

# Bankruptcy

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Material for this handout came from the publication *Bankruptcy Basics* on the Administrative Office of the U.S. Courts website: <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics>

## 1. **WHAT IS A DISCHARGE IN BANKRUPTCY?**

a. One of the primary purposes of bankruptcy is to discharge certain debts to give an honest individual debtor a “fresh start.” Bankruptcy is a legal proceeding where a debtor goes to court to have his or her obligations modified or forgiven when the debtor cannot meet his or her obligations after the debtor has honestly made a diligent effort to pay the obligations. The goals of bankruptcy are to (1) convert the assets of the debtor into cash and distribute it among creditors fairly and (2) give the debtor a fresh start, with such exemptions (property the debtor can keep) and rights as the bankruptcy laws permit. The U.S. Constitution gives Congress the power to make one set of bankruptcy rules for the entire country. Thus, when a debtor files for bankruptcy, the debtor is receiving federal protection from his or her creditors. Consequently, a bankruptcy proceeding must be filed in specially created federal bankruptcy courts.

b. A bankruptcy discharge releases the debtor from personal liability for certain specified types of debts. In other words, the debtor is no longer legally required to pay any debts that are discharged. The discharge is a permanent order prohibiting the creditors of the debtor from taking any form of collection action on discharged debts, including legal action and communications with the debtor, such as telephone calls, letters, and personal contacts.

c. Although a debtor is not personally liable for discharged debts, a valid lien (i.e., a charge upon specific property to secure payment of a debt) that has not been avoided (i.e., made unenforceable) in the bankruptcy case will remain after the bankruptcy case. Therefore, a secured creditor may enforce the lien to recover the property secured by the lien.

2. **NONBANKRUPTCY ALTERNATIVES:** Before filing for bankruptcy, you should consider other means of solving your financial problems. For example, you should consider making an appointment with the base Financial Counselor at (850) 882-9060. The services are free. Aside from helping you establish a monthly budget, the Counselor can discuss money-saving techniques, such as the following:

a. Stop the Cash-Flow Drain: Many times individuals own property they cannot afford. For example, a young Airman may have bought a very expensive vehicle, which causes the Airman to make high monthly payments. In cases where the individual is living beyond his or her means, it is preferable the individual sell the expensive property instead of filing for bankruptcy.

b. Negotiated Work-Outs: Sometimes creditors are willing to enter into a negotiated settlement with you if they believe you are simply not able to pay them back the entire amount. They may be willing to settle for much less than the full amount, such as getting 50 cents on the dollar. A consumer credit counseling agency may also provide some assistance for a "small" fee.

c. Consolidation Loan: Sometimes obtaining a loan from a financial institution may be beneficial in that by paying off your debts in one lump sum, you avoid all the high interest payments you usually make on all your debts, such as in the case with credit card companies. If you cannot obtain such a loan from a bank, you should consider asking family members and agreeing (in writing) to pay them back, either at no interest or at a minimal interest rate.

3. **TYPES OF BANKRUPTCY AVAILABLE**: Generally, six types of bankruptcy are provided for under the Bankruptcy Code. They are referred to by their chapter number in the Bankruptcy Code. This handout will mainly discuss filing for Chapter 7 and Chapter 13 bankruptcy, as they are the ones most typically used by military members.

4. **CHAPTER 7**: Chapter 7, entitled Liquidation, contemplates an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor's estate, reduces them to cash, and makes distributions to creditors, subject to the debtor's right to retain certain exempt property and the rights of secured creditors. Because there is usually little or no nonexempt property in most chapter 7 cases, there may not be an actual liquidation of the debtor's assets. These cases are called "no-asset cases." A creditor holding an unsecured claim will get a distribution from the bankruptcy estate only if the case is an asset case and the creditor files a proof of claim with the bankruptcy court. In most chapter 7 cases, if the debtor is an individual, he or she receives a discharge that releases him or her from personal liability for certain dischargeable debts. The debtor normally receives a discharge just a few months after the petition is filed. The application also requires a "means test" to determine whether individual consumer debtors qualify for relief under chapter 7. If such a debtor's income is in excess of certain thresholds, the debtor may not be eligible for chapter 7 relief.

a. Does the Debtor have the right to a Discharge or can Creditors Object? In chapter 7 cases, the debtor does not have an absolute right to a discharge. An objection to the debtor's discharge may be filed. Creditors receive a notice shortly after the case is filed that sets forth much important information, including the deadline for objecting to the discharge. To object to the debtor's discharge, a creditor must file a complaint in the bankruptcy court before the deadline set out in the notice. The court may deny a chapter 7 discharge for a number of reasons, to include:

- Failure to provide requested tax documents
- Failure to complete a course on personal financial management
- Transfer or concealment of property with intent to hinder, delay, or defraud creditors
- Destruction or concealment of books or records
- Perjury and other fraudulent acts
- Failure to account for the loss of assets
- Violation of a court order or an earlier discharge in an earlier case the date the petition was filed

b. May the Debtor Pay a Discharged Debt After the Bankruptcy Case is Concluded? A debtor may voluntarily repay any discharged debt. A debtor may repay a discharged debt even though it can no longer be legally enforced. Sometimes a debtor agrees to repay a debt because it is owed to a family member or because it represents an obligation to an individual for whom the debtor's

reputation is important, such as a family doctor.

c. What happens if a Creditor attempts to collect a discharged debt? If a creditor attempts collection efforts on a discharged debt, the debtor can file a motion with the court, reporting the action and asking that the case be reopened to address the matter. The bankruptcy court will often do so to ensure that the discharge is not violated. The discharge constitutes a permanent statutory injunction prohibiting creditors from taking any action, including the filing of a lawsuit, designed to collect a discharged debt. A creditor can be sanctioned by the court for violating the discharge injunction.

d. Can an Employer terminate a Debtor's Employment solely because the person was a Debtor or failed to pay a discharged debt? The law provides express prohibitions against discriminatory treatment of debtors by both governmental units and private employers. A governmental unit or private employer may not discriminate against a person solely because the person was a debtor, was insolvent before or during the case, or has not paid a debt that was discharged in the case. The law prohibits the following forms of governmental discrimination: terminating an employee; discriminating with respect to hiring; or denying, revoking, suspending, or declining to renew a license, franchise, or similar privilege. A private employer may not discriminate with respect to employment if the discrimination is based solely upon the bankruptcy filing.

e. Military Considerations: While a service member has a right to file for bankruptcy, a member can be discharged or prosecuted under Article 134 of the Uniform Code of Military Justice for "dishonorable failure to pay just debts." However, action will likely be taken only if it is determined the member is not acting in good faith. Additionally, a commander has discretion to restrict or withdraw access to classified information whenever a military member's financial situation makes the member vulnerable to bribes or blackmail. Loss of access is by no means automatic.

f. Chapter 7 Background: The bankruptcy trustee gathers and sells the debtor's nonexempt assets and uses the proceeds of such assets to pay holders of claims (creditors) in accordance with the provisions of the Bankruptcy Code. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors. In addition, the Bankruptcy Code will allow the debtor to keep certain "exempt" property; but a trustee will liquidate the debtor's remaining assets. Accordingly, potential debtors should realize that the filing of a petition under chapter 7 may result in the loss of property.

g. Chapter 7 Eligibility: Subject to the means test for individual debtors, relief is available under chapter 7 irrespective of the amount of the debtor's debts or whether the debtor is solvent or insolvent. Generally, no individual may be a debtor under chapter 7 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing.

h. How Chapter 7 Works: A chapter 7 case begins with the debtor filing a petition with the bankruptcy court serving the area where the individual lives. In addition to the petition, the debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a statement of financial affairs; and (4) a schedule of executory contracts and unexpired leases. Debtors must also provide the assigned case trustee with a copy of the tax return or transcripts for the most recent tax year as well as tax returns filed during the case. Individual debtors with primarily consumer debts have additional document filing requirements. They must file: a certificate of credit counseling and a copy of any debt repayment plan developed through credit

counseling; evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts. A husband and wife may file a joint petition or individual petitions. Even if filing jointly, a husband and wife are subject to all the document filing requirements of individual debtors.

i. Filing Fees: The courts must charge a \$245 case filing fee, a \$46 miscellaneous administrative fee, and a \$15 trustee surcharge. Normally, the fees must be paid to the clerk of the court upon filing. With the court's permission, however, individual debtors may pay in installments. Failure to pay these fees may result in dismissal of the case.

j. Required Documents: In order to complete the Official Bankruptcy Forms that make up the petition, statement of financial affairs, and schedules, the debtor must provide the following:

1. A list of all creditors and the amount and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly living expenses, *i.e.*, food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

Married individuals must gather this information for their spouse regardless of whether it is a joint petition or only one spouse is filing.

k. Exempt Property: The Bankruptcy Code allows an individual debtor to protect some property from the claims of creditors because it is exempt under federal bankruptcy law or under the laws of the debtor's home state. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law. The debtor should consult an attorney to determine the exemptions available in the state where the debtor lives.

l. Automatic Stays: Filing a petition under chapter 7 "automatically stays" (stops) most collection actions against the debtor or the debtor's property. 11 U.S.C. § 362. But filing the petition does not stay certain types of actions listed under 11 U.S.C. § 362(b), and the stay may be effective only for a short time in some situations. The stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even telephone calls demanding payments. The bankruptcy clerk gives notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor.

m. Meeting of Creditors: Between 21 and 40 days after the petition is filed, the case trustee will hold a meeting of creditors. During this meeting, the trustee puts the debtor under oath, and both the trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding the debtor's financial affairs and property. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting and answer questions. Within 14 days of the creditors' meeting, the U.S. trustee will report to the court whether the case should be presumed to be an abuse under the means test. It is important for the debtor to cooperate with the trustee and to provide any financial records or documents that the trustee requests. The Bankruptcy Code requires the trustee to ask the debtor questions at the meeting of creditors to ensure that the debtor is aware of the potential consequences of seeking a discharge in bankruptcy such as the effect on credit history, the ability to file a petition under a different chapter, the effect of receiving a discharge, and the effect of reaffirming a debt.

n. Role of the Case Trustee: When a chapter 7 petition is filed, an impartial case trustee is appointed to administer the case and liquidate the debtor's nonexempt assets. If all the debtor's assets are exempt or subject to valid liens, the trustee will normally file a "no asset" report with the court, and there will be no distribution to unsecured creditors. Most chapter 7 cases involving individual debtors are no asset cases. But if the case appears to be an "asset" case at the outset, unsecured creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors. A governmental unit, however, has 180 days from the date the case is filed to file a claim. In the typical no asset chapter 7 case, there is no need for creditors to file proofs of claim because there will be no distribution. If the trustee later recovers assets for distribution to unsecured creditors, the Bankruptcy Court will provide notice to creditors and will allow additional time to file proofs of claim. Although a secured creditor does not need to file a proof of claim in a chapter 7 case to preserve its security interest or lien, there may be other reasons to file a claim. The primary role of a chapter 7 trustee in an asset case is to liquidate the debtor's nonexempt assets in a manner that maximizes the return to the debtor's unsecured creditors. The trustee accomplishes this by selling the debtor's property if it is free and clear of liens (as long as the property is not exempt) or if it is worth more than any security interest or lien attached to the property and any exemption that the debtor holds in the property. The trustee may also attempt to recover money or property under the trustee's "avoiding powers." The trustee's avoiding powers include the power to set aside preferential transfers made to creditors within 90 days before the petition. The individual debtor's primary concerns in a chapter 7 case are to retain exempt property and to receive a discharge that covers as many debts as possible.

o. The Chapter 7 Discharge: A discharge releases individual debtors from personal liability for most debts and prevents the creditors owed those debts from taking any collection actions against the debtor. Generally, excluding cases that are dismissed or converted, individual debtors receive a discharge in more than 99 percent of chapter 7 cases. In most cases, unless a party in interest files a complaint objecting to the discharge or a motion to extend the time to object, the bankruptcy court will issue a discharge order relatively early in the case –generally, 60 to 90 days after the date first set for the meeting of creditors.

p. Grounds For Denying an Individual Debtor a Discharge in a Chapter 7 Include:

- Failed to keep or produce adequate books or financial records
- Failed to explain satisfactorily any loss of assets
- Committed a bankruptcy crime such as perjury
- Failed to obey a lawful order of the bankruptcy court
- Fraudulently transferred, concealed, or destroyed property that would have become property of the estate; or
- Failed to complete an approved instructional course concerning financial management.

q. Secured Creditors (Reaffirmations): Secured creditors may retain some rights to seize property securing an underlying debt even after a discharge is granted. Depending on individual circumstances, if a debtor wishes to keep certain secured property (such as an automobile), he or she may decide to "reaffirm" the debt. A reaffirmation is an agreement between the debtor and the creditor that the debtor will remain liable and will pay all or a portion of the money owed, even though the debt would otherwise be discharged in the bankruptcy. In return, the creditor promises that it will not repossess or take back the automobile or other property so long as the debtor continues to pay the debt. If the debtor decides to reaffirm a debt, he or she must do so before the discharge is entered. The debtor must sign a written reaffirmation agreement and file it with the court.

r. Debts Not Discharged in Chapter 7 Include:

- Debts for alimony and child support, certain taxes,
- Debts for certain educational benefit overpayments/loans made/guaranteed by a governmental unit,
- Debts for willful & malicious injury by debtor to another entity or to the property of another entity,
- Debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated from alcohol or other substances, and
- Debts for certain criminal restitution orders. 11 U.S.C. § 523(a).

5. **CHAPTER 13:** Also called a Wage earner's plan. It enables individuals with regular income to develop a plan to repay all or part of their debts. Under this chapter, debtors propose a repayment plan to make installments to creditors over three to five years. If the debtor's current monthly income is less than the applicable state median, the plan will be for three years unless the court approves a longer period "for cause." If the debtor's current monthly income is greater than the applicable state median, the plan generally must be for five years. In no case may a plan provide for payments over a period longer than five years. During this time the law forbids creditors from starting or continuing collection efforts.

a. Advantages of Chapter 13: Chapter 13 offers individuals an opportunity to save their homes from foreclosure. By filing under this chapter, individuals can stop foreclosure proceeding and may cure delinquent mortgage payments over time. Nevertheless, they must still make all mortgage payments that come due during the chapter 13 plan on time. Another advantage of chapter 13 is that it allows individuals to reschedule secured debts (other than a mortgage for their primary residence) and extend them over the life of the chapter 13 plan. Doing this may lower the payments. Chapter 13 also has a special provision that protects third parties who are liable with the debtor on "consumer debts." This provision may protect co-signers. Finally, chapter 13 acts like a consolidation loan under which the individual makes the plan payments to a chapter 13 trustee who then distributes payments to creditors. Individuals will have no direct contact with creditors while under chapter 13 protection.

b. How Chapter 13 Works: A chapter 13 case begins by filing a petition with the bankruptcy court serving the area where the debtor has a domicile or residence. Unless the court orders otherwise, the debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a schedule of executory contracts and unexpired leases; and (4) a statement of financial affairs. The debtor must also file a certificate of credit counseling and a copy of any debt repayment plan developed through credit counseling; evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts. The debtor must also provide the chapter 13 case trustee with a copy of the tax return or transcripts for the most recent tax year as well as tax returns filed during the case. A husband and wife may file a joint petition or individual petitions.

c. Filing Fees: The courts must charge a \$235 case filing fee and a \$46 miscellaneous administrative fee. Normally the fees must be paid to the clerk of the court upon filing. With the court's permission, however, they may be paid in installments. Debtors should be aware that failure to pay these fees may result in dismissal of the case.

d. Required Forms: In order to complete the Official Bankruptcy Forms that make up the petition, statement of financial affairs, and schedules, the debtor must compile the following information:

1. A list of all creditors and the amounts and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's monthly living expenses, *i.e.*, food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

Married individuals must gather this information for their spouse regardless of whether they are filing a joint petition or even if only one spouse is filing.

e. Trustee: When an individual files a chapter 13 petition, an impartial trustee is appointed to administer the case. The chapter 13 trustee both evaluates the case and serves as a disbursing agent, collecting payments from the debtor and making distributions to creditors.

f. Automatic Stays: Filing the petition under chapter 13 "automatically stays" (stops) most collection actions against the debtor or the debtor's property. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even make telephone calls demanding payments. The bankruptcy clerk gives notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor. Chapter 13 also contains a special automatic stay provision that protects co-debtors. Unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a "consumer debt" from any individual who is liable along with the debtor. Consumer debts are those incurred by an individual primarily for a personal, family, or household purpose.

g. Meeting of Creditors: Between 21 and 50 days after the debtor files the chapter 13 petition, the 13 trustee will hold a meeting of creditors. During this meeting, the trustee places the debtor under oath, and both the trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding his or her financial affairs and the proposed terms of the plan. If a husband and wife file a joint petition, they both must attend the creditors' meeting and answer questions.

h. Repayment Plan and Confirmation Hearing: Unless the court grants an extension, the debtor must file a repayment plan with the petition or within 14 days after the petition is filed. A plan must be submitted for court approval and must provide for payments of fixed amounts to the trustee on a regular basis, typically biweekly or monthly. The trustee then distributes the funds to creditors according to the terms of the plan, which may offer creditors less than full payment on their claims. Within 30 days after filing the bankruptcy case, even if the plan has not yet been approved by the court, the debtor must start making plan payments to the trustee. No later than 45 days after the meeting of creditors, the bankruptcy judge must hold a confirmation hearing and decide whether the plan is feasible and meets the standards for confirmation in the Bankruptcy Code. If the court confirms the plan, the chapter 13 trustee will distribute funds received under the plan "as soon as is practicable." If the court declines to confirm the plan, the debtor may file a modified plan. The debtor may also convert the case to chapter 7.

i. Making the Plan Work: The provisions of a confirmed plan bind the debtor and each creditor. Once the court confirms the plan, the debtor must make the plan succeed. The debtor must make regular payments to the trustee either directly or through payroll deduction, which will require adjustment to living on a fixed budget for a prolonged period. Furthermore, while confirmation of the plan entitles

the debtor to retain property as long as payments are made, the debtor may not incur new debt without consulting the trustee, because additional debt may compromise the debtor's ability to complete the plan.

j. Debts Not Discharged in Chapter 13: Includes certain long term obligations (such as a home mortgage), debts for alimony or child support, certain taxes, debts for most government funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for restitution or a criminal fine included in a sentence on the debtor's conviction of a crime. To the extent that they are not fully paid under the chapter 13 plan, the debtor will still be responsible for these debts after the bankruptcy case has concluded. The discharge in a chapter 13 case is somewhat broader than in a chapter 7 case. Debts dischargeable in a chapter 13, but not in chapter 7, include debts for willful and malicious injury to property (as opposed to a person), debts incurred to pay non-dischargeable tax obligations, and debts arising from property settlements in divorce or separation proceedings.

6. **FLORIDA EXEMPTIONS**: The Bankruptcy Code provides that some of the debtor's property is exempt (the member gets to keep it) so the debtor can have a "fresh start." The Code permits each state to opt out of the federal exemptions, in which case the only exemptions available to the debtor would be those afforded by state law and also by non-bankruptcy exemptions under federal law. Florida opted out and established its own state exemptions. Among other exemptions, debtors are allowed to exempt their homes from being considered in bankruptcy proceedings. Florida has one of the more generous homestead exemptions, allowing for an unlimited amount of value in the home or other property covered by the homestead exemption. The property cannot be larger than a half of an acre in a municipality or 160 acres elsewhere. Additionally, there is a requirement to have owned the exempted property for a time period prior to the filing. Consult your attorney about the current status of the homestead exemption and other exemptions.