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Bankruptcy: One Solution To Financial Problems

More people are borrowing more money than ever before. High consumer debt levels have led to high numbers of bankruptcy filings. Knowing about bankruptcy can help anyone consider if and when to seek bankruptcy protection.

A Fresh Start

Bankruptcies are a way for people with financial difficulties to eliminate some or all of their debts and get a fresh start. Problems that may lead a person to file bankruptcy include:

• you lost your job and have a lot of debt;

• you have large medical bills and don't have insurance to pay for them;

• you went through a divorce and are now having trouble paying for food, housing and other essentials; or

• you took on a lot of credit card debt and are having trouble making minimum payments.

If any of these situations applies to you, or if bill collectors are writing or calling and threatening to take legal action against you, bankruptcy may be the best way for you to cancel certain debts and get a fresh start.

Bankruptcies begin with the debtor filing a petition in bankruptcy court. The petition is usually completed by a lawyer. Filing the petition automatically stops most creditor actions, including harassing calls, threatening letters, foreclosure proceedings, eviction proceedings and most lawsuits. Although bankruptcy is a court procedure, most people who file bankruptcy spend very little time in a courthouse.

There are several types of bankruptcy. The most commonly used types are:

Chapter 7

This is for people whose debts far exceed their assets and ability to pay. In a Chapter 7 bankruptcy (also called a "liquidation"), the debtor turns over all non-exempt property to a bankruptcy trustee, who then converts it to cash for distribution to creditors. Generally, most property of the average debtor is exempt and he or she continues to own it. The definition of "exempt property" differs in each state, and it can include clothing, furniture, household appliances, tools of the trade, retirement plans and perhaps your home and car. In most Chapter 7 cases, debtors receive a discharge that makes them no longer liable for certain debts.

Changes made to the bankruptcy law in 2005 added a "means test" to determine if a person is eligible to file a Chapter 7 bankruptcy. If a debtor makes over a certain amount of money (the amount varies from state to state), he or she cannot use Chapter 7 and will likely be forced into a Chapter 13 bankruptcy.

Chapter 13

These bankruptcies are designed for people who have a regular income source and can work out a way to pay their debts over time. Under chapter 13 (often called a "wage earner bankruptcy" or "Adjustment of Debts of an Individual with a Regular Income"), the debtor is placed in a repayment plan that is approved by the bankruptcy court. The debtor then makes payments to the bankruptcy trustee for distribution to creditors. The repayment plan usually lasts three to five years, and it can be used to extend the time to repay bills. Chapter 13 is very different from chapter 7, since a chapter 13 debtor usually keeps possession of property and makes payments to creditors, through the trustee, based on his or her anticipated income over the life of the payment plan. The debtor must complete the payments required under the plan before the discharge is completed. While the plan is in effect, the debtor is protected from lawsuits, garnishments and other creditor action. More debts are usually eliminated under chapter 13 than under chapter 7.

Chapter 11

These bankruptcies are used mostly by businesses with financial problems. They allow a business to "reorganize" its debts while it continues to operate. The business, often with the participation of its creditors, creates a plan under which it will pay part or all of its debts. In many cases, the business can also end burdensome contracts and leases in order to return to profitability. Most Chapter 11 debtors emerge with a reduced debt load and a reorganized business.

The Bankruptcy Discharge

A main goal of filing bankruptcy is to obtain relief from burdensome debt. Relief is achieved through the bankruptcy discharge. A discharge is a release of the debtor from liability for certain types of debts. In other words, the debtor is no longer required by law to pay these debts. The discharge is a permanent order to creditors to stop all collection action on discharged debts, including legal action. If a creditor tries to collect a discharged debt, the debtor can ask a court to impose sanctions, including fines.

• When the discharge occurs. In chapter 7 cases, the discharge usually occurs when the time to file a complaint objecting to the discharge expires, which is often about four months from when the debtor files the petition. In chapter 13 cases, the discharge is granted by the court as soon as practicable after the debtor completes payments under the plan (usually three to five years).

• Which debts bankruptcy discharges. Bankruptcy does not discharge all debts. The debts discharged vary according to the type of bankruptcy. The most common types of debts that usually cannot be discharged are certain tax claims, debts not set forth by the debtor on lists filed with the court, alimony, child support, most student loans, debts for intentional injury to person or property, and government fines and penalties.

Pre-Bankruptcy Credit Counseling

Changes enacted to the bankruptcy laws in 2005 added a rule requiring most debtors to undergo credit counseling by government approved credit counseling agencies before filing bankruptcy. There are specific rules as to when the counseling must take place.

Importance of Legal Help

People who are considering filing bankruptcy should seek legal help. Bankruptcy laws are complicated, and bankruptcy typically involves following complex rules and procedures as well as filing many documents with the court. If a debtor's case is dismissed because there was a problem with the documents or the debtor missed certain requirements for filing bankruptcy, the debtor may be unable to file another case right away or may lose protections in another case, like the automatic ending of harassing calls, letters, foreclosure proceedings and other creditor actions. In addition, a mistake could result in certain debts not being discharged, meaning the debtor is still responsible to pay them. Because there are important long-term financial consequences to filing bankruptcy -- the success of a bankruptcy can determine if you will be relieved from burdensome debt -- using a lawyer when filing bankruptcy is highly recommended.

Today, the old stigma of bankruptcy is gone, as it is used by many honest, hard-working people who just took on too much debt, lost a job, had uninsured medical bills or had other financial problems. For these people, bankruptcy provides a fresh start and helps them get back on their feet. If you have financial problems, call us to learn about the choices for solving them as well as the benefits and other aspects of filing bankruptcy.