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Bankruptcy Fact Sheet

Introduction

Bankruptcy is a legal proceeding designed to protect consumers from creditors. It lets consumers reorganize or eliminate their debt. Because federal law provides the right to file bankruptcy, cases are handled in federal court.

Chapter 7 & Chapter 13

There are several types of bankruptcy. The most common are Chapter 7 and Chapter 13. If you are a family farmer or a business owner, you should ask an attorney about other types of bankruptcy that might be available to you.

Chapter 7 bankruptcy is often referred to as liquidation. It does not involve a monthly payment to creditors. In a Chapter 7 proceeding, most unsecured debts are eliminated. The individual filing for bankruptcy can choose to reaffirm a secured debt, like a car. It takes an average of 3 months before the debtor receives a discharge.

Chapter 13 bankruptcy is often called a debt consolidation plan. In a Chapter 13 proceeding, some secured debts may be restructured or given special payment provisions. This is done so a debtor can catch up on past-due payments and keep things that are necessary for life. In a Chapter 13 bankruptcy, the debtor follows a bankruptcy plan that lasts from 3 to 5 years. The plan requires monthly payments to a bankruptcy trustee, who sends the money to the creditors. At the end of the plan, the debtor's secured debts should be paid off, any home mortgage payments should be current (and resumed by the debtor), and most remaining unsecured debts will be discharged.

What Bankruptcy Can Do

If you are in debt and your finances are out of control, filing for bankruptcy may benefit you. Filing for bankruptcy should keep creditors from harassing you. Once you file, your creditors may no longer contact you about your debts. They cannot garnish your wages or bank accounts or take your property to satisfy debts, even if they already have a judgment against you. Bankruptcy can also help you catch up on missed payments and fees, stop the repossession of your car, and prevent the foreclosure of your home. In some cases, bankruptcy can even help you get your car back after it has been repossessed.

What Bankruptcy Cannot Do

Bankruptcy will not eliminate child support, alimony, or criminal fines. In most cases, it does not affect taxes or student loans. Bankruptcy does not apply to debt incurred after the bankruptcy is filed. Bankruptcy does not remove your debts from your credit history.

Law

To file a Chapter 7 bankruptcy, you must qualify based on income and expenses. In general, your normal and necessary living expenses, including secured debt payments, must take up so much of your income that you cannot afford to pay your unsecured creditors. You should be current on your secured debts when you file a Chapter 7 bankruptcy. If you are not, the secured creditor can repossess its collateral.

To file a Chapter 13 bankruptcy, you must have a source of income because Chapter 13 requires a payment plan. The income may be from job wages, unemployment benefits, worker's compensation, SSI, or disability income. Several factors determine how the payment plan will work. Some of these factors are the debtor's income, the size and type of debt, and any secured items the debtor plans to keep.

Before filing for bankruptcy, you must take a consumer credit counseling course. This course generally lasts from 30 minutes to 1 hour. The counseling may be done by phone, in person, or on the Internet. The court will require you to take another counseling course before completing your bankruptcy case.

Bankruptcy is still a viable option for those who need financial relief.

Glossary

- **secured creditor:** a creditor who has collateral for the loan or a lien on the item you purchased using the money from the loan—this usually means you signed a contract giving them the right to take the collateral if you do not pay for it (common examples are car loans and home mortgages)

- **unsecured creditor:** an individual or institution that lends money without obtaining specified assets as collateral—this poses higher risk to the creditor because they have nothing to fall back on if the borrower defaults on the loan (a common example is a credit card company)
- **reaffirmation:** voluntarily reaffirming a debt to a secured creditor as a promise to repay the debt rather than discharging the debt in bankruptcy—reaffirmation agreements are normally requested by secured creditors in Chapter 7 bankruptcy and are always optional
- **debtor:** the individual filing bankruptcy
- **discharge:** the removal of the legal obligation to pay a debt
- **trustee:** an appointed representative of the debtor's bankruptcy estate
- **bankruptcy estate:** the property interests of the debtor at the time of the bankruptcy filing

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