

# MANAGING



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## Deciding if bankruptcy is an option for you

**W**hen you have incurred more bills than you think you can possibly repay, bankruptcy may be the only way to relieve the pressure of overwhelming debt.

However, bankruptcy brings long-term consequences for your credit rating. So first, try working out repayment plans or other solutions using the fact sheets in this series *Deciding which bills to pay first/Cómo decidir qué cuentas pagar primero* and *Talking with creditors/Comunicación con los acreedores*.

Then use the information in this fact sheet to evaluate your decision carefully and to prepare for talking with a lawyer.

### What is bankruptcy?

**Bankruptcy** is a financial tool designed as a last resort for people with overwhelming debt.

**Filing a bankruptcy petition** is a legal process supervised by a federal bankruptcy court to:

- **discharge** — end — either your obligation to pay many or perhaps all your debts or
- **restructure** your debt to a more manageable level under a court-supervised plan.

### Watch for law changes

Information in this fact sheet reflects bankruptcy laws in effect as of 2005's Bankruptcy Abuse Prevention and Consumer Protection Act. The changes in the law are designed to reduce the number of Chapter 7 filings while still allowing for Chapter 13 filings. The central feature of the new bankruptcy law is a "means test." A means test stipulates that if your income is above a specified level, then you are prevented from filing bankruptcy under Chapter 7 and must instead use Chapter 13. The new law states that filers must obtain credit counseling and complete an approved financial management course.

Your county UW-Extension office is a good source of programs and services for families who want to learn to save and manage their money. Another provision of the new law is that retirement accounts, up to \$1 million, are exempt from consideration under Chapter 7.

Statements in this publication do not constitute legal advice or promote bankruptcy as the only solution to debt. Discuss your specific situation with your attorney.

## Who is involved?

Bankruptcy proceedings generally include the following people:

**The debtor** — also known as the **petitioner** — is the person who files the bankruptcy petition. The debtor is usually represented by a bankruptcy lawyer before and during the proceedings.

Married couples usually file jointly since they are both responsible for the debts. Unmarried partners do not have the option of filing jointly. However, their separate cases can be filed and administered together.

The **creditors** are any persons, firms, or other entities that claim the debtor owes them money.

The **trustee** is the court-appointed person who represents the creditors' interests in Chapter 7 and Chapter 13 cases. The trustee administers the bankruptcy proceedings and any property available for distribution among the creditors.

The **bankruptcy judge** presides over any hearings on disputed matters connected with the case.

## Bankruptcy provisions

Federal bankruptcy law offers three provisions for consideration as of 2005 (see the box on page 1):

- **Chapter 7** is often called straight or **liquidation bankruptcy** because all non-exempt property is sold to pay creditors.
- **Chapter 13** bankruptcy is referred to as the wage earner or **reorganization plan** for individuals and married couples who have enough income to pay at least some of their debts. Dairy farmers with regular income have found this more manageable than Chapter 12.

- **Chapter 11** bankruptcy is used mainly by corporations to reorganize their business affairs and should be considered by family farms and farm businesses only while Chapter 12 is not available.
- **Chapter 12 has expired** and is not currently available. It was written to accommodate the special needs of farmers in financial distress and streamlined the bankruptcy process so they could keep farming. Renewal of this chapter is part of a legislative package stalled in Congress.

Here is a brief outline of bankruptcy provisions, followed by their advantages and disadvantages.

### Chapter 7 bankruptcy

Chapter 7 is the most commonly used form of bankruptcy and provides debtors with a fresh start. The discharge granted at the end of the case eliminates many of the debtor's financial obligations.

Generally, the discharge will include credit card debts, medical bills, past due utility bills, and other unsecured debt. The discharge does **not** include unsecured loans such as most student loans, court-ordered child support, maintenance or alimony, taxes, government fines, and debts based on OWI (Operating While Intoxicated) liabilities, fraud, or malicious conduct.

In exchange for the discharge of debts, the debtor must turn over all non-exempt items to the court-appointed trustee. The trustee sells these items and uses the cash to pay creditors. Most creditors get only a small percentage of what the debtor owed — if they receive anything.

Chapter 7 bankruptcies rarely help with large secured debts such as home mortgages. For this loan, the creditor retains its rights to the **collateral** — your home — which secures the loan.

You can surrender the collateral to the secured loan's creditor. Or you can keep the collateral by paying the creditor its current value.

You can also keep the collateral by **reaffirmation** — agreeing to remain legally obligated to repay some or all of the debt you could have otherwise eliminated.

Approach reaffirmation agreements with caution — you are giving back the creditor's right to collect what you owed when you filed for bankruptcy.

You may only file a Chapter 7 petition every eight years. The filing will appear on credit reports for ten years after the discharge of your debts.

### Chapter 13 bankruptcy

Chapter 13 bankruptcy works very differently from Chapter 7 bankruptcy. Chapter 13 is limited to single or married petitioners who have regular income that can be assigned to pay off debts.

In a Chapter 13 case, the debtor submits a plan to repay creditors from future income over the next 3 to 5 years. Chapter 13 lets you keep your exempt property as in Chapter 7 — **and** your non-exempt property, which would be sold in Chapter 7.

After setting up a realistic budget, a plan is prepared that shows how you will repay as much debt as is feasible. Then this plan is submitted to your creditors for approval.

The trustee receives a specified amount each month from your paycheck and pays your creditors that amount minus a commission, according to the plan.

You owe no interest or finance charges on the debt when supervised by the court. When the plan ends, any remaining debt is discharged.

You may file a Chapter 13 petition every two years, but cannot file for 4 years after having filed Chapter 7. As with Chapter 7 bankruptcy, a Chapter 13 filing remains on credit reports for ten years.

## Chapter 11 bankruptcy

Normally, this provision would not be included here. Congress wrote Chapter 11 for large corporate debtors to reorganize their financial affairs while continuing to operate their businesses. Congress later extended Chapter 11 protection to partnerships, real estate developers, and sole proprietors.

Until Chapter 12 is restored or made permanent, Chapter 11 reorganization is an option for family farmers and farm businesses who do not have regular incomes. Farmers with regular incomes may find Chapter 13 more manageable.

Chapter 11 differs from Chapter 13 in that there are no asset or debt limits on who can qualify. Also, the court does not usually appoint a trustee for a Chapter 11 case. Instead, the debtor works with the creditors to make a plan to repay creditors from future earnings.

Chapter 11's goal is approval of a plan reorganizing the debtor's business affairs, including management changes, asset sales and purchases, and debt restructuring. This assumes that most of a debtor's secured creditors will support the reorganization. If significant secured creditors oppose the plan, a Chapter 11 case usually fails.

Drafting a reorganization plan the court will accept is complex. A successful plan requires pre-filing financial planning with full and accurate communication between you and your attorney.

Even though the law allows you to file a Chapter 11 petition without a lawyer, it would not be possible to meet all the technical requirements of the law without the help of an attorney.

## Chapter 12 bankruptcy

This protection was designed to allow farmers to keep farming while reorganizing their financial affairs. Chapter 12 blended favorable options of Chapter 11 with those of Chapter 13 for a streamlined reorganization with debt limits high enough to accommodate normal farm indebtedness.

Until Chapter 12 is restored, farmers with irregular incomes can consider Chapter 11 bankruptcy.

Farmers who have any regular income may find Chapter 13 a better tool for reorganizing. However, Chapter 13 eligibility is presently limited to:

- Debtors with less than...
  - \$307,765 in unsecured debt.
  - \$922,975 in secured debt.
- Individuals and married couples only
  - not partnerships, LLCs (Limited Liability Companies), or corporations.

Be sure to discuss bankruptcy provisions and consequences carefully with your attorney.

For more information, contact the Wisconsin Department of Agriculture, Trade, and Consumer Protection's **Wisconsin Farm Center** at (800) 942-2474 and ask for a free copy of the *Legal Guide for Wisconsin Farmers*.

## Advantages

**When you file a bankruptcy petition, most debt collection efforts are stopped.** This **automatic stay** can relieve the pressure from collectors and may also prevent repossessions, garnishment of wages or bank accounts, foreclosure or eviction, and utility shut-offs.

**Most of your debt is discharged.** This includes liabilities relating to credit card debts, past-due accounts, civil judgments, and judgments due to repossession or foreclosure.

**Discharged debt is not subject to income tax.** When your debts are discharged through bankruptcy proceedings, they are **not** considered income.

The Internal Revenue Service (IRS) **does** consider the dollar amount of a debt taxable income when the lender both:

- writes off or forgives a debt outside of bankruptcy proceedings **and**
- files IRS Form 1099-C, Cancellation of Debt.

**You may be able to keep most or all of your property.** Under federal or state law, certain property is exempt — cannot be used to satisfy your creditors. These exempt items include the equity in your home, vehicle, household furnishings, personal property, tools of trade, jewelry, cash value life insurance, and some retirement benefits up to certain dollar amounts.

**Note:** Wisconsin and federal exemptions differ, so you must choose one list **or** the other — not both. The value of your property is its current **market value** — the sale price you would receive now — not the original cost.

## Disadvantages

**Not all debt can be discharged.** Debts that cannot be discharged include those relating to certain taxes, child support, maintenance or alimony, most student loans, government fines, forfeitures, and restitution.

**Debts incurred after filing cannot be discharged.** Once you file, you cannot add any more debts. If you expect more expenses such as major medical bills, it may be best to wait for those bills and add that debt before filing.

**Creditors may still repossess property that secures loans.** If you fail to make payments after the bankruptcy closes, creditors having a mortgage or security interest in your home or vehicle may still be able to repossess their collateral.

If your mortgaged assets are later repossessed, sold, or foreclosed on, that may result in taxable income — even if you receive nothing from these assets.

**Bankruptcy filings are public records and stay on your credit report for ten years.** This makes it more difficult and costly to get credit. Besides requiring you to pay higher interest rates for credit, lenders may also require more collateral or a co-signer. Utilities and other services may require a higher security deposit.

**You must pay to file a bankruptcy petition.** First are the fees you must pay when you file (as of 2004):

- \$200 for Chapter 7
- \$185 for Chapter 13
- \$500 for Chapter 11

Then there are attorney fees and trustee fees. For example, in a Chapter 13 case, the trustee who administers your reorganization plan can receive up to 10 percent of the amount you pay creditors. So a debtor who repays \$100,000 to creditors may also owe the trustee \$10,000.

## Getting help

Bankruptcy laws are very complex. So consider hiring an attorney experienced in bankruptcy law. The attorneys who advertise the cheapest rates may not be the most helpful in this case.

### If you already have an attorney...

**Ask about his or her experience and successes in bankruptcy cases.** If it is not his or her area of expertise, ask for a referral to a lawyer who does specialize in bankruptcy. Or people who have filed for bankruptcy may be able to recommend the attorney they hired.

The State Bar of Wisconsin can refer you to an attorney who specializes in bankruptcy cases. Call their **Lawyer Referral Service** at (800) 362-9082 or 257-4666 (in Madison). Or consult [www.legalexplorer.com](http://www.legalexplorer.com) or [www.wisbar.org](http://www.wisbar.org).

Tribal members who have land held in trust can get help from staff in the **Bureau of Indian Affairs (BIA)** realty branch at (715) 682-5802.

### Before hiring an attorney...

**Call ahead.** Arrange a time to meet and ask what amount the attorney will charge for your first meeting. Some lawyers offer a short initial interview at no charge.

**Meet with the attorney in person.** Ask about his or her experience and successes with bankruptcy cases. Make sure you would feel comfortable working with this attorney. You may want to interview several attorneys before making your choice.

## After you choose an attorney...

**Be prepared to give all the relevant facts of your financial situation.** To get a thorough evaluation of your case, you must completely disclose all your assets, debts, and other commitments as well as any pending lawsuits or foreclosures.

**Discuss fees.** Fees are usually stated as an hourly charge, but may be a flat fee for a Chapter 7 case. The attorney cannot always give you an exact figure, but can estimate a cost range. Ask to have information about fees in writing.

## After bankruptcy

Although bankruptcy can help erase many financial problems, its effects are not permanent.

### If you choose bankruptcy...

- Take advantage of the fresh start bankruptcy offers.
- Make careful decisions about borrowing. Don't take on more credit than you can afford.
- Avoid offers to "repair" your credit. These scams cannot do anything for you that you cannot do for yourself.
- Be wary of auto dealers, mortgage brokers, and other lenders who advertise "Bankruptcy? Bad credit? No credit? No problem."

Predatory lenders may give you a loan after bankruptcy, but at a very high cost. The extra costs and fees on these loans can make it very difficult to keep up with payments and can ruin your chances to rebuild your credit record.

**The best way to repair your credit is to use credit wisely.** Stick to your spending plan and pay your bills on time, and you will gradually rebuild a solid credit history.



## Resources

### Know your rights

Look for these consumer guides at your local public library. If you do not have a computer, most libraries have one you can use.

*Answering Your Legal Questions about Bankruptcy.* Madison: State Bar of Wisconsin, 2002:  
[www.legalexplorer.com/legal/legal-QA.asp](http://www.legalexplorer.com/legal/legal-QA.asp).

Detweiler, Gerri. *The Ultimate Credit Handbook: How to Cut Your Debt and Have a Lifetime of Great Credit*, 3rd Edition. New York: Plume/Penguin, 2003.

Elias, Stephen R. et al. *How to File for Chapter 7 Bankruptcy*. Berkeley, CA: Nolo Press, 2002.

*Legal Guide for Wisconsin Farmers*, 5th Ed. Madison, WI: Department of Agriculture, Trade, and Consumer Protection and State Bar of Wisconsin, 1996: [www.legalexplorer.com/legal/legalQA.asp?PositionPoint=&Sid=1&Qid=1#quest](http://www.legalexplorer.com/legal/legalQA.asp?PositionPoint=&Sid=1&Qid=1#quest).

Leonard, Robin. *Bankruptcy: Is It the Right Solution to Your Debt Problems?* Berkeley, CA: Nolo Press, 2004.

Leonard, Robin. *Chapter 13 Bankruptcy: Repay Your Debts*. Berkeley, CA: Nolo Press, 2003.

Leonard, Robin. *Money Troubles: Legal Strategies to Cope with Your Debts*, 9th Ed. (Berkeley, CA: Nolo Press, 2003.

National Consumer Law Center. *Surviving Debt: A Guide for Consumers*. Boston: NCLC Publications, 2002:  
[www.consumerlaw.org/publications/guides/surviving\\_debt.shtml](http://www.consumerlaw.org/publications/guides/surviving_debt.shtml).

### For help managing less money...

See these money management fact sheets in this series, in English or Spanish:

*Setting spending priorities* (B3459-01)/  
*Cómo decidir cuáles son los gastos más importantes* (B3459-01S)

*Strategies for spending less* (B3459-02)/  
*Cómo gastar menos* (B3459-02S)

*Deciding which bills to pay first* (B3459-03)/  
*Cómo decidir qué cuentas pagar primero* (B3459-03S)

*Talking with creditors* (B3459-04)/  
*Comunicación con los acreedores* (B3459-04S)

*Keeping a roof overhead* (B3459-05)/  
*Cómo asegurarse de que la familia tenga donde cobijarse* (B3459-05S)

*Meeting your insurance needs* (B3459-06)/  
*Cómo pagar por el seguro que necesita* (B3459-06S)

*Bartering* (B3459-07)/  
*El trueque* (B3459-07S)

*Making the most of what you have* (B3459-08)/  
*Cómo sacar el mayor provecho de lo que tiene* (B3459-08S)

*Deciding if bankruptcy is an option for you* (B3459-09)/  
*Cómo decidir si la protección por bancarrota es una buena opción para usted* (B3459-09S)

*Taking care of yourself* (B3459-10)/  
*Cómo satisfacer las necesidades personales* (B3459-10S)

*How you can help when mom or dad is unemployed* (B3459-11)/  
*Cómo puedes ayudar cuando tu papá o tu mamá está sin empleo* (B3459-11S)

*Helping children cope* (B3459-12)/  
*Cómo ayudarles a los niños a sobrellevar las dificultades* (B3459-12S)

*Community agencies that can help* (B3459-13)/  
*Las agencias comunitarias pueden ayudar* (B3459-13S)

*Looking for a job—Watch out for scams* (B3459-14)/  
*Búsqueda de trabajo—Tenga cuidado con las estafas* (B3459-14S)

*Where to go for help finding a job* (B3459-15)/  
*Dónde conseguir ayuda para encontrar empleo* (B3459-15S)

*Starting your own business* (B3459-16)/  
*Cómo iniciar su propio negocio* (B3459-16S)



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