7 Reasons You Should Not File Bankruptcy

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I meet with a lot of people who believe that bankruptcy is going to be their best option. And truthfully, for most of the people I meet with bankruptcy is not only the best option but something they should have done a long time ago. However, when I meet with families, there are those that should not file for bankruptcy for one reason or another. I have put together a list of seven (7) reasons why you should not file for bankruptcy.

#1 You Can Afford to Pay Your Debts

This one seems simple, and is truly rare among most people I meet with, but every now and again someone comes in and simply wants to walk away from it all. The debt is relatively minimal compared to income. A good way to determine if you fall into this category is to take your monthly income, minus all of your monthly expenses, including your credit card payments, and if there is a significant amount of money left over, you are likely going to be better off in the long term just making arrangements to pay the debt.

That being said, I have had clients come in who have very little debt. Very little debt in my world is something in the range of $10,000. However, for some clients his might as well be $10 million. They have no job or very limited income and no serious prospects for improving their income situation in the near future. I also see many seniors who are living on a very fixed income fall into this category. For some, even when the debt is relatively small, if the ability to pay is not there, bankruptcy can be a good option.

#2 Your Debt is Mostly Tax Debt

Not all debts are created equal. Certain debts, even in bankruptcy, are not discharged or eliminated through the bankruptcy process. Most taxes fall into this category. Certain taxes like payroll taxes a business owner owes will never go away. The typical income tax will not be eliminated in your bankruptcy unless it meets certain criteria. Specifically, it must be at least three years old and must not have been assessed to you at any time in the last 240 days. If the majority of your debt is taxes and relatively recent, bankruptcy is likely not going to be a good option because you will not obtain the benefit of discharging those debts.

However, if your debt is income tax, and it is at least three years old, you should meet with a bankruptcy attorney to see if it can be eliminated through bankruptcy filing.

#3 Your Debt is Mostly Student Loan Debt

The only thing more difficult to eliminate through bankruptcy other than taxes is student loan debt. Back in 2005 the Bankruptcy Code was amended to include a provision that made all debt obtained for educational purposes presumed to be non-dischargeable. You can overcome this by showing hardship; however the bar has been set very high. I witnessed a trial once where an attorney who had significant student loan debt sought to eliminate these debts through bankruptcy after an auto accident left her a quadriplegic. The court ruled that she could still work and only reduced her loans by half.

If student loan debt is the main debt problem you have a better option than bankruptcy would be to seek out the many organizations that help with student loan borrowers going through financial hardship.

#4 Filing Bankruptcy Will Hurt Your Credit Score

It is pretty much common knowledge that filing for bankruptcy is going to damage your credit score. How much it will lower your score is hard to say; I have noticed that for those bankruptcy clients who have low scores when we file their case (550 or lower) that the bankruptcy doesn't lower the score that much more - typically another 30-50 points. However, for those clients who have decent credit (700 or higher) they usually take a hit in the range of 100 - 150 points. I don't know why this is or what the formula is for calculating this, but this is what I have observed in the hundreds of bankruptcy cases I have filed.

While bankruptcy will absolutely lower your credit score, most of my clients are surprised to see that their score will actually increase within 12 months of their bankruptcy case being discharged. Most who look to file for bankruptcy are behind on their bills. When you fall behind on your credit card payments each month the credit card company lets the credit bureaus know that you are late. This lowers your score and continues to hit you month after month.

The filing of a bankruptcy stops the bleeding. You are no long getting hit each month with a "late". You will get hit with a bankruptcy on your credit report, but that is a onetime thing; it is not re-reported each month. The further you get away from your filing date the better you will be.

#5 You Can Lose Assets in Bankruptcy

Another reason you may not want to file for bankruptcy, particularly Chapter 7 bankruptcy, is that you can be at risk of losing assets. A Chapter 7 bankruptcy is a liquidating bankruptcy, meaning that if you have assets that are not protected under the various exemption laws, then a bankruptcy trustee can seize the asset, sell it, and give the money to your creditors. If you have assets that are not protected you will likely lose them. For some, this is a big reason not to file. There may be land that is not protected that has been in the family for generations, or other property that is simply not worth the risk of losing.

That being said, most people that go through the bankruptcy process do not lose assets. Here in Arizona the last statistic I heard was that 94% of Chapter 7 bankruptcy filers did not lose any assets through the process. This is largely due to the exemption laws here in Arizona. Most people have heard of the homestead exemption that protects your home, however Arizona also has exemption laws that protect cars, wedding rings, retirement accounts, household items and even livestock. If you are thinking of filing bankruptcy but are worried about losing assets it is a good idea to meet with a bankruptcy lawyer to determine what you would be at risk of losing. Often this fear is unfounded.

#6 You Have Recently Become Entitled to an Inheritance

This one seems kind of random, but I have surprisingly had it come up enough times that it is worth mentioning. If you have received an inheritance, or the more relevant situation is that you have become entitled to receive an inheritance but have not yet received it, filing bankruptcy may not be a good option for you. For example, say you were the beneficiary under a will or trust of a person that had died. You became entitled to a certain asset or cash upon their death. It is likely that it will take some time to process everything and you may not actually receive the inheritance for some time. If you file for bankruptcy and then receive the inheritance, your bankruptcy trustee can take that asset and use that for the benefit of your creditors.

Similarly, if you become entitled to an inheritance within 180 after you file your bankruptcy case the bankruptcy trustee can go after those funds to pay your creditors. In situations where the inheritance is large, your creditors end up receiving 100% payment but you still have to deal with a bankruptcy on your credit report.

If you have become entitled to an inheritance or expect to become entitled to an inheritance in the near future, you should consult with a bankruptcy attorney about this situation prior to jumping into a bankruptcy case.

#7 You Have Business Debts that are Not Personally Guaranteed

Many small business owners file for bankruptcy. In fact, if you think about it, without the bankruptcy laws how many people would be willing to lay it all on the line and start their own business? Bankruptcy allows entrepreneurs to take the risk knowing that if necessary they have bankruptcy as a fallback position. If most of your debt is business debt AND you do not have personal guarantees on that debt, bankruptcy may not be necessary. If you have properly set up a corporation or limited liability company (LLC), you will have some protection against creditors of the business. Without a personal guarantee the creditors are left to the assets of the business but cannot come after you personally.

However, in most small businesses the owners of the business have personally guaranteed nearly all of the debts of the business. If this is the case, then a personal bankruptcy filing can be very helpful at eliminating all personal liability on those business debts.

Bankruptcy is not for every person or every situation. There are absolutely draw backs for filing a bankruptcy case. However, for many suffering through debt problems the benefits obtained from filing a bankruptcy case outweigh the drawbacks the come with filing.

If you are concerned that the obstacles to bankruptcy may be too great in your situation, give me a call. My bankruptcy consultations are always free. I would be happy to sit down with you, go over your situation, and help advise on the best course of action. I can be reached at (480) 420-4028 or shoot me an email at john@skibalaw.com.