



Bankruptcy

Individuals and businesses use bankruptcy as a way to obtain relief from debts owed to creditors.

The United States Constitution authorizes Congress to pass uniform laws on bankruptcy. Laws governing bankruptcy have existed since the early 1800s. The Bankruptcy Code (Title 11 of the *United States Code*), enacted in 1978, has been amended several times, most recently with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. While there is no constitutional right to relief from debts, relief granted by the bankruptcy courts is available to the extent Congress provides.

The Bankruptcy Code provides for relief from debts either through *liquidation* (Chapter 7) or *reorganization* (Chapters 11, 12, or 13). This pamphlet discusses some of the issues to consider before filing for bankruptcy and the differences between a liquidation and a reorganization case. Before deciding whether to seek bankruptcy protection, one should consult a qualified bankruptcy lawyer.

What types of bankruptcy relief are available?

Individuals are eligible to file for bankruptcy under Chapter 7, Chapter 11, Chapter 12 or Chapter 13 of the Bankruptcy Code.

Chapter 7 bankruptcy is known as *liquidation*, or “fresh start” bankruptcy. In a Chapter 7 case, a trustee (assigned by the U.S. Trustee’s Office or chosen by the debtor’s creditors) may liquidate, or sell, the debtor’s non-exempt assets to pay all or a portion of the debts owed to creditors. As a practical matter, you, as a debtor, typically can protect all of your assets by using state or federal exemptions. Many Chapter 7 trustees find that more than 80 percent of their cases are resolved as “no asset” cases, meaning that all assets are exempt or encumbered with liens.

State law, and in some states federal law, protects you from having certain property taken. This property is “exempt” from liquidation during bankruptcy, and may include, for example, a certain amount of equity in a home, a vehicle, furniture, clothes, certain retirement accounts, life insurance policies, etc.

When estimating the amount of money that can be made from selling a particular non-exempt item in a Chapter 7 liquidation bankruptcy, a bankruptcy trustee typically will subtract your exemption from your property’s “fair market value” (what a ready, willing and able buyer will pay for the property in “as is” condition). The trustee also will subtract whatever you may owe for any liens or mortgages that may be on your property.

The trustee will only liquidate assets that will net cash to pay your creditors. The trustee also must deduct the fees and expenses paid to any professionals (such as Realtors or auctioneers) assisting in the liquidation of your property. Through this liquidation process, any debts the trustee does not pay (with certain exceptions) will be discharged (eliminated), and creditors will not be able to force you to pay any remaining amount owed.

Chapter 13 bankruptcy, or *individual reorganization*, is an alternative to Chapter 7 that allows you to keep your property. In a Chapter 13 bankruptcy (unlike a Chapter 7 bankruptcy), you must pay a portion or all of the debt back. If you are filing bankruptcy under Chapter 13, you must be able to fund a payback plan and meet certain debt and asset limits. You can also use a Chapter 13 bankruptcy to bring your mortgage arrearages and taxes current.

Effective October 17, 2005 under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, if you earn more than the median income (based on family size) in the state where you lived before filing bankruptcy, you probably will not qualify for relief under Chapter 7. Whether you are over the median income is determined by the *mean’s test*. The mean’s test takes an average of your last six months of income, excluding certain forms, and multiplies that number by twelve. If the result of that calculation is over the applicable median income rate, you might not qualify for a Chapter 7 bankruptcy. Sometimes, the deduction of certain standard and actual monthly expenses can allow an above-median debtor to qualify for a Chapter 7 bankruptcy.

Chapter 13 debtors must repay all or part of their creditors over time through a Chapter 13 plan. Under Chapter 13, you would submit a plan detailing how all your debts will be paid from disposable monthly income (income after providing for ordinary living expenses) over a period of time of up to five years. The plan of reorganization is monitored by a Chapter 13 trustee and supervised by the bankruptcy court. Upon the successful conclusion of payments under the plan, the bankruptcy court enters a discharge order. As a Chapter 13 debtor, you must pay the creditors at least as much as they would receive if the assets were liquidated in a Chapter 7 case.

A Chapter 13 bankruptcy is typically voluntary and you can choose to dismiss or convert the case into a Chapter 7 bankruptcy. You must otherwise qualify for a Chapter 7 bankruptcy in order to convert.

Chapter 11 “reorganization” is typically used by corporations or businesses, or individuals whose debts exceed the Chapter 13 debt limits, as an alternative to Chapter 7 liquidation. Since a reorganization under Chapter 11 can be a very expensive process, it is not frequently used by individuals. In a Chapter 11 reorganization, as in a Chapter 13 reorganization, the business debtor keeps business assets and must pay creditors with future earnings according to a reorganization plan.

Chapter 12 is a special reorganization for family farmers. To qualify, a family farmer must earn most of his or her income from family farming operations.

When is it appropriate for me to file for bankruptcy?

The decision whether to file for bankruptcy is based upon each debtor’s unique situation. If you are considering bankruptcy, whether individually or for a business, you should consult with an experienced bankruptcy lawyer who can determine whether you should explore such an option and when it would be most beneficial to file. Generally speaking, it may be appropriate to file for Chapter 7 bankruptcy when you are unable to pay your debts *and* regular living expenses and when all of your property is exempt. Your income or your assets might make a Chapter 13 bankruptcy more appropriate.

Before filing, consider:

- changing the terms of a loan (duration, balance due, interest, monthly payments), but beware of the potential impact the forgiveness of debt might have on your taxes and your credit score;
- surrendering your property to fully satisfy the debt (a "short sale"), while taking into account the potential impact the short sale may have on your taxes and your credit score;
- determining whether you may be eligible for certain entitlement programs that may exempt your property from seizure;
- discussing the financial impact of your decisions with an accountant;
- entering a state court trusteeship or consulting with a reputable debt relief adviser. Be sure to do your research before signing an agreement.

How would I go about filing for bankruptcy relief?

To initiate a bankruptcy, you would file a petition with the bankruptcy court and pay a filing fee. In certain circumstances, the court may waive the fee. You also may be able to pay the filing fee in installments. The petition consists of *schedules* that detail information about all your assets, liabilities, and income. The petition schedules include an accurate list of everything you own, the outstanding amount of the debts you owe to all your creditors, as well as personal information about your employment and whether you have made any transfers of money or property before you filed for bankruptcy.

After these documents are filed, you meet with a trustee. This meeting is called the *341 hearing*. It is open to the public and creditors are invited to attend. The trustee checks the petition and schedules for accuracy. Also, the trustee and the creditors will ask you questions about your financial situation and your assets.

Can a husband and wife file together for bankruptcy?

Yes; it is possible, but not required. Spouses can file a joint petition if they both need relief from their creditors. However, depending on the circumstances, one spouse may file for relief under Chapter 7 or 13 and the other spouse may choose not to file at all or may file his or her own separate bankruptcy case. When spouses file separately, the assets and liabilities for each spouse will be considered separately by the bankruptcy court. However, the court looks at total household income, as well as total household expenses, to determine eligibility for either a Chapter 7 or a Chapter 13 bankruptcy.

Can the bankruptcy court refuse to discharge my debts in bankruptcy?

Yes. Filing a bankruptcy petition does not guarantee that your debts will be discharged.

The bankruptcy court may deny a general discharge of debts if you commit certain acts of misconduct before or after filing the bankruptcy petition, such as destroying, concealing, or removing assets that might otherwise be used to pay creditors. A discharge of debts may be denied if you have destroyed or concealed records that show what assets are available to pay creditors. Finally, the bankruptcy court may deny a general discharge if you have lied under oath during the bankruptcy case, or have refused to answer questions.

Certain debts may not be discharged, based upon an action taken by your creditor. If you incurred a debt within three months of filing a bankruptcy, a creditor may presume you incurred that debt fraudulently and file an adversary proceeding (lawsuit) against you to keep the court from discharging that debt. In the adversary proceeding, your creditor can claim that you made a "luxury" purchase (like buying a new television set) or incurred any debt with the intention of not paying it back. Such legal action can be taken in a Chapter 7 to force you to pay that entire debt back. In a Chapter 13, a creditor would bring this action to force you to pay that entire debt back, rather than only paying a portion of it.

Even if a discharge of debts is denied, your assets still may be liquidated in a Chapter 7 case. There are certain limitations to your ability to convert your case to a Chapter 13 after you have filed a Chapter 7. The denial of a discharge does not relieve you from your other obligations under the Bankruptcy Code.

Can I file bankruptcy more than once?

Yes, but you might be ineligible for a Chapter 7 bankruptcy or a discharge of your debts. You must wait eight years from a previously filed Chapter 7 to file a new Chapter 7 case. You can file and receive a discharge in a Chapter 7 six years after having filed a previous Chapter 13 that was discharged.

You can file a Chapter 13 case any time after the conclusion of the previous bankruptcy, but you might not be eligible for a discharge. You can file and receive a discharge in a Chapter 13 four years after having filed a previous Chapter 7 that was discharged. You can also receive a discharge in a Chapter 13 two years after having filed a previous Chapter 13 that was discharged.

If a general discharge is granted, will I still have to pay any debts?

Yes. Even if a general discharge is granted, some debts are not discharged in bankruptcy. Further, the type of bankruptcy affects what debts may be discharged.

Debts that might not be discharged in bankruptcy include taxes assessed within 240 days of the bankruptcy filing, student loans, most debts arising from a divorce court order, criminal fines and debts arising from a DUI, and any debt incurred because a debtor has committed fraud, breached a fiduciary duty as a trustee, or committed a "willful" act causing injury to a creditor. The bankruptcy court ultimately will decide whether these types of debts will be discharged.

How does filing bankruptcy affect my credit?

Filing bankruptcy will be noted on your credit record for up to ten years, but the effect of this notation to a particular creditor may depend on whether a discharge was granted or the case was dismissed, and what type of bankruptcy case it was: a Chapter 13 reorganization or a Chapter 7 liquidation. It is common for individuals who file bankruptcy to have trouble getting a new loan, or they may have to pay a higher rate of interest to secure one.

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