

## Deciding if Bankruptcy Is an Option for You

*Celia Ray Hayhoe, CFP®, Extension Specialist, Family Resource Management, Virginia Tech*

If you find yourself “over-extended” and have tried financial counseling, spending plans, reducing your payments, and/or paying more than the minimum amount due and still cannot make headway in repaying your debts, bankruptcy may be an option worth investigating.

When you have incurred more debt than you think you can reasonably repay, bankruptcy may be a way to debt relief.

Filing for bankruptcy, however, brings long-term consequences for your credit rating.

### What Is Bankruptcy?

Bankruptcy is a privilege based on the United States Constitution and the laws passed by Congress. Bankruptcy adjusts the relationship between you, the debtor, and your creditors. Many of your debts will be forgiven. You will be allowed to keep some property known as exempt items. The rest of your property may be sold and the money used to pay off your debts. If any property has been pledged as collateral (such as a home for a mortgage, a car for a vehicle loan, etc.), the proceeds from the sale of that item will first go to the repayment of that debt. Any balance will be applied to other debts.

Your creditors may receive nothing, a small amount per dollar owed, or be paid off in full. The proceedings take place in federal court and are governed by federal law.

Bankruptcy will not help everyone. Some people can pay all or most of their debts. These people just need help so they can make better choices on how to manage and spend their money.

Keep in mind bankruptcy will stay on your credit report for 10 years and may make it difficult or very expensive to get credit in the future. Once you have filed for bank-

ruptcy, you are not able to file again for six years (except if you file Chapter 13 and repay at least 70 percent of your debt).

Bankruptcy is not free. You will have to pay court costs and administrative fees, trustee fees, and probably will want to pay a lawyer. In most cases, you must pay these fees when you file.

No one should file for bankruptcy unless they cannot see any other way to pay off their debts. Bankruptcy no longer carries the stigma it once did. Yet, many feel hostility from neighbors and business owners who accuse them of “walking away from their debts.”

Some of the reasons people file for bankruptcy are:

- Large medical bills,
- Cannot pay debts after a divorce,
- Large amount of credit-card debt, and
- To buy time, for example to keep a home out of foreclosure or a car from being repossessed while they catch up on the payments.

### Deciding to Declare Bankruptcy – Pre-filing Credit Counseling

If you are considering bankruptcy, you must contact a government-approved provider for a pre-filing credit counseling session. (See Bankruptcy Time Lime.) To find an approved organization, you will need to know in which of Virginia’s two judicial districts (East or West) you reside. You can go to <http://www.usdoj.gov/ust/r04/virginia.htm> to find out. Then visit [http://www.usdoj.gov/ust/eol/bapcpa/ccde/CC\\_Files/CC\\_Approved\\_Agencies\\_HTML/cc\\_virginia/cc\\_virginia.htm](http://www.usdoj.gov/ust/eol/bapcpa/ccde/CC_Files/CC_Approved_Agencies_HTML/cc_virginia/cc_virginia.htm) for a list of organizations approved to offer the pre-filing credit

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counseling. The Eastern District providers are listed first followed by the Western District providers. Be sure you get a Department of Justice Certificate that you received this kind of counseling. The counseling is to determine if you can work with an informal repayment plan or if you really need to file. You are required to participate but not to go through with any offer from the provider to manage a repayment plan. If you accept the repayment plan, you will not file. However, if a repayment plan is offered and you do not accept, you will have to submit it to the court along with the certificate. Make sure you receive your pre-filing credit counseling certificate and make a copy for your records.

If the counselor says you are approved to file bankruptcy, contact a lawyer experienced in bankruptcy proceedings. The lawyer will require you to give her/him the counseling certificate to go with your documents. The lawyer will require you to complete a means test form to determine if you can qualify to file Chapter 7; if you do not qualify for Chapter 7, the means test will determine how much you have for debt repayment for Chapter 13. In addition, the lawyer will help you prepare the necessary documents and file with the court. Discuss attorney and court fees at the first appointment because costs vary.

## **Pre-discharge Personal Finance Education Class**

Before your petition can be discharged (released from the court), you must take a personal finance education class. The class must be at least two hours long and cover a set of objectives determined by the Executive Office of United States Trustees. Classes can be in person, over the phone, or by Internet. Providers must be approved by the trustees' office in a manner similar to those providers offering the pre-filing credit counseling. For a list of providers in Virginia, visit [http://www.usdoj.gov/ust/eo/bapcpa/ccde/DE\\_Files/DE\\_Approved\\_Agencies\\_HTML/de\\_virginia/de\\_virginia.htm](http://www.usdoj.gov/ust/eo/bapcpa/ccde/DE_Files/DE_Approved_Agencies_HTML/de_virginia/de_virginia.htm). Eastern District providers are listed first followed by Western District providers. You do not need to use the same provider for both pre-filing counseling class and pre-discharge education class. You will need to have filed and have a case number when you register to take the personal finance education class.

Virginia Cooperative Extension (VCE) offers only the in-person personal finance education class, NOT the pre-filing credit counseling session. For more

information on VCE in-person classes, visit [www.ext.vt.edu/personalfinance/](http://www.ext.vt.edu/personalfinance/).

## **Bankruptcy Time Line**

1. Seek pre-filing credit counseling within six months of filing; go to [http://www.usdoj.gov/ust/eo/bapcpa/ccde/CC\\_Files/CC\\_Approved\\_Agencies\\_HTML/cc\\_virginia/cc\\_virginia.htm](http://www.usdoj.gov/ust/eo/bapcpa/ccde/CC_Files/CC_Approved_Agencies_HTML/cc_virginia/cc_virginia.htm) to find a government approved organization; obtain pre-filing credit counseling certificate.
2. Take your pre-filing credit counseling certificate to the bankruptcy lawyer.
3. Complete the means test to determine if you qualify for Chapter 7 or Chapter 13 bankruptcy
4. File a bankruptcy petition with the clerk of the bankruptcy courts.
5. Pay court costs and administrative fees.
6. Clerk gives petition to United States Trustee (bankruptcy trustee).
7. United States Trustee takes charge of nonexempt property, reviews petition, and in Chapter 13, reviews repayment plan.
8. Court approval of repayment plan (Chapter 13 only).
9. Completion of plan over three to five years (Chapter 13 only).
10. Nonexempt property sold to pay debts (Chapter 7 only).
11. Complete the pre-discharge personal finance class and obtain certificate of completion; go to [http://www.usdoj.gov/ust/eo/bapcpa/ccde/DE\\_Files/DE\\_Approved\\_Agencies\\_HTML/de\\_virginia/de\\_virginia.htm](http://www.usdoj.gov/ust/eo/bapcpa/ccde/DE_Files/DE_Approved_Agencies_HTML/de_virginia/de_virginia.htm) to find a government approved provider; obtain a Certificate of Debtor Education.
12. Forgiveness of dischargeable debts.
13. End of court proceedings.

## **Automatic Stay Provision**

Some people file bankruptcy because of the automatic stay provision, the part of the bankruptcy code that offers

legal protection against bill collectors. Even though this sounds inviting, the automatic stay provision should not be the only reason you file. The automatic stay stops:

- Collection activities, such as calls and letters from your creditors;
- Filing of liens, lawsuits, or seizure of property by your creditors;
- Utility companies from disconnecting your utilities for at least 20 days;
- Foreclosure on your home mortgage;
- Collection of the overpayment of public benefits; and
- Wage garnishments.

Under the new law, the automatic stay provision no longer applies to:

- Evictions;
- Suspension or restriction of driver's license;
- Suspension or restriction of a professional or occupational license;
- Lawsuits to establish paternity, child support, or child custody;
- Divorce proceedings;
- Lawsuits related to domestic violence;
- Certain tax proceedings;
- Administrative freezes – a bank can't withdraw money from your account to pay a delinquent loan but they can freeze enough money in the account to cover the delinquency until the court determines what will happen with the debt; and
- Criminal proceedings.

## Income Taxes

Under the new law there is a requirement that you provide past tax returns. You must provide:

- Chapter 7 – the income tax return for the most current year (i.e. if you file in October 2006, you must have filed your 2005 income taxes);
- Chapter 13 – past four years; or
- Proof that income was such that you did not have to file.

The tax consequences of bankruptcy can vary dramatically depending on the way the bankruptcy is structured. Planning with a tax attorney or an accountant may be money well spent before you file for bankruptcy.

**There are four provisions in the bankruptcy laws:**

- Chapter 7 – used most often by people who are unemployed or deeply in debt

- Chapter 13 – used by people who have an income
- Chapter 11 – for businesses filing for bankruptcy
- Chapter 12 – for family farmers and family fishermen

## Chapter 7 Bankruptcy

Chapter 7 is a "liquidation" of nonexempt assets to pay debts. It is also referred to as straight bankruptcy. Through a lawyer, you petition the court to have yourself declared unable to pay your debts. You will be required to pay (in 2006) a \$245 filing fee, a \$39 administration fee, and a \$15 trustee fee for a total of \$299.

In filing Chapter 7 bankruptcy, your honestly incurred, dischargeable debts – those not incurred by fraud or intentional harm to another person – are forgiven (canceled).

You receive a fresh start without worrying about past creditors coming to you for payment. The fresh start promised is relief from most debts and the ability to begin rebuilding your life with substantially less debt – not a clean credit slate. (See the section on Nondischargeable Debts later in this publication for a list of debts that are not forgiven.) In exchange, you surrender all nonexempt property under state law to a trustee who will divide it among your creditors in proportion to what you owe. (See Chapter 7 Virginia Exemptions.) The trustee will usually abandon property to the extent that it was used as collateral. It may be possible for you to reaffirm (agree to pay) the debt with the creditor and retain the property. The trustee may also abandon property that is difficult to sell. If this happens, you may keep this property. As you consider Chapter 7 bankruptcy, inventory your debts to determine which can be discharged and your property to see what you would have to sell.

## Dischargeable Debts

After Chapter 7 bankruptcy, you will not longer owe money on:

- Credit cards;
- Retail charge cards, such as department stores;
- Unsecured loans from banks, credit unions, finance companies, friends, or relatives (an unsecured loan is one in which no item was pledged as collateral);
- Unpaid hospital and medical bills;
- Unpaid utility bills; and
- Unpaid rent (but you must move).

Discharge only applies to debts that you incurred before you filed and listed on your application. If you do not list a debt, it is possible that debt will not be discharged. Your debts also may not be discharged if you do not list all of your assets. Once a debt is discharged you do not need to pay it. However, you can voluntarily choose to repay it without signing a reaffirmation agreement.

If you have special reasons you want to pay a debt that could have been discharged, you can sign a reaffirmation agreement. For example, you may want to keep your car or your home. This must be a voluntary agreement, not place too heavy a burden on your family, and be in your best interest. The court must approve your decision to reaffirm a debt. If you plan to reaffirm an item be sure you keep the payments up to date so that the property is not seized when your bankruptcy is discharged.

## **Nondischargeable Debts**

These debts are not eliminated by Chapter 7 bankruptcy. You will still owe the following:

- State and federal taxes – unless they are more than three years old;
- Child support required by law;
- Spousal maintenance (alimony);
- Government-backed student loans (only dischargeable in special circumstances);
- Debts due to fraud;
- Court fines and penalties;
- Debts due to death or injury caused by the operation of a motor vehicle while intoxicated; and
- Debts due to willful or malicious injury to another person or property.

## **Exemptions**

You will be allowed to keep some of your property to survive after bankruptcy. You must live in a state for at least two years (40 months for homestead exemptions) to take advantage of that state's exemptions. Otherwise you must use the exemptions available in the state where you used to live. In some states you can choose between the federal and state exemptions. Increasingly, states are allowing only state statutes to determine the exemptions. Under Virginia statutes, federal exemptions are not allowed. If you and your spouse are both filing, each of you has a set of exemptions.

Exemption planning involves deciding what to include in your state exemptions. You may be able to convert

nonexempt assets into exempt assets before filing. Consult a lawyer who can help you choose to your best advantage.

In states where there is a choice of federal or state exemptions, both spouses must choose the same type of exemptions. In those states where you have the right to choose, you should seek preplanning assistance from a lawyer. Under The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 assets are valued at replacement cost at a retail vendor taking into account the assets age and use. (You used to be able to value it at what it would sell for at a yard sale or auction.)

## **Chapter 7 Virginia Exemptions**

### **Homestead Exemptions pursuant to § 34-4 and 34-4.1 Code of Virginia.**

- \$5,000 in equity in your home (\$10,000 if husband and wife file together) plus \$500 per dependent (for example, each child)
- \$2,000 wildcard exemption if you are a disabled veteran and own a home

### **Poor Debtor Exemptions pursuant to § 34-26 Code of Virginia**

- \$2,000 in equity in your vehicle (car, truck, etc.)
- Bible, wedding and engagement rings
- \$1,000 worth of clothing
- \$5,000 worth of family portraits and heirlooms
- \$5,000 worth of household furnishings
- \$4,000 worth of farm equipment
- \$10,000 in tools of your trade (implements, books, and tools)
- \$5,000 wildcard exemption of any property if you do not claim equity in a home
- Employer sponsored retirement plans regardless of the amount if they meet the laws (ERISA) that govern retirement plans
- Individual retirement accounts (IRAs) may be exempt; ask a lawyer

## **Chapter 13 Bankruptcy**

Chapter 13 bankruptcy is called "Adjustment of Debts of an Individual with Regular Income." It is also known as the debtor-rehabilitation chapter. Under Chapter 13, the debtor who can make regular payments is given the opportunity to propose a realistic plan to pay creditors

over three to five years (depending on the results of your means test and the amount of your debt) while supervised by a trustee. A spouse without regular income may file joint bankruptcy with an income-earning spouse. If you file Chapter 13, your income is used to pay part or all of the debts through a plan filed with the bankruptcy court. The repayment plan must be filed in “good faith” and designed so that creditors receive at least as much as they would under Chapter 7. You may use Chapter 13 bankruptcy if your unsecured debts are less than \$307,625 (2006) and your secured debt is less than \$922,975 (2006). A secured debt is an asset pledged as collateral that can be sold to repay it, such as a car loan, mortgage, or furniture loan. An unsecured debt has no collateral to secure its repayment, such as credit-card debt or medical bills. If you successfully complete the Chapter 13 repayment plan, you will be free of your debts. One exception is home mortgages, which must be repaid according to the contract.

To determine whether Chapter 13 bankruptcy is appropriate, the court will use the means test to determine if your take-home pay, other income sources, and living expenses will allow you to repay debts within a reasonable time period. Filing for Chapter 13 forces an automatic end to all your credit and contracts with creditors except home mortgages. You are allowed to keep your property but may sell some of it to help complete your repayment plan.

If you decide to file Chapter 13 bankruptcy, you will submit all your disposable income (amount left after you pay normal living expenses) to the trustee who pays your creditors according to the plan. During the repayment period, a debtor is protected from further collection activities by creditors. Little or no sale of assets is required. Once you file your plan and it is approved, interest stops accruing on your current debts.

Depending on your situation, the income available for debt repayment may be less than the amount of your unsecured debts. If this is the case, then the plan reflects your request that your debts be discharged (canceled) when the repayment period ends. A court hearing will be held after the plan is filed. At the hearing, the court will decide if:

- The repayment plan is truly your best “good faith” effort,
- Unsecured creditors are receiving at least as much as they would have under a Chapter 7 bankruptcy case,
- The plan can be feasibly completed in the time allowed,

- A copy of your repayment plan has been given to all creditors and interested parties, and
- In 2006, a \$235 filing fee and a \$39 administration fee for a total of \$274 have been paid.

The court and your trustee (usually a local lawyer appointed by the United States Trustee) must approve your plan. Your creditors do not necessarily need to approve it. After the plan is approved, you will make monthly payments to the trustee and pay your regular living expenses yourself. If you have a mortgage, you will make those monthly payments while the trustee usually pays any amounts in arrears before you filed bankruptcy.

## **Chapter 11 Bankruptcy**

Chapter 11 was designed by Congress to allow businesses to reorganize their debts and pay what they can without folding. Unlike Chapter 13, there usually is no trustee involved in Chapter 11. It was originally designed for large corporate debtors, but is now available to partnerships, real estate developers, and sole proprietors. Working with creditors, a debtor works out a repayment plan from future earnings of the business. The creditors approve a plan reorganizing any or all other business affairs.

Chapter 11 is available to individual debtors whose debts exceed the limits imposed by Chapter 13. However, the filing fee (including administrative fee) is much higher, \$1,039 in 2006.

## **Chapter 12 Bankruptcy**

Chapter 12 was established in 1986 especially for farmers and fishermen. It combines some requirements of both Chapter 11 and Chapter 13. Farmers and fishermen are eligible for Chapter 12 bankruptcy if their debt does not exceed \$1,500,000. In addition, 80 percent or more of the debt must be due to operations. At least 50 percent of the stock or equity of the corporation or partnership must be held by one family, with that family conducting the farming or fishing operation, and more than 80 percent of the value the corporation or partnership assets must be related to the operation of the business. Finally, if corporate stock exists, that stock must not be publicly traded.

In Chapter 12, the owner is allowed to file a plan for paying off some debts and discharging (canceling) others. Creditors must receive as much as they would have

received under Chapter 7 bankruptcy. The filing and administrative fee for Chapter 12 is \$234 in 2006.

## Fees and Legal Help

Counseling and personal finance education providers may charge a fee for their services. However, they have to keep you even if you cannot afford to pay. Different groups have different requirements for who does not have to pay, so shop around.

A lawyer experienced in bankruptcy proceedings can give you valuable advice. If you already have a lawyer, ask about her or his experience and successes in bankruptcy cases. If it is not your lawyer's area of expertise, ask for a referral. People who have filed bankruptcy may be able to suggest a lawyer they used. If you need a lawyer referral, call the Virginia Lawyer Referral Service at (800) 552-7977 or (804) 775-0808 (metro Richmond area).

Bankruptcy trustees, reporters, and others who see lawyers in action may be able to suggest lawyers. You may find a visit to bankruptcy court helpful.

Calling several lawyers and interviewing them before making your choice may be to your advantage. Call ahead and see what they will charge for the initial appointment. Some may offer a short interview at no charge.

After you select a lawyer, be prepared to give all the relevant facts. Completely disclosing all your assets, debts, and other commitments is essential for a thorough evaluation.

Do not be afraid to discuss fees. Fees are usually stated as an hourly charge. The lawyer cannot give you an exact figure but can estimate a cost range. Ask for information about fees in writing.

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Original author: Karen P. Goebel, Extension Specialist, University of Wisconsin.

If you are uncomfortable or lack confidence in the lawyer after discussing facts and fees, discontinue the relationship at the beginning. Continuing may only lead to more unhappiness and costs that could be avoided.

**The Virginia Legal Aid Society** may be able to help individuals who cannot afford a lawyer. There are income restrictions that must be met to qualify to use legal aid lawyers.

Phone: (800) 552-9963 or (888) 201-2772

Website: [www.vlas.org/](http://www.vlas.org/)

For a listing of individual legal aid offices in Virginia go to [www.vlas.org/](http://www.vlas.org/) and click Office Locations on the left-hand side. If your location is not listed, scroll down the page and click additional outreach locations.

## Conclusion

A person leaves bankruptcy debt free or with a significantly reduced debt. Bankruptcy is designed to give the debtor a fresh start and a chance to establish sound financial management.

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