

This is the thirteenth in a series of articles from NCLC that provide advice for families in financial difficulty. Other articles address such topics as debt collection harassment, medical debt, credit reporting, reverse mortgages, foreclosures and loan modifications, car repossessions, and wage and bank account garnishment. [Click here](#) [1] for a list linking to all the articles in this series.

Federal law provides the right to file bankruptcy for people with debt problems. This article explains how bankruptcy can help you and when it may be the wrong solution for you. It also describes the difference between chapter 7 and 13 bankruptcies, lets you know the best time to file for bankruptcy, and sets out what a bankruptcy will cost. Importantly, the article corrects common misconceptions about bankruptcy.

While you should consider other options first, do not wait until the last minute to think about bankruptcy. Important rights may be lost by delay.

What Bankruptcy Can and Cannot Do

Bankruptcy may make it possible for you to:

- Eliminate your responsibility for many of your debts and get a fresh start. When a debt is discharged at the close of a successful bankruptcy, you have no further legal obligation to pay that debt.
- Stop foreclosure on your house or manufactured home and allow you an opportunity to catch up on missed payments.
- Prevent repossession of your car or other property, or force the creditor to return property even after it has been repossessed.
- Stop wage garnishment, debt collection harassment, and other similar collection activities to give you some breathing room.
- Prevent termination of utility service or restore service if it has already been terminated.
- Lower the monthly payments on some debts, including car loans.
- Allow you an opportunity to challenge the claims of creditors who seek to collect more than they are legally entitled.

Bankruptcy, however, cannot cure every financial problem, nor is it an appropriate step for every individual. In bankruptcy, it is usually *not* possible to:

- Eliminate certain rights of “secured” creditors. A “secured” creditor has taken some form of lien on your property as collateral for a debt. Common examples are car loans and home mortgages. You can force secured creditors to take payments over time in the bankruptcy process, but you generally cannot keep the collateral unless you continue to pay the debt.
- Discharge certain types of special debts, such as child support, alimony, most student loans, court restitution orders, criminal fines, and some taxes.
- Protect all cosigners on their debts. When a relative or friend has cosigned a loan and you discharge the loan in bankruptcy, the cosigner may still have an obligation to repay all or part of the loan.
- Discharge debts that are incurred after bankruptcy has been filed.

Understanding the Difference Between a Chapter 7 and a Chapter 13 Bankruptcy

Your rights are very different depending on whether you file a chapter 7 or a chapter 13 bankruptcy. In a chapter 7 bankruptcy (called a “liquidation”), you eliminate most of your debts, but may lose your property other than “exempt” property—that is property the law says creditors cannot reach unless they take that property as collateral. For many families most of their property is exempt. In a chapter 13 case (called a “reorganization”), you keep all your property, and pay a portion or all of your debts in installments over a period of three to five years.

How a Bankruptcy Can Help You

An Immediate Stop of Foreclosures, Evictions, Repossessions, Utility Shut-Offs, Garnishments, and Other Creditor Actions. Your bankruptcy filing will automatically and immediately, without any further legal proceedings, stop most creditor

actions against you and your property, at least temporarily.

Your request for bankruptcy protection creates an “automatic stay,” which stops the continuation of or the start of repossessions, garnishments, attachments, utility shut-offs, foreclosures, evictions, and debt collection harassment. The automatic stay provides you time to sort things out and address your financial problems. A creditor cannot take action against you or your property without bankruptcy court permission. Some creditors seek such permission immediately; others never seek permission.

Permission to continue collection activity is rarely granted to *unsecured* creditors. Secured creditors can get “relief from the stay” in a *chapter 7* case to continue foreclosure or repossession of their collateral. But an automatic stay will almost always continue to be in effect to protect you in a *chapter 13* bankruptcy case as long as you are making payments on the secured debt. If the creditor takes action against you despite the automatic stay, the creditor may have to pay you damages and attorney fees and the creditor’s actions against you can be reversed. For example, a foreclosure sale which is held in violation of the automatic stay can be set aside.

Discharge of Most Debts. When you successfully complete a bankruptcy, there is a “discharge” (that is, a cancellation) of many of your unsecured debts, such as medical bills and credit card obligations, which eliminates all debt collection and other actions concerning those debts. Certain debts may not be discharged, such as most taxes, liens associated with many secured debts, alimony, child support, and debts you incurred after the bankruptcy case was started. After bankruptcy, you will continue to owe those debts. Student loans can be discharged only if you can prove that repayment will be an undue hardship on you and your family.

Bankruptcy cannot prevent creditors from taking your home or car unless you make sufficient payments on your mortgage or car loan. The bankruptcy though prevents these creditors from seeking additional cash from you after they take the collateral. For example, if you do not pay a car loan, the creditor can seize and sell your car, but the bankruptcy prevents the creditor from seeking additional payment from you if the car’s sale price does not cover the full amount of the debt.

Protection Against Wage Garnishment, Bank Seizures, and Enforcement of Judgment Liens. After you file bankruptcy, creditors are prohibited from garnishing your wages or other income or your bank account. Bankruptcy even stops government agencies from recovering Social Security or other public benefit overpayments, so long as your receipt of the overpayment was not based on fraud.

Bankruptcy also is an effective tool to deal with some types of court judgments against you. If a court judgment for money does not create a lien against your property, that judgment debt can be discharged in bankruptcy. If the judgment does create a lien on your property, you may ask the bankruptcy court to remove the lien if it affects “exempt property,” and then the creditor can never touch that property.

Protection of Your Household Goods from Seizure. Most families’ household goods are exempt from seizure—you keep them even in bankruptcy. This is the case even when a creditor has taken household goods as security for a loan, as long as that loan was not used to purchase those goods. If those household goods were taken as security to purchase those goods (such as when you purchase furniture on credit and the store takes the furniture as collateral for the loan), then see the next paragraphs on “secured creditors” where your rights are explained.

Added Flexibility in Dealing with Auto Loans, Mortgages, and Other Secured Creditors. Bankruptcy can help deal with creditors who take your property as collateral for their loans, such as car loans and mortgage loans. You still have to make payments on these loans if you want to keep the collateral. However, bankruptcy does provide added flexibility in dealing with these debts.

A chapter 7 bankruptcy lets you keep your car by paying the creditor the lesser of what you owe on the loan or the car’s value. If your car is worth \$1,000, and the remaining amount on your car loan is \$3,000, you can keep the car by paying the creditor only the \$1,000. The \$1,000 payment usually must be made in a lump sum before the chapter 7 bankruptcy ends (usually after three to five months). Some creditors instead let you pay that amount in installments over a number of months even after the bankruptcy ends, but that is up to the creditor.

A chapter 13 bankruptcy gives you greater flexibility to keep your property. For example, if you are six months delinquent on a mortgage, filing a chapter 13 bankruptcy stops a threatened foreclosure and allows you to gradually catch up on the back-payments, over as many as three to five years. In some cases a chapter 13 filing also allows you to make lower monthly payments by extending the repayment period or lowering the loan’s interest rate. But you have to keep making payments until the loan is paid off.

Utility Terminations. A bankruptcy filing stops a threatened utility termination and restores terminated service, at least for

twenty days. To keep utility service beyond twenty days after the bankruptcy filing, you provide a security deposit (usually equal to approximately twice the average monthly bill) and keep current on new utility charges, but you need not pay the past-due charges incurred before the bankruptcy was filed. Often you can take sixty days to pay the deposit and some utilities may not require a deposit.

Driver Licenses. If your driver's license was or will be taken away because you have not paid a court judgment, such as one arising from an automobile accident, bankruptcy normally can discharge the obligation to pay the court judgment, and you then have a right to regain or retain the driver's license.

The Best Time to File for Bankruptcy

It is often stated that bankruptcy is a "last resort" for financially troubled consumers. This is not really true. In some cases, legal rights can be lost by delaying a bankruptcy. Be especially careful to get early advice about bankruptcy if you are concerned about saving your home or your car or protecting your bank account or wages from seizure.

For example, bankruptcy may not help you after your home is sold at a foreclosure sale or money in your bank account is seized. Bankruptcy can stop an eviction proceeding, but you have fewer rights in bankruptcy after a court has ordered you to be evicted. Act quickly to consider your bankruptcy rights.

While not ideal, all is not lost if you wait to the last minute before a foreclosure, repossession, or garnishment. Bankruptcies in an emergency can be filed with little preparation by filing only a brief petition, a statement of your Social Security number, and a list containing the names and addresses of your creditors. Additional forms must be completed and filed shortly thereafter. But you must still complete an approved budget and credit counseling briefing before filing your bankruptcy. The counseling usually takes less than an hour, and can be done over the phone or over the internet.

On the other hand, if you are not facing immediate loss of property, but in the future you will incur new debts that you will not be able to pay, a bankruptcy filing should be delayed until you incur those new debts. New debts incurred after the bankruptcy filing are *not* discharged in that bankruptcy case—you will still be obligated to repay those new debts. If you file too soon and incur a lot of debt after the filing, you may be back to where you started from or even worse.

If you file a first bankruptcy too soon, you will find it more difficult to file a second bankruptcy to discharge the new debts incurred after you file the first bankruptcy. After you first file a chapter 7 bankruptcy, you have to wait eight years to file another chapter 7 case. There is more flexibility to file a chapter 13 case after first filing a chapter 7 bankruptcy. Thus it is a good idea to wait to file for bankruptcy until your debts have peaked.

If you decide to wait to file bankruptcy, avoid the temptation to go on expensive vacations or credit card shopping sprees that you do not intend to repay. In a chapter 7 bankruptcy, debts incurred in this way can be declared non-dischargeable. On the other hand, pre-bankruptcy expenses for medical care and other essentials are rarely challenged. Similarly, it may make sense before filing bankruptcy to purchase in installments needed medical or automobile insurance.

The Cost of Filing Bankruptcy

Unfortunately, it is expensive to file bankruptcy. Bankruptcy is a legal proceeding with complicated rules and paperwork. You may want to get professional legal help, especially if you hope to use bankruptcy to prevent foreclosure or repossession. Most bankruptcy attorneys provide a free consultation to help you decide whether bankruptcy is the right choice. If the attorney takes the case, the attorney will expect to be paid, unless he or she works for a nonprofit legal services office or is doing the bankruptcy pro-bono.

You also have to pay the court a bankruptcy filing fee—\$310 for chapter 13 or \$335 for chapter 7. The fee can be paid in four installments over 120 days (or 180 days with court permission). You can also ask the court to waive the filing fee in a chapter 7 case if your household income is less than 150% of the official poverty guidelines (for 2018, \$24,690 for a family of two or \$37,650 for a family of four). No waiver is allowed in a chapter 13 case.

In a chapter 13 case, you pay your debts over time, and you usually have to pay the trustee handling your payments a 10% commission on each payment. While this can add up, you will be paying far lower interest on your debts in a chapter 13 plan than if you had not filed bankruptcy. Even more significantly in a chapter 13 plan, you may only have to repay a small percentage of what you owe on most of your unsecured debts.

Common Misconceptions About Bankruptcy

When You File Bankruptcy Typically You Will Lose Little or None of Your Property. People are wrong who believe that a bankruptcy filing results in the loss of most of their property. Everyone who files bankruptcy gets to keep some of their possessions, and most people get to keep *all of them*.

No matter the type of bankruptcy you file, unless property is collateral for a loan, you get to keep all your property that is protected by “exemption” laws. Exemption laws typically protect clothes, appliances, furniture, jewelry, and often even your car and home.

An exemption law may state that you get to keep property that is worth less than a certain amount. What that property is worth is based not on how much the property cost, but rather on your “equity” in the property: the amount that the property is worth in its present condition minus how much you owe on a loan for that property.

For example, if an exemption law protects a \$2,000 motor vehicle, this dollar amount applies to \$2,000 of your equity in the car, not to the total value of the car. If your car has a total value of \$7,000 today with a \$5,000 car loan balance, you have \$2,000 in equity in the car. In this scenario, you can fully protect a \$7,000 car with the \$2,000 exemption. You will still have to repay the \$5,000 car loan in the bankruptcy or the auto lender will take the car, but you won’t lose the car to pay your other creditors.

What property and the amount of that property that is exempt varies widely from state to state and the application of exemptions in bankruptcy can be complex, particularly if you have moved within the last two years to a different state or bought a home within the last 40 months. You should discuss what property is exempt with a bankruptcy attorney, but the general rule of thumb is that, for most consumers filing bankruptcy, much of their property is exempt.

What property you keep also depends on the type of bankruptcy you choose—a chapter 7 or a chapter 13. In a chapter 7 case, you keep your exempt possessions, but other property may be sold, with the money distributed to pay your creditors. In a chapter 13 case, you keep all your property by paying their nonexempt value over time from future income under a plan approved by the bankruptcy court. If you have very valuable property, it might be sold in a chapter 7 bankruptcy, but you keep it if you pay its value to your creditors over a number of years in a chapter 13 plan.

The Effect of Bankruptcy on Your Credit Report. The effect of a bankruptcy on your credit report is of understandable concern. Most often, you should not worry about bankruptcy making it harder for you to obtain credit. If you are delinquent on a number of debts, this already appears on your credit record. A bankruptcy is unlikely to make your credit rating any worse, but instead may make it *easier* for you to obtain future credit.

New creditors will see that old obligations have been discharged in the bankruptcy and that you have fewer other creditors competing with them for payment. Creditors also recognize that you cannot receive a second chapter 7 bankruptcy discharge for another eight years.

After bankruptcy, your credit file will also list the outstanding balance as zero dollars for each of your debts. The credit file will list the fact that you filed bankruptcy and that certain debts at one time were delinquent, but creditors are most interested in what you owe now on each debt. That your credit report shows that you owe nothing on a debt improves your credit standing.

After your bankruptcy is complete, check your credit report to make sure all the debts you discharged in bankruptcy are listed as now owing zero dollars. File a dispute with the credit bureaus if your discharged debts continue to be listed as having a balance owed.

Bankruptcy also often will enhance the stability of your employment and income. Wage garnishments, continuous collection calls, car repossessions, telephone disconnections, and other consequences of an unaffordable debt burden are eliminated, and this should help you find and hold steady employment. Steady income is key to creditworthiness.

Bankruptcy will make it more difficult for you to obtain a new conventional mortgage to purchase a home. Even then, most lenders will not hold the bankruptcy against you if you re-establish a good credit reputation for two to four years after your bankruptcy.

After bankruptcy, some new lenders may demand collateral as security, ask for a cosigner, or want to know why bankruptcy was filed. Other creditors, such as some local retailers, may not even check your credit report.

Bankruptcies stay on your credit record for ten years from the bankruptcy filing, while your debts are usually only reported for seven years from their delinquency. If delinquencies on your debts are five or six years old, bankruptcy will not help your credit record. The debts will be deleted from your credit report within a year or two, while the bankruptcy will stay on your record for ten years.

If you file bankruptcy, you usually do *not* need to go to court, unless something out of the ordinary occurs. You will have to attend one meeting with the bankruptcy trustee (not with a judge). Creditors are invited to that meeting but rarely attend. In the rare case that you do receive a notice to go to court, it is important that you go and also check with your attorney if you have one. Before your case is closed, you must also take a course in personal finances, which will last for approximately two hours.

The Effect of Bankruptcy on Your Reputation in the Community. Most people find their reputations do not suffer from filing bankruptcy. Bankruptcies are not generally announced publicly, although they are a matter of public record. It is unlikely that your friends and neighbors will know that you filed bankruptcy unless you tell them.

However, especially in a small town, where debts are owed to local people, reputational issues connected with filing bankruptcy may arise. In such a situation, weigh possible embarrassment and damage to reputation against bankruptcy's potential advantages. If you believe that your reputation in a small town is a concern, you may choose to voluntarily pay selected debts after bankruptcy, but you cannot leave selected creditors out of the bankruptcy process entirely.

Feelings of Moral Obligation. Most people want to pay their debts and make every effort to do so if payment is possible. If bankruptcy is the right solution to your financial problems, you should balance these feelings of obligation with the importance of protecting your family.

Bankruptcy is a legal right. A provision concerning bankruptcy is even contained in the United States Constitution. Big corporations like Kmart, American Airlines, Chrysler, and Macy's, and famous people like Toni Braxton, Tammy Wynette, Larry King, Mickey Rooney, Henry Ford, and Walt Disney have all chosen to file bankruptcy. The book of Deuteronomy states:

At the end of every seven years thou shalt make a release. And this is the manner of the release: every creditor shall release that which he has lent unto his neighbor and his brother; because the Lord's release hath been proclaimed. (Deut. 15:1-2.)

Most importantly, during hard times, bankruptcy may be the only way to provide your family with food, clothing, and shelter. This book explores alternatives to bankruptcy, and these should be considered carefully. But it may be that bankruptcy is your best or only realistic alternative.

Potential Discrimination After Bankruptcy. The federal bankruptcy law offers you protection against being discriminated against because you have filed for bankruptcy. Government agencies, such as housing authorities and licensing departments, cannot deny you benefits because of a previous bankruptcy, including debts discharged in bankruptcy that were owed to those agencies. Government agencies and private entities involved in student loan programs also cannot discriminate against you based upon a bankruptcy filing.

Employers are not permitted to discriminate against you for filing bankruptcy. However, for some sensitive jobs which involve money or security, your bankruptcy may be considered evidence of financial problems which could be detrimental to your work. Bankruptcy law does not prevent discrimination by others, including private creditors, deciding whether to grant you any new loans.

When Bankruptcy May Be the Wrong Solution

There are at least seven situations in which bankruptcy may not be the right option for you:

1. If all your assets and income are exempt, then you are "collection-proof." (See a previous article in this series: [Wage Garnishments and Bank Account Seizures](#) [2] for more information about what it means to be "collection-proof.") In that case, most creditors can do virtually nothing to harm you even if you don't filing bankruptcy. At which point, there may not be a compelling reason to file for bankruptcy. Waiting until you are no longer collection-proof is generally more prudent than filing right away, unless you are concerned with a home mortgage, car loan, or other secured loan.
2. The debts at issue are secured by your property—such as home mortgages or car loans—and you do not have sufficient income to keep up payments while also catching up on past-due amounts. Bankruptcy may not help you when the long-term expense of keeping your home or car exceeds your long-term income.
3. You have valuable assets that are not exempt in the bankruptcy process and you do not want to lose these assets. A chapter 13 filing may still help if you can afford the necessary payments.
4. Your main reason for filing bankruptcy is to discharge a student loan, alimony or child support obligations, court restitution orders, criminal fines, or some taxes. These obligations are difficult if not impossible to discharge in bankruptcy.
5. You have only a few debts and strong defenses for each. Instead of filing for bankruptcy, you can raise these defenses aggressively. Usually the disputes can be settled out of court in an acceptable way. If they are not settled, you can use bankruptcy later.
6. Because of a prior bankruptcy, you cannot receive a discharge in a chapter 7 bankruptcy. However, in most cases, a chapter 13 petition can still be filed.

7. You can afford to pay all of your current debts without hardship.

Author Name: John Rao

About Author:

John Rao is an attorney with the National Consumer Law Center, where he focuses on consumer credit, mortgage servicing, and bankruptcy issues. Mr. Rao frequently appears as a panelist and instructor at bankruptcy and consumer law trainings and conferences, and serves as an expert witness in court cases. He has testified in Congress on bankruptcy and mortgage servicing matters. Mr. Rao is a contributing author and editor of NCLC's Consumer Bankruptcy Law and Practice; and a co-author of NCLC's Foreclosures and Mortgage Servicing and Bankruptcy Basics. He is also a contributing author to Collier on Bankruptcy and the Collier Bankruptcy Practice Guide. Mr. Rao served as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules from 2006 to 2012, appointed by Chief Justice John Roberts. He is a conferee of the National Bankruptcy Conference, fellow of the American College of Bankruptcy, member of the editorial board of Collier on Bankruptcy, board member of the National Association of Consumer Bankruptcy Attorneys, Commissioner on the American Bankruptcy Institute's Commission on Consumer Bankruptcy, and former board member of the National Association of Consumer Bankruptcy Attorneys and the American Bankruptcy Institute.



Source: National Consumer Law Center, [], updated at www.nclc.org/library

Source URL: <https://library.nclc.org/deciding-whether-file-bankruptcy-consumer-debt-advice-nclc>

Links

[1] <https://mailchi.mp/nclc/consumerdebt>

[2] <https://library.nclc.org/wage-garnishments-and-bank-account-seizures-consumer-debt-advice-nclc>

[3] https://disqus.com/?ref_noscript