you can make the payments that the bankruptcy law requires you to make to these creditors. In most cases, these payments will be at least as much as your regular monthly payments on your mortgage or car loan, plus some extra payment to get caught up on the amount you have fallen behind.

You should consider filing a chapter 13 plan if you:

- (1) own your home and are in danger of losing it because of money problems;
- (2) are behind on debt payments, but can catch up if given some time;
- (3) have valuable property that is not exempt, but you can afford to pay creditors from your income over time.

You will need to have enough income in chapter 13 to pay for your necessities and to keep up with the required payments as they come due.

What Does It Cost to File for Bankruptcy?

It now costs \$335 to file for bankruptcy under chapter 7 and \$310 to file for bankruptcy under chapter 13, whether for a single person or a married couple. If you hire an attorney you will also have to pay the attorney’s fees, usually before you actually file. Some attorneys will ask you to pay 1/2 the attorney’s fees when you retain the attorney and the other 1/2 before you actually file with the Court.

What Must I Do Before Filing Bankruptcy?

You must receive budget and credit counseling from an approved credit-counseling agency within 180 days *before* your bankruptcy case is filed. The agency will review possible options available to you in credit counseling and assist you in reviewing your budget. Different agencies provide the counseling in-person, by telephone, or over the Internet. If you decide to file bankruptcy, you will need to file a certificate from the agency stating that you received the counseling along with the bankruptcy forms.

If you decide to go ahead with bankruptcy, you should be very careful in choosing an agency for the required counseling. It is extremely difficult to sort out the good counseling agencies from the bad ones. Many agencies are legitimate, but many are simply rip-offs. And being an “approved” agency for bankruptcy counseling is no guarantee that the agency is good. It is also important to understand that even good agencies won’t be able to help you much if you’re already too deep in financial trouble.

Some of the approved agencies offer debt management plans (also called DMPs). This is a plan to repay some or all of your debts in which you send the counseling agency a monthly payment that it then distributes to your creditors. Debt management plans can be helpful for some consumers. For others, they are a terrible idea. The problem is that many counseling agencies will pressure you into a debt management plan as a way of avoiding bankruptcy regardless whether it makes sense for you or not. It is important to keep in mind these important points:

- Bankruptcy is not necessarily to be avoided at all costs. In many cases, bankruptcy may actually be the best choice for you.
- If you sign up for a debt management plan that you can’t afford, you may end up in bankruptcy anyway (and a copy of the plan must also be filed in your bankruptcy case).
- There are approved agencies for bankruptcy counseling that do not offer debt management plans.

It is usually a good idea for you to meet with an attorney before you receive the required credit counseling. Unlike a credit counselor, who cannot give legal advice, an attorney can provide counseling on whether bankruptcy is the best option. If bankruptcy is not the right answer for you, a good attorney will offer a range of other suggestions. The attorney can also provide you with a list of approved credit counseling agencies, or you can consult the web site for the United States Trustee Program office at www.usdoj.gov/ust.

What Property Can I Keep?

In a chapter 7 case, you can keep all property that the law says is “exempt” from the claims of creditors. You can choose between your exemptions under Vermont or under federal law. The choice will depend on the kind of property you own.

Vermont exemptions include:

- \$125,000 in equity in your home;
- \$2,500 in equity in your car;
- \$5,000 in equity in tools of your trade;
- Wedding rings Unlimited. \$500 in equity in other jewelry;
- Basic appliances plus \$2,500 in equity for household furnishings and clothes;
- \$700 in a deposit account;
- Any amount in an Individual Retirement Account (I.R.A.) necessary for your family’s support;
- \$7,400 (usually) in equity in **any** property; and
- Your right to receive certain benefits such as social security, unemployment compensation, veteran’s benefits, public assistance, personal injury claims, life insurance, and pensions is also protected by Vermont law.

*The amounts of all Vermont exemptions except for the home are **doubled** when a married couple files together.*

Federal exemptions include:

- \$23,675 in equity in your home;
- \$3,775 in equity in your car;
- \$600 per item in any household goods up to a total of \$12,625;
- \$2,375 in things you need for your job (tools, books, etc.);
- 1,250 in any property, plus part of the unused exemption in your home, up to \$13,100;
- Your right to receive certain benefits such as social security, unemployment compensation, veteran’s benefits, public assistance, and pensions—regardless of the amount.

The amounts of all Federal exemptions, including the home, are doubled when a married couple files together.

In determining whether property is exempt, you must keep a few things in mind: The value of property is not the amount you paid for it, but what it is worth **now**. Especially for furniture and cars, this may be a lot less than what you paid or what it would cost to buy it new.

You also only need to look at the **equity** in property. This means that you count your exemptions against the full value minus any money that you owe on mortgages or liens. For example, if you own a \$150,000 house with a \$50,000 mortgage, you count your exemptions against the \$100,000, which is your equity (what will be left) if you sell it.

While your exemptions allow you to keep property even in a chapter 7 case, your exemptions do not make any difference to the right of a mortgage-holder or car loan creditor to take the property to cover the debt if you are behind in payments. In a chapter 13 case, however, you can keep all your property if your plan meets the requirements of the bankruptcy law. In most cases you will have to pay the mortgages or liens as you would if you didn't file bankruptcy plus also catch up on the back payments over time.

What Will Happen to My Home and Car If I File Bankruptcy?

In most cases you will not lose your home or car during your bankruptcy case as long as your equity in the property is fully exempt. Even if your property is not fully exempt, you will be able to keep it if you pay an amount equal to the amount that is not exempt to your creditors in chapter 13.

Some of your creditors, however, may have a "security interest" in your home, automobile, or other personal property. This means that you gave that creditor a mortgage on the home or put your other property up as collateral (security) for the debt. Bankruptcy does not make these security interests go away. If you don't make your payments on that debt, the creditor may be able to take and sell the home or the property, regardless of the bankruptcy case.

There are several ways that you can keep collateral or mortgaged property after you file bankruptcy. You can be current and keep making your payments on the debt until it is paid in full. Or you can pay the creditor the amount that the property you want to keep is worth in one payment. In some cases involving fraud or other improper conduct by the creditor, you may be able to challenge the debt. If you put up your household goods as collateral for a loan (other than a loan to purchase the goods), you can usually keep your property without making any more payments on that debt.

Can I Own Anything After Bankruptcy?

Yes! Some people believe they cannot own anything for a period of time after filing for bankruptcy. This is not true. You can keep your exempt property and anything you obtain **after** the bankruptcy is filed. In a chapter 7 case, any property you receive after filing bankruptcy is yours, and any debt you incur after filing will not go away (will not be discharged). The only exception is if you become entitled to receive an inheritance, a property settlement in a divorce, or life insurance benefits within 180 days after filing for bankruptcy. That money or property may have to be paid to your creditors if the property or money is not exempt. Otherwise, a chapter 7 case looks only backward from the date of filing.

Will Bankruptcy Wipe Out All My Debts?

Mostly, with some specific exceptions. Bankruptcy will not usually wipe out:

- (1) money owed as a result of a divorce, fines, and most taxes;
- (2) debts not listed on your bankruptcy petition;
- (3) loans you got by knowingly giving false information to a creditor, who reasonably relied on this information in making you the loan;
- (4) debts resulting from “willful and malicious” harm;
- (5) student loans, except if the court decides that payment would be an undue hardship (which is quite difficult to establish);
- (6) mortgages and other liens that are not paid in the bankruptcy case (but bankruptcy will wipe out your obligation to pay any additional money if the property is sold by the creditor for less than you owe).

Will I Have to Go to Court?

In most bankruptcy cases, you only have to attend a proceeding called the “meeting of creditors” to meet with the bankruptcy trustee and any creditor who chooses to come. Usually, this meeting will be a short and simple procedure where you are asked a few questions about your bankruptcy forms and your financial situation by the trustee. Creditors do not usually appear.

Occasionally, if complications arise, or if you choose to dispute a debt, you may have to appear before a judge at a hearing. If you need to go to court, you will receive notice of the court date and time from the court and from your attorney.

What Else Must I Do to Complete My Case?

After your case is filed, you must complete an approved course in personal finances. This course will take about two hours to complete. Your attorney can give you a list of organizations that provide approved courses, or you can check the web site for the United States Trustee Program at www.usdoj.gov/ust. In a chapter 7 case, you should sign up for the course soon after your case is filed. If you file a chapter 13 case, you should ask your attorney when you should take the course.

Will Bankruptcy Affect My Credit?

There is no clear answer to this question. Unfortunately, if you are behind on your bills, your credit may already be bad. Bankruptcy will probably not make matters any worse.

The fact that you've filed a bankruptcy can appear on your credit record for ten years. But because bankruptcy wipes out your old debts, you are likely to be in a better position to pay your current bills, and you may be able to get new credit much earlier.

What Else Should I Know?

Utility services – Public utilities, such as the electric company, can not refuse or cut off service because you have filed for bankruptcy. The utility can, however, require a deposit for future service within 20 days of filing and you do have to pay the bills that arise after you file.

Discrimination – An employer or government agency cannot discriminate against you because you have filed for bankruptcy

Student loans – You cannot be denied a student loan because you filed bankruptcy.

Driver's license – If you lost your license solely because you couldn't pay court-ordered damages caused in an accident, bankruptcy will allow you to get your license back.

Co-signers – If someone has co-signed a loan with you and you file for bankruptcy, the co-signer may have to pay your debt. If you file a chapter 13, you may be able to protect co-signers, depending on the terms of your chapter 13 plan.

How Do I Find a Bankruptcy Attorney?

As with any area of the law, it is important to be careful in selecting an attorney who will respond to your particular situation. The attorney should not be too busy to meet you individually, to explain what will happen, and to answer your questions.

The best way to find a trustworthy and competent bankruptcy attorney is to seek recommendations from family, friends, or other members of the community, especially any attorney you know and respect. You should carefully read retainers and all other documents the attorney asks you to sign. You should not hire an attorney unless he or she agrees to represent you throughout the bankruptcy case.

In bankruptcy, as in other areas of life, remember that the person advertising the cheapest rate is not necessarily the best. Some of the best bankruptcy lawyers do not advertise at all.

Document preparation services, also known as “typing services” or “paralegal services,” use non-lawyers who offer to prepare bankruptcy forms for a fee. Problems with these services often arise because non-lawyers cannot offer advice on difficult bankruptcy cases and they offer no services once a bankruptcy case has begun. There are also many shady operators in this field who give bad advice and defraud consumers.

When first meeting a bankruptcy attorney, you should be prepared to answer at least the following questions:

- What types of debt are causing you the most trouble?
- What are your more valuable assets?
- How did your debts come about and are they secured?
- Is any action about to happen to foreclose or repossess property or to shut off utility service?
- What are your goals in filing the case?

Could I File Bankruptcy Without an Attorney?

Although it may be possible for some people to file a bankruptcy case without an attorney, it is not a step to be taken lightly. The process is difficult and you may lose property or other rights if you do not know the law. It takes patience and careful preparation. Chapter 7 (straight bankruptcy) cases are easier. Few people have been able successfully to file chapter 13 (debt adjustment) cases on their own.

Remember: The law often changes. Each case is different. This handout is meant to give you general information and not to give you specific legal advice.