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the BANKRUPTCY issue

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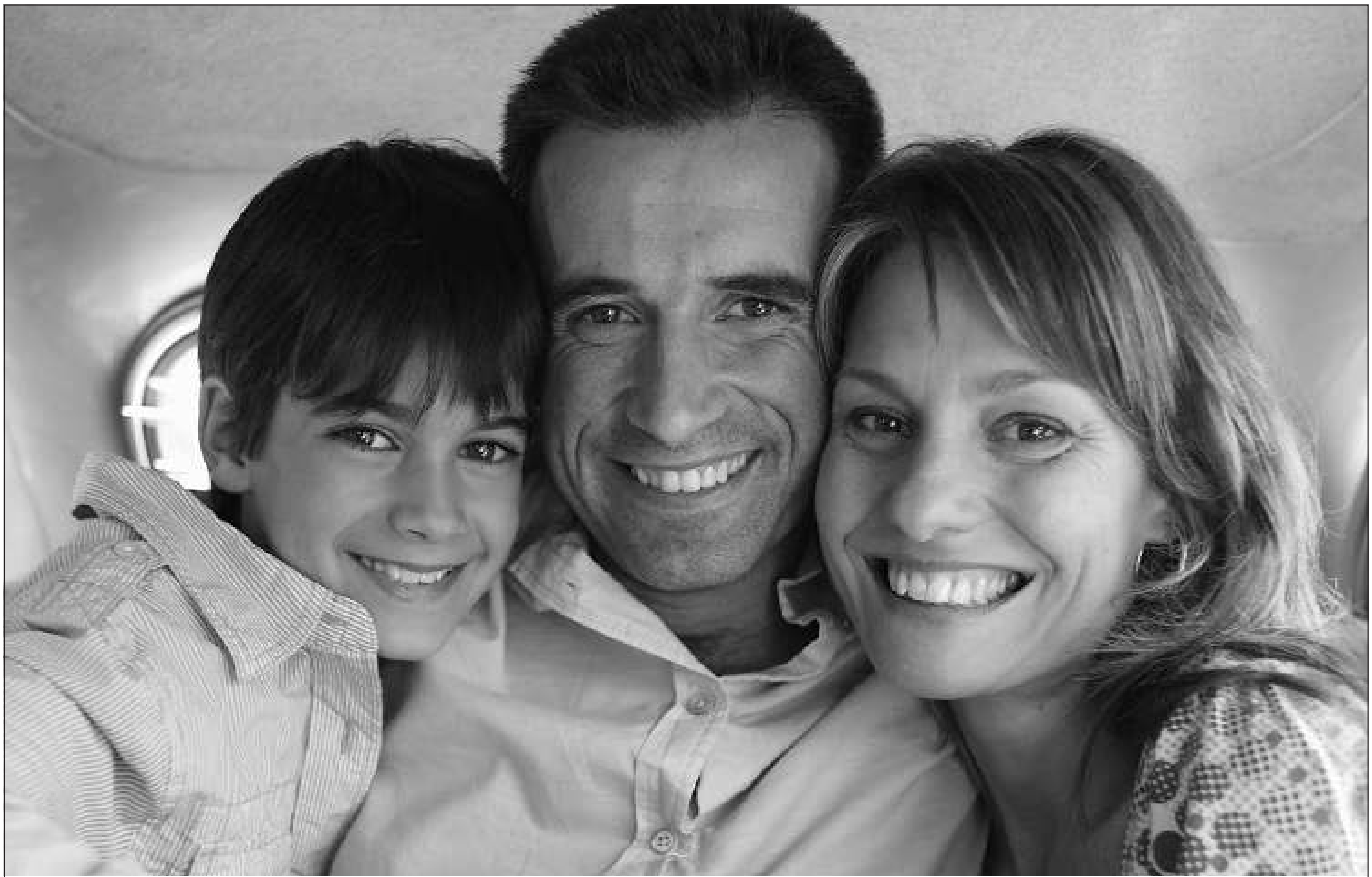

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Things that make you go hmmm....

Debt Gone. Or Is It?
Bankruptcy approval is not automatic and may not remove all your debt.

Recent Debt
Even with bankruptcy, debt made within the last 90 days could still be your responsibility.

THE BANKRUPTCY ISSUE

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FCEF MISSION

Promote and provide education as the foundation of a productive society through scholarships and financial literacy programs.

INTRODUCTION

This module discusses when filing for bankruptcy may be appropriate, the pros and cons, and the different options available. U.S. Bankruptcy Code provides protection to people who are in financial jeopardy and are suffering under mountains of debt. The bankruptcy laws were originally created by Congress to provide relief to those who have been victimized by divorce, job loss, identity theft, large medical bills, or disability. The decision to file for bankruptcy is not an easy one to make and should be considered only as a last resort after all other options for debt reduction have been exhausted.

In April 2005, President Bush signed a new bankruptcy law that went into effect in October 2005. The purpose was to force debtors to repay their debts rather than having them discharged. Under the new law, if your income exceeds your state's median income, you will not qualify to file bankruptcy under Chapter 7, where most debts are erased. If you do not qualify for Chapter 7, the only other option for non-business bankruptcy filings is Chapter 13, where debts have to be repaid within 3-5 years.

TERMS TO LEARN

Asset
A resource having monetary value that is owned by an individual or corporation.

Automatic Stay
A provision under the U.S. Bankruptcy Code prohibiting creditors from beginning or continuing proceedings for collection of monies owed by an individual who files for bankruptcy.

Bankruptcy
A legal declaration of the inability to repay debt.

Credit
A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future. Also, credit can be the borrowing capacity of an individual or institution.

Creditor
A person or institution who lends money and to whom funds are owed.

Custodian
An organitation, typically a commercial bank, that has the legal responsibility of safe keeping someone else's assets. These assets may be cash, securities or virtually anything of value.

Debt
Something owed, such as money, goods, or services. An obligation or liability to pay or render something to someone else.

Debtor
An individual or institution that owes an obligation to another party. If the debt is in the form of a loan from a financial institution, the debtor is referred to as a borrower. If the debt is in the form of securities, such as bonds, the debtor is referred to as an issuer.

Discharge
To clear the record of an obligation or loan.

Insolvent
A financial condition in which the sum of debts is greater than the sum of all assets/property.

Lien
A claim on the property of another as security for the payment of a legal debt.

Means Test
An investigation into the financial well-being of a person to determine the person's eligibility for financial assistance.

Unsecured Debt
A loan not secured by an underlying asset or collateral.

BANKRUPTCY BASICS

Bankruptcy is a legal declaration of the inability to repay debts. The decision to pursue bankruptcy protection is not an easy one. A bankruptcy stays on your credit report for 10 years, making it challenging to acquire credit and make purchases. Bankruptcy is not a solution in all cases.

Federal student loans, federal tax debt, and child support are exempt from bankruptcy protections and must still be paid in full.

It may be worth your time to consult with a bankruptcy lawyer prior to making a decision about filing for bankruptcy.

When should you consider filing bankruptcy?

Bankruptcy should be a last resort. Do not file for bankruptcy unless you have thoroughly researched and attempted all other methods of reducing your debt. Just as serious financial difficulties do not arise overnight, bankruptcy will not erase your financial burdens overnight. Assess your situation by answering these questions:

- Are you heavily in debt, with little prospect of resolving it in the next five years?
- Are your creditors threatening a foreclosure on your home, a repossession of your car, or other legal action to take your property?
- Have you experienced a dramatic drop in income?
- Are you frequently paying bills late?
- Do you only pay the minimum on your credit cards?
- Are you unable to make even the minimum payment?
- Do you have to sacrifice basic necessities just to make minimum payments on your debt?
- Are you paying more money on monthly living expenses than you make?
- Are your wages currently garnished or in jeopardy of being garnished?
- Have you recently become partially or totally disabled?
- Are you going through a divorce, resulting in a decrease of income and an increase in expenses?

If you answered yes to a majority of these questions, bankruptcy may be something to consider.

BANKRUPTCY

ADVANTAGES

A Fresh Financial Start

In most cases, the allure of bankruptcy is a release of debt and a fresh start.

Keeping Assets

You may be able to keep many of your assets.

Collection Efforts Stop

As soon as your petition is filed, most collection activity ceases.

DISADVANTAGES

Loss of Privacy

You will be subject to a full investigation of your affairs and your financial status, and others will be alerted to your recent bankruptcy.

Loss of Assets

There is a chance that you will lose your assets, including your home, inheritances, and/or insurance settlements. If you own a business, your employees may be terminated and your business closed.

Closed Accounts

Your bank and credit card accounts will be closed, and anything you are leasing or buying will be returned to the owner.

5 COMMON MISTAKES WHEN FILING

1. Do not run up your credit cards or take out cash advances

Many consumers think that since their debts are going to be discharged, it does not matter how much they charge today. Certain debts incurred within 90 days before filing for bankruptcy are presumed to be non-dischargeable, which means you may be obligated to pay those charges in full.

2. Do not transfer property out of your name

Some people think they can protect property like homes, cars, jewelry, and cash by giving it to a family member before filing for bankruptcy. A bankruptcy trustee may be able to reverse a transfer of property, if it was made in an attempt to hide assets from creditors. Such a transfer is often unnecessary, since exemptions may protect property like your home, auto, wedding ring, etc.

3. Do not cash in your retirement account unnecessarily

Most funds in tax-qualified retirement accounts are protected, so you may be able to discharge your debts and still keep your retirement account. It is not a good idea to attempt to reduce your assets by liquidating your retirement account.

4. Do not ignore pending lawsuits

Until your bankruptcy case is filed, any pending legal action will continue to move forward, and it is important that you protect your rights and assets until a stay from the bankruptcy court is in effect.

5. Do not pay back loans to friends and family while neglecting your other creditors

In bankruptcy, you can’t choose to treat one creditor better than another. All creditors are entitled to a proportionate share of whatever funds are available to pay your debts. In fact, if you’ve made payments to a family member within a year before filing bankruptcy, the bankruptcy trustee may be able to take action to recover that money from your family member and distribute it proportionately among all of your creditors.

DISCHARGE OF DEBT

One of the reasons people file bankruptcy is to get a "discharge." A discharge is a court order which eliminates the debtor's personal liability for repayment of the debt. Not all debts can be discharged.

Debts that cannot be discharged:

- Most taxes.
- Child support.
- Most student loans.
- Court fines and criminal restitution.
- Personal injury caused by driving under the influence of alcohol or drugs.

Debts that can usually be discharged:

- Credit card debt.
- Medical bills.
- Most personal loans.
- Judgments resulting from car accidents.
- Some older tax debts.
- Payday loans.
- Garnishments.

This discharge only applies to debts that arose before the date you filed for bankruptcy. It is important to list all your property and debts in your bankruptcy schedules. If you do not list a debt, it may not be discharged.

If the judge finds that you received money or property by fraud, that debt may not be discharged. The judge can also deny you discharge if you do something dishonest in connection with your bankruptcy case, such as destroy or hide property, falsify records or lie, or if you disobey a court order.

You can only receive a Chapter 7 discharge once every eight years. No one can make you pay a debt that has been discharged, but you can voluntarily pay any debt you wish to pay. You do not have to sign a reaffirmation agreement or any other kind of document to do this.

Some creditors hold a secured claim (for example, the bank that holds the mortgage on your house or the loan company that has a lien on your car). You do not have to pay a secured claim if the debt is discharged, but the creditor can still take the property.

FILING BANKRUPTCY PROCEDURE

The process of filing bankruptcy entails the completion of forms and the submission of a petition to the court. The bankruptcy petition and related forms and schedules list personal information, including all income, assets, expenses, and debts. The petition is filed in local bankruptcy court. Upon review and approval, the court appoints a bankruptcy trustee to your case, and an automatic stay is imposed on all creditors. This prohibits the creditors from collecting any debts owed to them until the court contacts the creditors directory. A federal code then applies specific amounts to what is exempt and what assets must be turned over to the court's trustee to sell and apply toward debts.

Before you can file a bankruptcy petition, the law requires that you receive financial education from a certified credit counseling agency. The agency will explain financial management and how to do a budget analysis. They will also discuss alternatives to bankruptcy. Failure to go to counseling may result in the dismissal of your bankruptcy case by the judge.

When filing for bankruptcy, you can choose the kind of bankruptcy that best meets your needs.

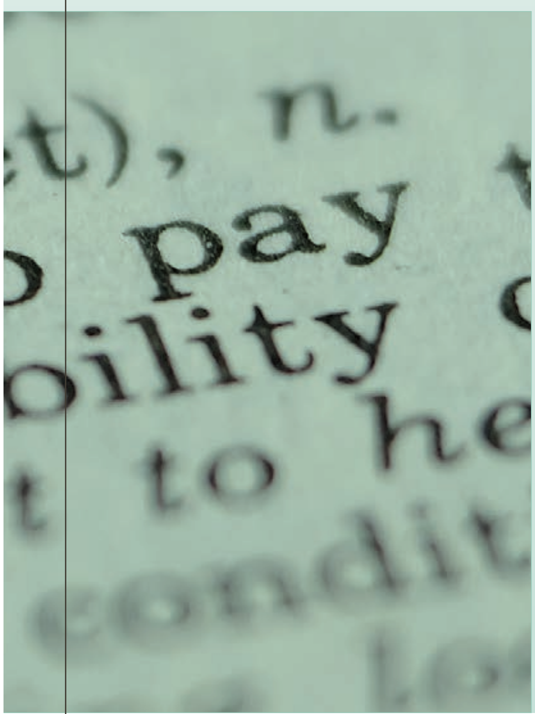
CHAPTER 7 LIQUIDATION

Chapter 7 is referred to as liquidation because your non-exempt assets are liquidated. A trustee is appointed to take over your property. Any non-exempt property of value will be sold or turned into money to pay your creditors.

You may be able to keep some personal items and possibly real estate, depending on the laws of the state where you reside.

With Chapter 7, you will be liquidating most of your assets and walking away from some of your debts, usually unsecured debt like credit cards. In order to file under Chapter 7, you must qualify. To make sure the debtor is not abusing the system, the current bankruptcy laws state your income must be less than your state's median income to qualify.

A "means test" will calculate your median income and may examine your income and expenses. The median is determined by your geographic location and size of your family.



Chapter 7 bankruptcy may be right for you if you:

- Have no income or low income.
- Have little or no money left after paying your necessary living expenses each month.
- Rent or have little equity in your home.
- Have few assets (or no assets) aside from your furniture, clothing, and other necessities.

Exempt Property under Chapter 7

One advantage of Chapter 7 bankruptcy is that certain property is untouchable by creditors. Exemptions vary by state but typically include:

- Your primary residence.
- Certain items of personal property.
- Tools.
- Work equipment.
- Your vehicle.

More often than not, your exemptions will protect all of your assets. If not, your court-appointed trustee will ask to begin liquidation proceedings to pay your creditors. In most cases, however, the trustee will only liquidate if it is possible to obtain enough money from a sale to make a significant payment to your creditors.

If your creditors are paid or a settlement is reached, your debts are permanently wiped out.

Advantages of Chapter 7 Bankruptcy

No minimum or maximum debt requirement.

Any unpaid balances due after your assets have been distributed are discharged.

You keep wages you earn or property you acquire, except for inheritances, after the bankruptcy filing date.

Most cases are discharged and over in about 3-6 months.

Disadvantages of Chapter 7 Bankruptcy

- Nonexempt property is sold by the trustee.
- Foreclosure is only temporarily stopped.
- Not all debts are discharged, and those not discharged can still be collected after your case is closed.
- Withdrawing a Chapter 7 filing is difficult.


Growing financially means learning from your mistakes. A bad debt here and there will not lead to bigger problems, if you choose not to let it. Educate yourself on how to manage your debts, create a budget, and find ways to keep your costs down.
Everyone needs help. Lean on a financial counselor or advisor to provide financial insights you might not have on your own.
GROW. SMART.

Expect the unexpected.

Financial emergencies can come in the form of a job loss, medical expenses, home or auto repairs or even something that has never crossed your mind. The last thing you want to do is be forced to rely on credit cards or a loan which could compound the problem. Establishing an emergency savings account is vital in good times and in bad. An emergency fund is an easily accessible stash of money for use *only* in case of emergency.

LIVE. SMART.

CHAPTER 13

ADJUSTMENT OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME

If you have a job or some source of regular income, but you are overwhelmed by debts, Chapter 13 bankruptcy may be right for you. Chapter 13 bankruptcy can give you the opportunity to renegotiate debt with your creditors, set up a reasonable debt repayment plan, and get a fresh financial start.

You can usually keep your property, but you must agree to pay a portion of your income to your creditors as part of a repayment plan.

The repayment plan is the centerpiece of a Chapter 13 bankruptcy. The repayment plan is an agreement between you and your creditors. The court must approve your repayment plan and your budget.

Your creditors agree to forgive a portion of your debts in exchange for your commitment to repay your reduced debt over time. A Chapter 13 bankruptcy is designed to force creditors to negotiate for dimes on the dollar.

The plan requires you to make monthly payments to the bankruptcy trustee, who will then make distributions to your creditors.

The trustee is also responsible for making sure you live up to the terms of your repayment plan. Typical repayment plans last from 3-5 years.

Chapter 13 bankruptcy may be for you if:

You are behind in your payments for property that you want to keep after bankruptcy. For example, if you are late on your mortgage or automobile loan, and you want to get current with these payments and keep your property, you can do this under a Chapter 13 plan.

You have tax debts. It is very difficult to discharge your tax debt in Chapter 7 bankruptcy. Even if you are able to discharge some tax debt through Chapter 7, any IRS tax liens recorded against you will survive your bankruptcy. They will still be on your record, and the IRS can seize any property you owned at the time you filed bankruptcy.

Accordingly, if a large percentage of your debt involves unpaid federal taxes, and you have the ability to repay them over time, a Chapter 13 bankruptcy may be a better alternative for you than a Chapter 7.

You have nonexempt property you want to keep. Chapter 13 may allow you to keep nonexempt property, the same you may have had to give up to creditors if you filed under Chapter 7.

You have received a Chapter 7 discharge previously. You cannot file another Chapter 7 bankruptcy for 8 years; Chapter 13 may be an option during that time.

You want to protect cosigners on your debts. If you had your spouse or parent cosign on an auto or other personal loan for you prior to your bankruptcy, a Chapter 7 won't protect your cosigner. Your creditor could go after your family member for the full amount of your debt. If, instead, you file under Chapter 13, your cosigner will be fully protected from your creditors as long as you make your payments under the repayment plan.

You need to consolidate your student loans. Although you can't discharge your student loans in a Chapter 7 bankruptcy, you can include them in your Chapter 13 repayment plan and repay them over time.

Exempt Property under Chapter 13

Certain property may be exempt under Chapter 13 bankruptcy. Exemptions vary but typically include:

- Your primary residence.
- Certain items of personal property.
- Your vehicle.

Do you qualify for Chapter 13 Bankruptcy?

A Chapter 13 bankruptcy is not for everyone. You may qualify for a Chapter 13 bankruptcy only if you can satisfy the following three requirements:

You must have a regular source of income. You must be able to meet the terms of your repayment plan, so the bankruptcy law requires that your income be "stable and regular" if you wish to file a Chapter 13.

You must have enough disposable income. The law requires you to have a "regular" source of income and sufficient "disposable income." In other words, you must have money left over after your expenses for basic human needs each month to allow you to make monthly payments under your repayment plan. There is no set formula for determining how much income is enough; the courts are flexible in determining this. Courts often require a proposed budget to see if you can satisfy these requirements.

Your debts must not be too high. If secured debts, which include loans you have secured by liens on your property (such as your home and auto loans, and even IRS tax liens), exceed certain debt limits, you are not eligible for a Chapter 13 bankruptcy.

Also, your unsecured debts may not exceed a certain limit. Unsecured debts are debts for which you have not pledged any of your property as collateral, such as most credit card debt, personal loans, and utility bills.

Debt limits may change from year to year, based on cost-of-living changes.

7 & 13 BANKRUPTCY

ADVANTAGES

- Protection against collection efforts and wage garnishment.
- Protection against foreclosure on primary residence.
- Nonexempt property that would otherwise be relinquished under Chapter 7 is protected under Chapter 13.
- Allows rescheduling of secured debt which provides more time to pay off debts.
- Cosigners are fully protected from creditors as long as payments are made under the repayment plan.
- Chapter 13 can be filed after a Chapter 7 discharge in order to reduce/repay remaining debts or liens.
- No limit to the number of times you can file Chapter 13.

DISADVANTAGES

- Foreclosure is only temporarily stopped under Chapter 7.
- Not all debts are discharged, and some can still be collected afterwards.
- The amount of debt discharged is limited.
- Limit amounts change based on bankruptcy law changes.
- Your ability to apply for a loan or credit card may be impaired.
- Your interest rates may be higher to obtain future credit.

AFTER BANKRUPTCY

At first it is a relief; you filed for bankruptcy, and the creditors have stopped harassing you. You can now devote your income to keeping up with your living expenses and trying to get your financial life back on track. So what comes next?

Naturally, when you file for bankruptcy, your credit will be weak. For the next few years after filing bankruptcy, expect difficulty getting mortgage loans, car loans, or low-interest credit cards. You will also probably pay higher interest rates on any loan that is approved until you can improve your credit score.

You need to change your spending habits. Your old way of doing things need to change; it resulted in bankruptcy.

To avoid another bankruptcy, keep track of your spending by living within your means. Create a budget and stick to it. Ask for financial counseling to help you move forward.

Cut Expenses

Here are some tips on how to reduce your spending:

- Build up emergency savings to stop your use of credit cards when the unexpected occurs.
- Avoid impulse buying. Ask yourself, “Can I do without it?”
- Set priorities, make a plan, and stick to it.
- Pay off all credit card balances at the end of each month.
- Pay with cash. If you don’t have enough cash, you probably don’t need it.
- Move balances to cards with lower interest rates.
- Keep a spending journal to help you see where your money is going.
- If credit cards are a serious problem for you, avoid using them altogether; cut them up. If you want a new stereo or TV, put money into savings each payday until you can afford to buy it outright.
- When you get a raise, put 10%, 25%, or 50% of the raise aside for investing or paying off bills.
- Shop around for the best deals and the best prices, especially on major purchases (TV, car, computer, kitchen appliances). Use the internet, and you’ll cover a lot of territory in a short amount of time.
- Do not tie up too much money in your mortgage. No more than 28% of your gross monthly income should go to your mortgage payment.
- Keep all debts, mortgage, car payments, credit cards, etc., to less than 36% of your gross monthly income.
- Clip coupons; do not pay full price when you don’t have to.
- Reduce the frequency of dining out.
- Pack a lunch for work a couple of times a week.
- Cut down on conveniences.
- Change your own oil.
- Wash your own car.
- Barbeque at home instead of buying hamburgers out.
- Shampoo your own carpet.
- Maintain the lawn yourself instead of hiring an outside company.
- Share a newspaper, or get Sunday only. If you take a Sunday paper, you may not need to buy a separate TV guide.
- How many cable premium stations, movies, and “pay per-view events” do you pay for? How many do you need? Is renting DVDs a better option?
- How many phone lines do you have? How many do you need?
- Check with different cell phone providers to make sure you are getting the lowest cost plan that suits your needs.
- Go through your last six months’ bank statements, and find out where and how much you spent. What can you change?
- Use a list when shopping. Impulse buying at the checkout register is a gold mine for a retailer and a money pit for the consumer.
- Late fees cost money. Pay bills on time.
- Do not carry cash in your pocket. If you have to go through the trouble of cashing a check or withdrawing money from the bank, you might think twice about the purchase.

By changing the way you spend and use money now, you can avoid financial difficulties in the future.

FREQUENTLY ASKED QUESTIONS

Will I lose anything if I file for bankruptcy?

Generally, you may file bankruptcy and retain all of your personal belongings, including your house, your car, and all household goods.

Legal assistance will help make sure that all of your personal belongings are protected. If you owe more on your car than the car is worth, the bankruptcy court will not sell your car because after sale there would be no money left over to make a distribution to your creditors.

The same goes for your home and personal property. Even if your property is worth more than what is owed on it, you can usually use the state bankruptcy exemptions to protect these items.

You may be more at risk of losing property if you don't file bankruptcy, as creditors can sue you and attack your bank accounts, garnish your wages, and seize your property. As a result, you may miss rent, mortgage, or car payments, making it difficult to provide even your most basic necessities.

When do I get relief from creditor harassment?

Relief from credit harassment happens immediately. When you file a bankruptcy petition in the local bankruptcy court, the court appoints a bankruptcy trustee to your case and an "Automatic Stay" is entered. An automatic stay is a court order that prohibits most of your creditors from taking any further action against you outside of bankruptcy court.

This action is designed to:

- Stop most calls and bills from creditors.
- Protect much of your property from seizure.
- Prohibit most creditor lawsuits against you.
- Prevent foreclosure of your home.
- Stop wage garnishments.
- Block the repossession of your automobile.

Does my spouse have to file jointly with me?

If all or most of the debts are in your name only, your spouse may not have to file. Creditors usually cannot pursue a non-filing spouse, unless he or she is legally a co-debtor.

Additionally, the bankruptcy should not show up on the non-filing spouse's credit report. The law varies from state to state, so it may be appropriate to speak with a bankruptcy attorney about whether or not your spouse has to file.

Who knows about my bankruptcy case?

Your bankruptcy will be reported to creditors, the bankruptcy court, and the IRS. Usually, bankruptcy does not affect your taxes. Your employer will not be notified of the bankruptcy unless your employer is also a creditor. Generally, only you, your creditors, and the IRS will know about the bankruptcy; however, bankruptcy filings are public record, so anyone who wants to find out could learn that you filed.

Will I be able to rent after I file bankruptcy?

If you are presently renting a home or apartment, it is common for your present landlord to renew your lease without running an updated credit report, so it is possible that the landlord will have no knowledge that you even filed for bankruptcy. If you are applying for a new lease, there could be some difficulties.

A good faith gesture, such as offering an extra month's security deposit, may be enough for the landlord to overcome any concerns about your blemished credit.

Can I get rid of student loans or tax debts?

Until October 1998, student loans were discharged through Chapter 7 bankruptcy, if the first payment on the loan became due more than seven years prior to the date of filing.

In October 1998, President Clinton signed a new law into effect that disqualified all student loans from discharge.

It may still be possible to obtain relief from your student loan debts through the use of Chapter 13. Under Chapter 13, you can consolidate your student loan debt, along with any other outstanding bills, and arrange an interest-free repayment plan, so that you do not have to suffer through the burden of garnishments, harassment, and other collection efforts by student loan agencies.

It may also be possible to reduce the amount paid to the student loan agency during the course of your Chapter 13 so that your consolidation payment is as low as possible.

Tax debts are generally subject to discharge only if you file bankruptcy more than three years after you file a timely, truthful tax return. If your return is filed late, the taxes are generally discharged only if you file bankruptcy more than two years after filing a truthful tax return.

Can I get credit after filing bankruptcy?

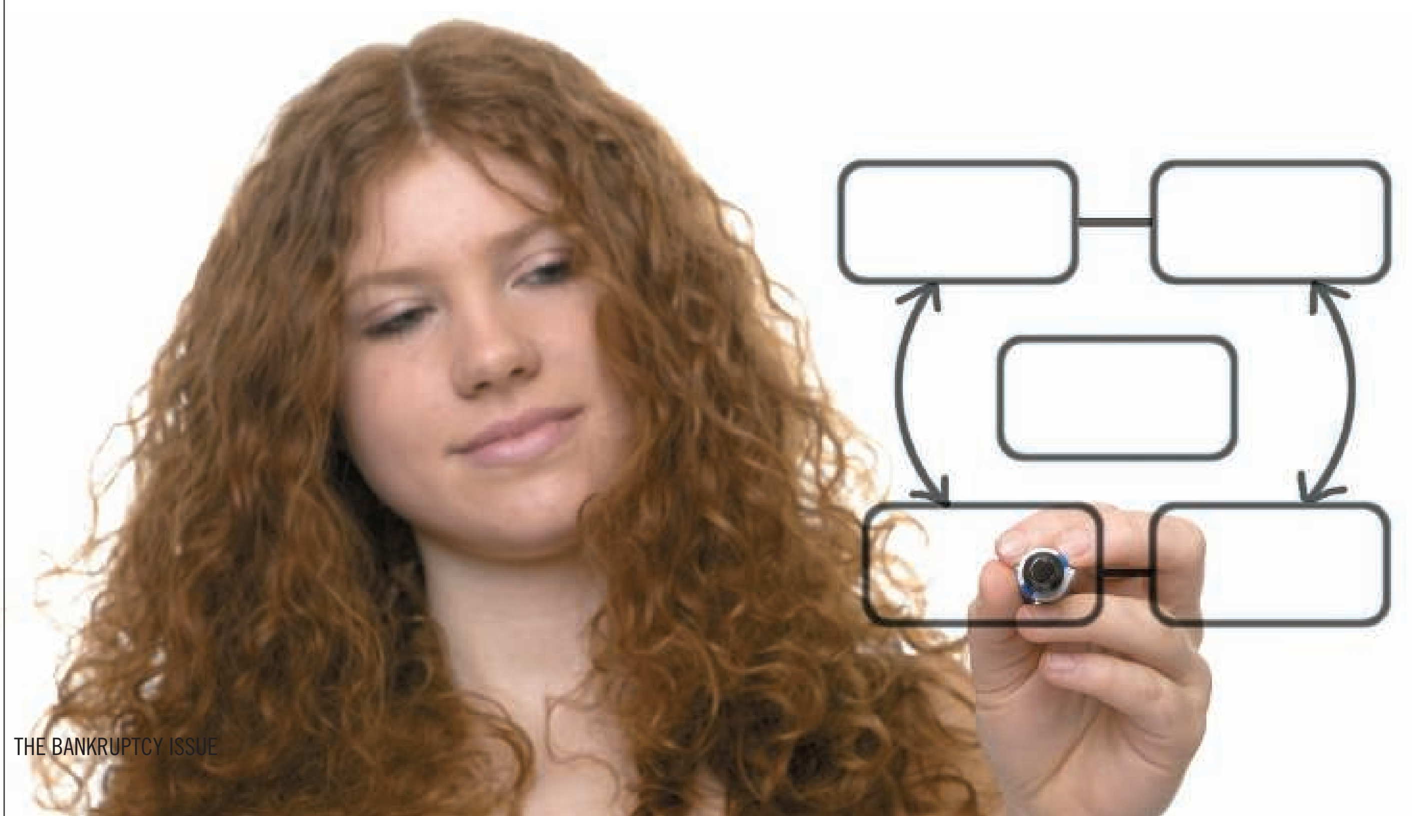
Although bankruptcy may legally be kept on your credit report for up to 10 years, you can begin to reestablish your credit immediately.

Filing Chapter 7 eliminates most, if not all, of your debts, which reduces your debt-to-income ratio, potentially improving your ability to borrow money in the future. Some financial institutions actively solicit business from people who have filed Chapter 7.

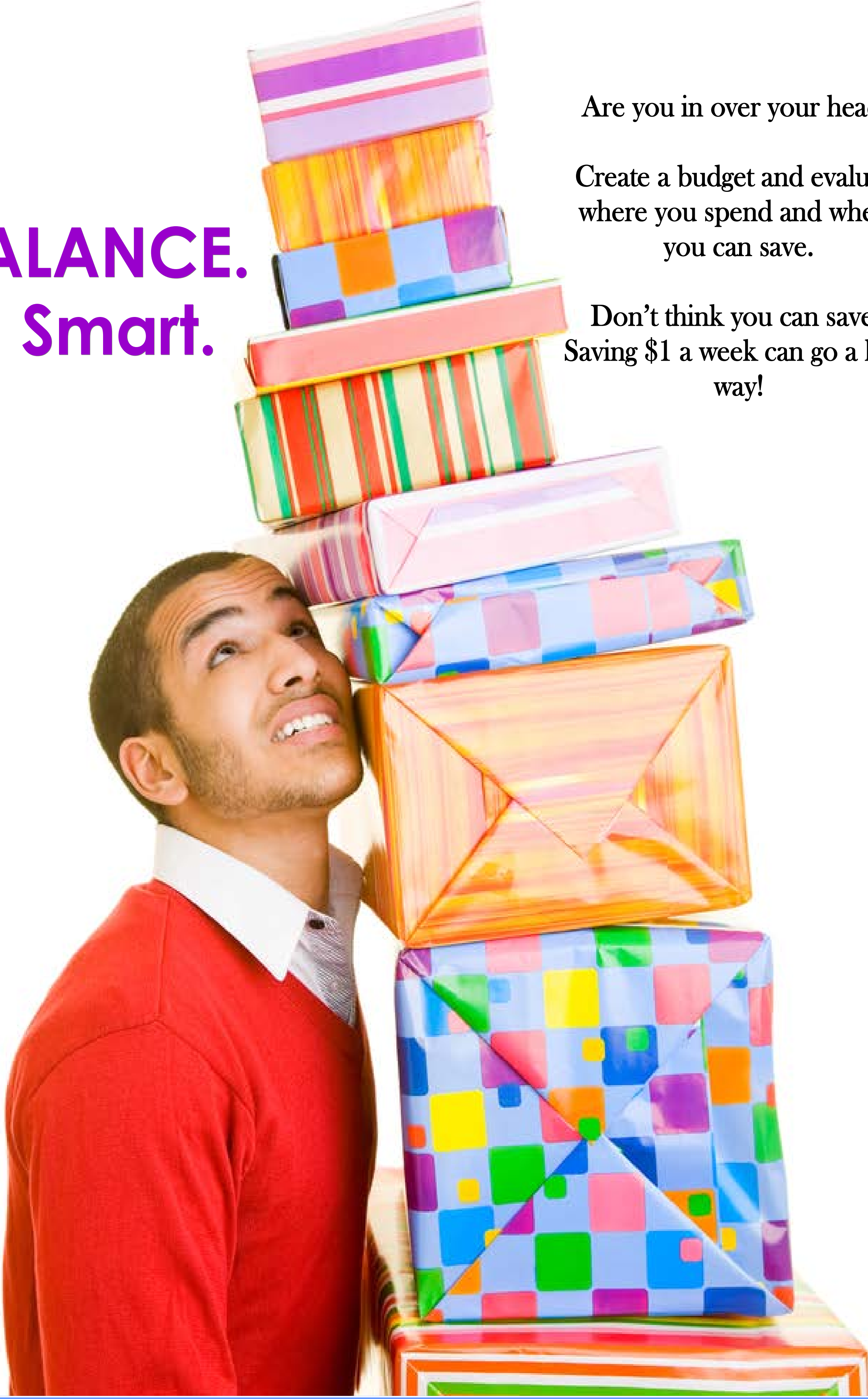
Lenders are in business to make money by lending you money and charging you interest. Lenders know that once you have filed Chapter 7, you will not be able to file again for eight years.

Should I hire a bankruptcy lawyer?

Filing for bankruptcy can be complicated. The decision to seek the advice of a bankruptcy lawyer is left solely to the individual.



BALANCE.
Smart.



Are you in over your head?

Create a budget and evaluate where you spend and where you can save.

Don't think you can save? Saving $1 a week can go a long way!

CONCLUSION

The decision to file bankruptcy should not be taken lightly. Even though it helps get your debt and finances under control, it will dramatically affect your credit. You will not immediately be able to qualify for most loans.

Expect to pay higher interest rates on mortgages, car loans, and credit cards when they become available. This could be as long as 5-7 years after filing bankruptcy.

Filing bankruptcy should be your last alternative and done only if all other attempts and methods of reducing the debt have failed.

Bankruptcy provides the opportunity to start over. Use this opportunity to keep on top of your expenditures. Reduce your dependency on credit cards, increase your emergency savings, and stay away from the spending habits and pitfalls that lead to bankruptcy.