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BANKRUPTCY

Introduction

Service members having problems paying their bills can be faced with garnishment or repossession. In such situations they consider bankruptcy to be a solution to their problem. This article provides guidance on the basics of bankruptcy law.

1. What is Bankruptcy?

The bankruptcy law is a federal law available to people throughout the United States. Bankruptcy provides a method to temporarily suspend (during the course of the proceeding) and subsequently enjoin all debt collection practices regarding pre-filing debts.

A. Automatic Stay

Once a person files for bankruptcy, an "automatic stay" is put in place that prevents creditors from attempting to collect on any debts incurred before filing. Creditors may petition the court for relief from the automatic stay and permission to continue. Often, creditors whose loans are secured by a pledge of property are permitted to take possession of that property.

B. Discharge

After the bankruptcy proceedings are completed, the bankruptcy adjudication (a finding that a person is "bankrupt") results in a discharge of the personal debts. The discharge acts as a forgiveness of personal liability for all debts incurred prior to filing for bankruptcy. In most instances, creditors are prohibited from suing or attempting to collect debts that have been discharged. Once discharge is granted, former creditors also have no claim on future income.

In exchange for the discharge, a debtor must turn over all non-exempt property to a court-appointed trustee. (See Chapter 7 below.) The trustee is required to sell the property and distribute the proceeds to creditors. A debtor can be denied a discharge for certain "bad acts" such as concealing or fraudulently transferring assets prior to filing. Even if a discharge is granted, certain debts can never be discharged. These include:

1. alimony and child support,
2. student loans,
3. taxes, and
4. any debt incurred through the debtor's fraud or theft.

2. Your Options

Individuals may choose several different types of bankruptcy based upon the amount and nature of the debts, the exemptions available and the types of assets owned by the debtor. The different bankruptcies are named after a corresponding chapter in the code.

A. Chapter 7

Chapter 7 is referred to as "straight" or "liquidation bankruptcy." In a liquidation, the debtor turns all of his or her assets over to a trustee who then liquidates (sells) all the assets and distributes the proceeds to the debtor's creditors. The person is then discharged of all debts. Creditors must look solely to the assets held by the trustee for payment and are prohibited from attempting to collect their claims from the discharged debtor. A debtor can receive a Chapter 7 discharge once every eight years. Every state allows a debtor, even in a liquidation, to keep some small amount of property.

B. Chapter 13

Chapter 13 debtors pay their debts through future income rather than liquidation or foreclosure of present assets. This chapter usually allows the debtor to keep much of his or her property. The chapter is available to those debtors with unsecured debts (usually credit cards) less than $307,675 and secured debts less than $922,975 (home mortgages and car loans). These amounts are adjusted periodically to reflect changes in the consumer price index.

Under Chapter 13, the debtor presents a plan for repayment that is reviewed by the trustee, the creditors and the bankruptcy court. Over time, the plan must provide creditors with an amount at least equal to what they would receive under a Chapter 7 and must be feasible in light of the debtor's income. If the plan is approved, then the debtor makes payments to the trustee who in turn pays the creditors. Plans usually run at least three years and cannot run longer than five. While a debtor under Chapter 13 gets to keep much of his or her property, there are certain disadvantages such as:

a. Debtors remain under court supervision for the life of the plan (up to five years) and are forbidden to make new debts or sell assets without court permission.
b. Debtors who propose less than full payment to unsecured debtors will be forced to live on a budget for the life of the plan and pay all excess income to the creditors.
c. Even if the debtor pays all of the creditors in full, the bankruptcy will still appear on the debtor's credit record.

If the debtor is unable to complete the plan payments, then any creditor may petition to have the court convert the case to a Chapter 7 liquidation.

C. Chapter 11

Chapter 11 is a reorganization proceeding, usually involving corporate debtors, but also available to individuals who have been engaged in a commercial enterprise. This chapter is used when the owner desires to stay in business, restructure existing debts, retain assets and attempt to reorganize under court supervision.

3. Taxes

Filing bankruptcy under either Chapter 7 or Chapter 11 will stop all IRS or state tax collection activities. But if a Chapter 7 is filed, the tax collection activities resume shortly after filing because the tax obligation cannot be discharged in bankruptcy. Furthermore, interest and penalties continue to accrue. Under Chapter 13, on the other hand, filing halts the accumulation of interest and penalties and taxes may be paid over the life of the plan.

4. Co-Debtors

A bankruptcy filing often involves other persons (such as the debtor's spouse) who have cosigned notes or mortgages with the debtor. The filing of a Chapter 13 plan can be used to stop all creditor actions against certain co-debtors. This is true even if the co-debtors are solvent and do not join the Chapter 13 petition. This protection can become permanent if the plan provides for payment of the cosigned debt in full and is fully performed.

5. Conclusion

Your individual financial situation may alter the generalities and conclusions set forth in this article. For your specific situation, you should seek counsel from an attorney before filing for bankruptcy relief. If you have any questions, please stop by the legal office.