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FILING A BANKRUPTCY

Bankruptcy is a drastic step. A successfully completed Chapter 7 bankruptcy can wipe out most debts. On the other hand, a person can usually file a Chapter 7 only once every 8 years. The fact that you filed for bankruptcy can stay on your credit history for up to 10 years. For these reasons, it is important to learn about the bankruptcy process before filing a bankruptcy case.

BANKRUPTCY BASICS

The bankruptcy court will not complete your bankruptcy case until you have attended two credit-counseling classes. Before filing for bankruptcy, you must take a credit counseling class. Before the bankruptcy case is over, you must take a second credit counseling class. If you cannot afford to pay for credit counseling, you can request a fee waiver.

In most cases, you can only file one of two kinds of bankruptcy: Chapter 7 or Chapter 13. The type of bankruptcy that is right for you depends on your income and what property you would like to keep after the bankruptcy.

TYPES OF DEBT

When you owe a debt, you owe it to someone else, called a creditor. The bankruptcy court decides whether to discharge (wipe out) the creditor's right to collect this debt from you. This depends on whether your creditor's right to collect from you is **secured** or **unsecured**.

A **secured** creditor has the right to get the property back if the creditor is not receiving payment. Examples of secured debts include a mortgage on a house, or car loans. Even in a bankruptcy, these creditors have a right to get their property back if they are not paid.

An **unsecured** creditor has no right to the get your property, no matter how much you owe. Examples of unsecured debts include credit cards, payday loans, medical bills and utility bills.

CHAPTER 7

The purpose of a Chapter 7 is to discharge most debts and allow the debtor a "fresh start." This means that most **secured** and **unsecured** debts are dischargeable in Chapter 7. You can usually file a Chapter 7 only once every 8 years.

When you file a Chapter 7 bankruptcy, you must tell the Court what you owe AND what you own. This is because you can only keep certain property in a Chapter 7. To keep certain property in a Chapter 7, you must "claim exemptions" to say that you need that property to avoid hardship. State and federal law creates exemptions limited by dollar amount.

Exemptions refer to the value or "equity" that you may keep when you file bankruptcy. Equity is the difference between the value of the property and what you still owe on it. For example, if your house is worth $35,000 and you owe $30,000, you have "equity" of $5,000.

The most common exemptions are **(these are the exemptions for IL, please check with your local bankruptcy attorney for the allowable equity in a Chapter 7):**
Up to $15,000 worth of equity in your primary residence.
Up to $2,400 worth of equity in one motor vehicle.
Up to $4,000 worth of personal property of any kind. This is called your "wild card" exemption because it includes <u>any</u> personal property and can include money in a bank account.

Chapter 7 does not wipe out all debts. In a Chapter 7 bankruptcy, the following debts are usually non-dischargeable: alimony, child support, certain taxes, and student loans (except in very rare cases). You must tell the bankruptcy court about these debts even if you do not think that they are dischargeable.

If a debtor has assets (owns anything) <u>above</u> the allowed exemption limits, those assets may be taken by the bankruptcy trustee, sold, and the money used to pay back your creditors. If the equity in those assets are below the equity exemptions, you can keep the asset and reaffirm the debt.

<u>CHAPTER 13</u>

Chapter 13 is sometimes called the "Wage Earner's Plan" because you must be able to make payments on your debts to qualify for a Chapter 13 bankruptcy.

You can keep more property in a Chapter 13 than in a Chapter 7. If you want to keep certain property, then you must pay your "secured" creditors what you owe them. For example, if you want to keep your car in a Chapter 13, you may be able to get the car loan balance reduced. If you are behind on your home mortgage, you can use Chapter 13 to catch up on the mortgage. Still, you will have to make payments on the loan balance. Unsecured creditors generally receive very little payment, but that depends on your income.

In order to pay your "secured" creditors what you owe them, and pay your "unsecured creditors" what you can, you have to make a payment plan. Then the Court must decide that it is reasonable. The Court will only confirm your payment plan if it is convinced that you can meet your monthly living expenses AND make payments toward your debts using your <u>regular monthly income</u>. It does not matter what the source of your income is, as long as it is stable and regular.

Once the bankruptcy court confirms your payment plan, you make payments to the Chapter 13 Trustee. Then the Trustee sends that money to your creditors. A Chapter 13 plan can last as long as 60 months (5 years). If you have filed bankruptcy before, you might have to wait another 2 years or more to file again.

<u>Financial Coaches and Bankruptcy</u>
<u>Steps to Address the Issue:</u>

1. Coaches should not be making bankruptcy advice or decisions – we are not lawyers and should not be giving legal advice. All clients thinking about filing bankruptcy need to consult with a lawyer first.

2. After gathering information about income, budget, and credit report ask clients what their financial goals are? Are they being garnished by any of the their debts? Are they judgment proof?

3. Review credit report and budget to see how much debt that client owes and how much of it could potentially be discharged in a bankruptcy. If a client has $50,000 in student loan debt that's in collections but only $1,000 in other collections, bankruptcy probably shouldn't be an option. If a client has $15,000 in collection debt from a repossessed car and makes $10/hour, Chapter 7 bankruptcy may be an option (as long as they are low income and meet the exemption requirements).

4. Educate clients on how long a bankruptcy will stay on the credit report, how it can affect their ability to obtain assets in the future (2 years from discharge before they can purchase a house) and how to re-build credit after a Chapter 7 bankruptcy (most importantly be careful about car loan and credit card solicitations post bankruptcy).

5. Stress that bankruptcy cases are complex – to be weary of lawyers that claim they will file your bankruptcy for $99. Bankruptcy is a major decision and you want to make sure it is done correctly.