ILC INTERACTIVE LAW CENTER

# BANKRUPTCY CHECKLIST
## What You Should Know Before You File



## I. COLLECT YOUR INFORMATION

You must know where you stand financially. In general, this means the following:

### A. Income and Expense

1. Break income down according to each person contributing to the household and separately as to each income source.

2. Classify expenses according to official bankruptcy forms (scroll down to Schedule I for income and Schedule J for expense) http://www.uscourts.gov/bkforms/bankruptcy_forms.html#official

3. Take a look at the bankruptcy Means Test requirements. To qualify automatically for Chapter 7 elimination of debt your income must fall below the median for your family size and where you live, and your expenses in various categories are measured in comparison to IRS Collection Guidelines. For details, see US Trustee Program standards available on the web at http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm

4. Gather documentation consisting of six (6) months of pay stubs from each employment through the most recent month, and the last four (4) years' tax returns filed including the most current

   a. Self employed individuals need a profit and loss statement for the previous 6 months

### B. Assets and Liabilities

1. You'll need **values** for home(s), cars, etc and amount owed against each. This will affect the determination of what you can keep and what you should do with each item.
   a. Web resources resources for this research are kbb.com (Kelly Bluebook) for vehicles and Zillow.com for homes.

2. Classify and total your debts by **unsecured** (credit cards, charge accounts, medical bills, etc), **secured** (i.e. you purchased or refinanced a house or car and gave the creditor a lien against the property, and **priority** (most taxes, student loans, domestic support and property settlement obligations, fines and penalties, criminal restitution, punitive damages to name some)

## II. CONSIDER THE ALTERNATIVES

**A.** Take advantage of a **free attorney consultation** to determine whether you face an immediate bankruptcy filing deadline, or whether you have time to pursue a bankruptcy avoidance strategy. If it appears bankruptcy may be necessary, identify the appropriate Chapter for your circumstances and start preparing right away.

1. For **homeowners** (you can skip to section III "*If There's no Other Choice, How does Bankruptcy Work?*" if you're not a homeowner) there are emerging options arising from new legislation, litigation settlements and the like that need to be constantly monitored. A careful interview may reveal a strategy unique to your situation.

   a. **A Forensic Loan Audit** of your home loan documents may uncover legal violations in the underwriting process which will give you leverage in negotiations with your lender.

   b. A **lawsuit** regarding a mortgage lender's unlawful practices, such as predatory lending or inadequate disclosure, may be appropriate.

**B.** **Loan Modification** is a complex procedure yet people whose primary purpose is saving their home are often encouraged to go through the process without representation. There are legitimate free counseling programs available, but if at all possible getting legal advice at the earliest possible stage is usually the right choice.

1. Think ahead about **Chapter 13** bankruptcy as this procedure provides a legally standardized format for keeping a home after payments fall in arrears. Many Chapter 13 calendar cases involve court approval of a voluntary loan modification. This suggests that –

   a. The cost of attorney representation in loan modification negotiations may be included, at least to some extent, in the standard flat fee for a case under Chapter 13.

   b. If the lenders move too slowly or are unreasonable in their demands, they may become more amenable to a fair modification once they land in court.

2. Here are some things to **watch out** for in applying for loan modification:

   a. There are a multitude of **foreclosure scams** prompting major crackdowns by the federal government, the State of California, and California State Bar audits of attorney advertising for loan modification services.

b. Before you share your **confidential information** with a lender, be careful lest you limit your options for the future should the lender become an adversary in court.

c. There's likely more to your situation than loan modification alone can rectify.

d. Junior liens are a complication. Have you considered **loan stripping**?

e. The lender is under no obligation to negotiate in good faith. Often they will just extract payments at various intervals in return for short term commitments that keep you treading water.

f. Do you have unsecured debts like credit card bills, or medical bills? These can't be disregarded indefinitely.

g. What if you're behind on your taxes? There are types of debt that won't go away. This factor must be included in your long term planning.

**C. Short Sale** - A buyer facing foreclosure makes a deal with his lender to sell the property for less than is owed. This procedure may be used to avoid foreclosure and keep you in possession while the home is being sold.

1. A homeowner's credit will still be adversely affected by a short sale. In fact, the effects on credit are about the same for short sale and foreclosure and could drop a sellers overall score by as much as 200-300 points. Aside from this, however, short sale sellers are widely seen as less risky than foreclosed sellers.

**D. Deed in Lieu of Foreclosure** – Is simply giving up a deed to the lender voluntarily in exchange for a release of all obligations under the mortgage.

**E. Walk Away – What to do When Upside Down -** Things have changed since prior recessions. It used to be that people would hang onto their homes at virtually any cost. That was before the wave of borrowing without regard to the possibility of home values going down instead of up.

1. The Mortgage Debt Relief Act protects borrowers from income tax when a primary residence is sold for less than amount owed.

2. Determine whether it's better to pay other things, such as credit cards and car loans instead of mortgages.

3. Compare the likely effect on your future credit of short sale, deed in lieu of foreclosure, walkaway (allowing a foreclosure to appear on your record) and chapter 13

4. Compare Fannie Mae rules on qualification for future home loans which may vary according to the option you select today.

5. Estimate how long you will stay in the home, how that will affect your emotional well being, and

6. Assess your eligibility for a suitable rental

## III. IF THERE'S NO OTHER CHOICE, HOW DOES BANKRUPTCY WORK?

Well, it's simply a means of getting legal protection from your creditors that will enable you to either work out your financial problems over time (**regorganization – Chapter 13 for most consumers**) or erase your excess debt and get a fresh start (**liquidation – Chapter 7**).

While this should be only a last resort, failure to timely recognize the need for a bankruptcy, and/or procrastination resulting in failure to properly prepare can have a negative effect on the outcome. Also, there has been a dramatic increase in the detail and precision required to qualify.

### A. Liquidation Bankruptcy

**Chapter 7** - This is the most commonly recognized type, utilized to eliminate ("discharge") debts. You need to qualify according to more stringent standards of the bill that passed Congress in 2005. For example, the law now provides that...

1. If your income is over the median [varies according to household size] for your State and County, you need to justify extra expenses to qualify under Chapter 7 rules. [**Means Test**]

2. If you can't pass the personal spending limitations of the Means Test, which is based on IRS Collection Guidelines, you'll have to go with a repayment plan for up to five years [see Chapter 13].

3. When you file a Petition under this Chapter, your assets are subject to sale by a court Trustee so the proceeds can be used to pay creditors. This is avoided by the application of legal **exemptions** which define what you're entitled to keep.

### B. Reorganization

**Chapter 13** - Commonly known as the "wage earner's repayment plan," this requires you to pay all or part of your obligations over a period of time varying from three to five years.

1. Unlike Chapter 7, you can keep your property even if not exempt, but there are still restrictions

**C. Chapter 11** - This is another type of reorganization utilized primarily by businesses that can be adapted for individuals with greater amounts of debt than are allowed for the more streamlined Chapter 13 program [$336,900 unsecured debt and $1,010,650 secured debt]

## IV. How do I go About Charting the Best Course?

Just because you potentially qualify for one or a combination of the above avenues to relief doesn't mean you're going to get it. The next steps are:

**B. Evaluate** your financial situation in more detail

1 Obtain your credit profile

2 What debts must be paid, can be adjusted as to amount or terms, or *discharged* (eliminated so the creditor can never come back after you)

3 Develop a realistic budget. Identify what can be achieved by cutting back expenses, and anticipate any changes in income.

4 Decide whether to keep or surrender assets in light of the effect on your finances

**C. Try to Avoid Bankruptcy** - Sometimes you just need to improve your liquidity and get some breathing room so you can get on your feet.

1 Prepare a brief account of what happened to you, be it unexpected medical bills, illness, loss of job, business reversals or other misfortune and what prospects exist for a turnaround.

a. This information will be required for your *hardship letter* in applying for loan modification

2. If you have business interests, look for ways to separate business from personal finances.

a. Separate entities such as corporations and limited liability companies are treated differently from sole proprietorships. They can often be terminated or dissolved without going to court.

b. Consider whether formation of a new separate business entity is feasible.

3. Determine whether loan modification will enable you to make ends meet in the long term and what prospects you have of qualifying for the needed relief.

4. Perhaps both loan modification and voluntary arrangements with unsecured creditors can be accomplished.

5. Identify assets that should be sold or surrendered.

**D. Plan a Strategy** - Your case is best managed by staying ahead of events so there is time for exploration of the above alternatives while also being able to properly prepare for a bankruptcy, should one become necessary.

There's a lot to know and plenty to handle. That's why having an experienced lawyer in your corner can improve your chances of getting a good result.