

# When Should I Apply For Bankruptcy?

Is filing for bankruptcy in your best interest? Consider the following:

## Review the article entitled Alternatives to Bankruptcy.

This article list several alternatives, based on your problems and goals, to consider before looking at filing for bankruptcy.

## What are the different types of bankruptcy?

For a private individual, there are 2 main types of bankruptcy, **chapter 7** and **chapter 13**.

**Chapter 7** is known as the *liquidation* bankruptcy. In a chapter 7 all non-exempt property is seized and sold by the trustee. The trustee will then distribute the proceeds form the sale to the creditors based on the rules and priorities provided for in the Bankruptcy Code.

**Chapter 13** is the *adjustment of debts* bankruptcy. In a chapter 13, like in a chapter 7, all non-exempt property is seized, sold and the proceeds are distributed by the trustee. A chapter 13 is different in that it allows a debtor who has enough income to enter into a payment plan with the trustee to pay off debts owed on secured property to keep the property from being seized by the lender. In a chapter 13, the debtor is required to pay all disposable income (money left after all allowable expenses have been deducted) to the trustee who will then pay off creditor based on the Bankruptcy Code.

## Can I choose which bankruptcy to file?

Not really. The recent changes in the Bankruptcy Code have all but eliminated the debtor's choice.

Under the Bankruptcy Code, there is a test (called the Means test) that a debtor will have to use to see what type of bankruptcy (if any) the debtor qualifies for. The Means Test will determine what the debtor's income is by taking into consideration what money the debtor has coming in each month and allowable deductions (the IRS determines what allowable amounts for monthly expenses are).

If the debtor's income, after applying the means test, is greater than the median income for a family that size in debtor's state of residence, debtor will have to file chapter 13. If the debtor's income is equal to or lower than the median income, the debtor may file chapter 7.

The Department of Justice has a website with more information about means test.

<http://www.usdoj.gov/ust/eo/bapcpa/meanstesting.htm>

The Census Bureau is responsible for determining the median income.

<http://www.census.gov/hhes/www/income/statemedfaminc.html>

The IRS is responsible for the standard amounts used as deductions in the means test.

<http://www.irs.gov/individuals/article/0,,id=96543,00.html>

### **Are there any other requirements for filing Chapter 7?**

Yes. You cannot file for chapter 7 bankruptcy if:

- You obtained a discharge from a previous chapter 7 case within the last 8 years;
- You obtained a discharge from a previous chapter 13 case within the last 6 years; or
- Previous bankruptcy was dismissed within previous 180 days because:
  - Willful failure of the debtor to abide by orders of the court, or
  - Debtor requested the dismissal after a creditor filed a motion for relief from the automatic stay.

### **Are there any other requirements for filing Chapter 13?**

Yes, sort of. Sufficient income, debts must not be too high, and current on your income tax filings.

The major requirement for filing a chapter 13 is that the debtor must have sufficient disposable income (income after all allowable deductions) to meet your repayment plan obligations.

Your secured debts cannot exceed \$922,975 and your unsecured debts cannot exceed \$307,675. These amounts are increased every three years.

### **What types of debts are discharged in Bankruptcy?**

Bankruptcy (chapter 7 and 13) will discharge most unsecured debts. The major examples are credit cards, medical bills, cash advance loans, pay day loans, etc. If a creditor has filed a lawsuit, gotten a judgment against you and filed a lien on your property, you may be able to have the lien removed.

### **What types of debts are NOT discharged in Bankruptcy?**

Even though these debts are unsecured, they are given special status and are NOT dischargeable in bankruptcy (not every single type of non dischargeable debt is listed):

- Child support obligations
- Alimony obligations
- Debts not listed in the bankruptcy paperwork, unless the creditor learned of the bankruptcy case anyways
- Debts for personal injury or death caused by intoxicated driving
- Fines and penalties imposed for violating the law (ie traffic tickets, criminal restitutions, etc.)

- Debts where the creditor convinces the judge that they should survive a bankruptcy. This may include debts incurred through fraud (ie lying on a credit card application or passing off borrowed property as your own as collateral for a loan).

Some debts may be dischargeable under certain circumstances. Student loans can be wiped out BUT the debtor has to show “extreme hardship,” which is a very difficult standard to meet.

Tax debts also fall into the possible, but very difficult to prove category. A debtor would have to prove all of the following conditions:

- Taxes are income taxes.
- The debtor did not willfully evade or commit fraud.
- The debt is 3 yrs old or older.
- The debtor filed a tax return.

**AND**

- The debtor must pass “240-day rule.” This means that the IRS must have assessed the tax debt at least 240 days before debtor filed the bankruptcy petition, or the tax debt must not be assessed yet.

### **What other factors should be considered?**

#### The Home

Since the recent amendment to the bankruptcy laws, the home may not be entirely protected anymore. If you have moved within the 730-day period (2 years) prior to filing, the bankruptcy code limits the increase in property value to \$125,000 during the 1215-day period prior to filing.

By filing bankruptcy you may be able to afford the mortgage again since you will not be paying other creditors. BUT if you can not afford to pay the mortgage because of your other essential monthly expenses, you will still lose the home.

#### The Car “Cram Down”

If you file a chapter 13, you can “cram down” secured debts that are worth more than the property that secures them. For example, if you owe \$10,000 on your car note BUT the car is only worth \$6,000, you can propose that you pay \$6,000 under the plan and the balance will be discharged. HOWEVER, the car must have been purchased more than 30 months before the filing of the bankruptcy. You can not cram down a secured debt on other personal property that was purchased within one year of your bankruptcy filing.

#### Pension, IRA & 401(k)

Texas provides for full protection of the pension and 401(k) value. Roth IRAs are protected but other types of IRAs are not.

#### Cosigners

If a friend or relative cosigned on a debt to help you get financing, **Chapter 13** bankruptcy will protect the cosigner, *so long as you make your payments*. **Chapter 7** will stick the cosigner with any debt that the debtor does not pay.

### **So what is the bottom line?**

Each individual must make the final decision for himself or herself. Keep in mind that bankruptcy is a powerful weapon and should be treated as such. You need to be aware of the pros and cons of bankruptcy. Bankruptcy can be intrusive because it requires you to disclose every last detail about your finances to the court. Other people may learn about your bankruptcy and there is still a public stigma against people who file for bankruptcy protection. Bankruptcy can be a good way to either dig yourself out from under the pile of debts or to give yourself a fresh start without debts.