

# Answering your legal questions about bankruptcy

People who are having difficulty paying their debts sometimes consider bankruptcy to obtain relief from collection efforts, eliminate some or all of their debts, or restructure their debt payments to a more manageable level. This pamphlet gives you general information about bankruptcy and is not a substitute for consulting qualified legal advisors.

## What is bankruptcy?

Bankruptcy is a uniform, federal court-supervised procedure to relieve individuals and businesses from debts, while protecting and preserving the rights of secured creditors and providing unsecured creditors with equal treatment of their claims.

There are four types of bankruptcy that individuals may select, depending on their particular financial circumstances. Most individuals file under **Chapter 7** of the Bankruptcy Code (the Code), sometimes known as “straight” or “liquidation” bankruptcy. **Chapter 11** is available to individuals, but generally is used by corporations to reorganize their business affairs. **Chapter 12** is designed for use by farmers. **Chapter 13**, also referred to as a “wage-earner” or “debt-adjustment” plan, is available to individuals and unincorporated businesses that intend to use future income to pay some or all of one’s debts according to a plan designed by the individual (within certain statutory limitations) to meet his or her needs.

This pamphlet concentrates on the more frequently used procedures, Chapters 7 and 13.

## Who may declare bankruptcy?

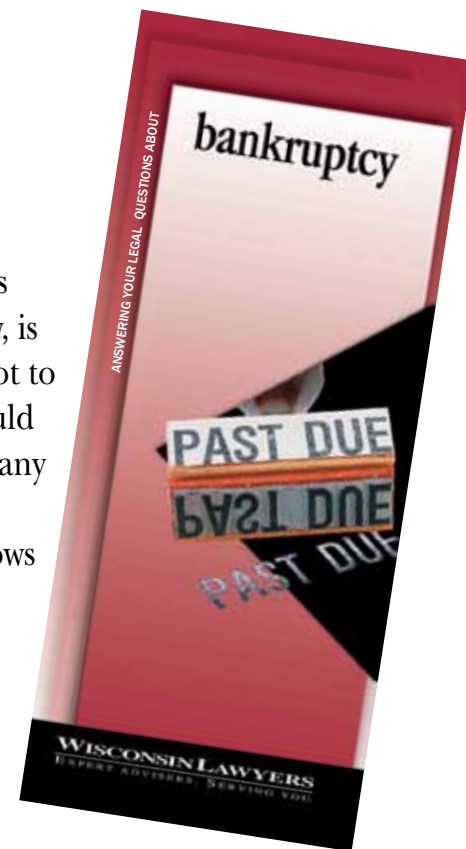
There are relatively few limitations on who can file bankruptcy. The decision of whether to file, and under what Chapter, is based on each individual’s need for relief from debts, their ability to pay, and their capacity and willingness to undertake a procedure that will have long-term consequences on their financial life. A debt-counselor or attorney can help you consider alternatives to bankruptcy.

## Who is involved in bankruptcy proceedings?

In general, bankruptcy proceedings under any Chapter involve:

- the **debtor** – the person who files bankruptcy, also known as “the petitioner”;
- the **creditors** – any persons, firms, or entities that claim the debtor owes them money;
- the **trustee** – a court-appointed person who administers the bankruptcy proceedings and any property available for distribution to creditors (called the bankruptcy estate). The trustee represents the interests of the unsecured creditors, and must liquidate nonexempt assets, investigate the debtor’s financial affairs, examine creditors’ proofs of claim, provide information to parties in interest, file reports, estate tax returns and recommend, when appropriate, criminal or civil proceedings against the debtor who has committed fraud or other crimes in connection with the case.
- the **bankruptcy judge** – who presides over any hearings on disputed matters in connection with the case.
- the **credit counselor** – an independent financial advisor who must certify both before filing and before the debtor’s discharge is granted that the debtor has completed the required credit counseling and financial management courses.

This pamphlet, which is based on Wisconsin law, is issued to inform and not to advise. No person should ever apply or interpret any law without the aid of a trained expert who knows the facts, because the facts may change the application of the law. 3/10



## What constitutes the bankruptcy estate?

In general, the bankruptcy estate consists of all property owned by the debtor or in which the debtor has an interest whether individually or as a co-owner with any other person. In a Chapter 13 case, this also includes post-filing income from all sources, including the income of a nonfiling spouse. The estate includes property the debtor acquires by gift, devise, inheritance, divorce settlements, and life insurance proceeds the right to which arises within 180 days after the filing of the case, and also includes property recovered by the trustee under certain Code provisions. The estate is reduced by exempt assets. The balance of any property remaining for administration by the trustee constitutes the final bankruptcy estate.

## What is Chapter 7 bankruptcy?

The most commonly used form of bankruptcy, Chapter 7, provides honest debtors who have limited financial means with a fresh start by eliminating many of a debtor’s most common financial obligations through the discharge (which is generally granted at the end of the case). In return for the discharge, the debtor must turn over to the trustee certain nonexempt assets. These nonexempt assets are sold with the proceeds distributed to creditors according to priorities set forth in the Code. Generally, priority expenses of administering the estate, unpaid wages, domestic support obligations, and taxes are paid ahead of ordinary unsecured claims. If assets remain for distribution to unsecured creditors, those creditors who file formal proofs of claim within the time fixed by the court share proportionately in the remaining proceeds. As discussed below, property that is subject to an otherwise unavoidable lien is generally not administered by the trustee. Such property is covered by the contract between the parties and the rights and remedies available under state law.

## What are some of the advantages and disadvantages of filing bankruptcy?

### Advantages:

- With a few notable exceptions, bankruptcy stops all ongoing legal actions against the debtor, prevents a creditor from beginning new legal actions against the debtor, and prohibits creditors with notice of the bankruptcy case from contacting the debtor, or anyone else besides the debtor's attorney, to discuss or seek collection of a debt;
- Most liabilities relating to credit card debts, civil judgments, past-due accounts, and judgments due to repossessions and foreclosures may be discharged;
- A debtor may be able to keep all or most of his or her property through federal and/or state exemptions; and
- Certain liens and certain involuntary transfers (such as garnishments), may be avoided if timely action is taken.

### Disadvantages:

- Debts relating to certain taxes, governmental fines, forfeitures and restitution, criminal or fraudulent conduct, child and spousal support, drunk driving, most student loans, and willful and malicious injuries, may not be dischargeable;
- Creditors having a mortgage or security interest in a home or in motor vehicles, may be able to repossess their collateral after the bankruptcy unless the debtor reaffirms the debt or redeems the collateral (see discussion below);
- Bankruptcy filings are matters of public record and are generally noted on a debtor's credit history for 10 years, making it more difficult to obtain credit in the future. A stigma may be associated with bankruptcy which views a debtor as being financially or socially irresponsible. Some debtors find the proceedings embarrassing since they must submit to a public examination about their financial affairs and must provide detailed financial disclosures, which are open to the public;
- In most cases, a debtor may receive a discharge only once in eight years. Debtors contemplating bankruptcy must consider their financial stability and ability to avoid the problems resulting in the bankruptcy during that period; and
- There may be significant tax consequences from a bankruptcy.

## What debts are not discharged in a Chapter 7 bankruptcy?

It is important to understand that not all debts are subject to discharge under Chapter 7. Among the common debts unaffected by bankruptcy are certain income and business taxes, alimony, child support, property divisions incident to divorce, governmentally imposed fines, forfeitures or restitution, most student loans, and liabilities resulting from drunken driving. Certain abuses of cash advances and credit cards on the eve of bankruptcy are presumed to be nondischargeable, as are debts arising from fraud, misrepresentation, theft, and willful and malicious injuries to a person or property.

For these latter forms of debts to be held nondischargeable, the creditor must bring a lawsuit against the debtor in the bankruptcy court within 90 days of the filing, and obtain a judgment declaring the debt, or some portion thereof, to be nondischargeable. In such a proceeding, the debtor has most of the rights attendant to any other civil trial in federal court, except the right to a jury trial.

The entire discharge may be denied or revoked if the debtor has engaged in fraud (such as making false statements, concealing assets, or fraudulently transferring assets) before, in, or in connection with the

case. Proceedings to deny or revoke a discharge are subject to the right to a nonjury trial on the merits as are claims for nondischargeability of debts.

Finally, while a debtor's *personal* liability for debts secured by a home, car, boat, furnishings, and the like may be discharged in a Chapter 7 bankruptcy, the affected creditor's right to enforce its lien against collateral pledged for a loan (such as the right of repossession) is generally unaffected by bankruptcy. To retain the collateral, the debtor may have to reaffirm the debt or redeem the collateral. These concepts will be discussed later.

## What property may I keep in a Chapter 7 bankruptcy?

Wisconsin law provides certain protections, called exemptions, that restrict the types of property a creditor holding a judgment may seize and sell to satisfy the creditor's claim. The federal bankruptcy laws also contain certain property exemptions that protect similar assets, but in quite different amounts. Specific dollar-value of these exemptions are not listed here because they are subject to legislative change. The types of property for which exemptions are permitted include a specified amount of equity in, among other things, one's personal residence, vehicles, household goods and personal effects, tools of trade, life insurance, and even deposit accounts. Generally, qualified retirement benefits may be excluded from the bankruptcy estate in whole or in part.

When a debtor's property (called collateral) is secured by a lien (such as a home mortgage, vehicle purchase loan, some furniture purchases, and so on), the debtor must decide whether to retain it or surrender it to the secured creditor. If the decision is to surrender the collateral, the unpaid portion of the loan (or any deficiency after sale of the collateral) generally is subject to discharge along with the unsecured debts.

If a debtor wishes to retain the collateral, the debtor *must* choose either to reaffirm the debt (sign a written document agreeing to continue making regular or agreed-upon payments on the debt and grant the creditor all prebankruptcy rights upon a subsequent default) or redeem the collateral (pay the creditor the present fair market value of the collateral in one lump-sum). Only items used for personal, household, and family use (including vehicles, but not real estate) are subject to redemption. A motor vehicle may not be redeemed for less than the balance due, if the loan is less than 2 ½ years old.

Finally, a debtor may be able to avoid certain liens on items held for personal or household use (but *not* vehicles or real estate) and retain the items without either reaffirming the debt or redeeming the collateral. Lien avoidance generally is a matter for the bankruptcy court, and usually has additional cost to the debtor beyond the basic cost of a bankruptcy case. Debtors should ask about additional costs when contacting an attorney about bankruptcy.

## What is a Chapter 13 bankruptcy?

Chapter 13 is a proceeding under which a debtor proposes to his or her creditors and the court, a plan that enables the debtor to repay as much debt as is feasible given the debtor's financial circumstances. To be confirmed by the court, a plan must provide that the debtor's future income be subject to court administration. After determining a reasonable budget, the debtor's remaining income is paid (generally monthly) by the debtor's employer to the trustee who, after taking a commission, pays the creditors according to the plan provisions. A plan generally lasts three years, but may last up to five years if the court approves the longer period, or if a debtor is required to propose a five-year plan due to their income level. At the end of the plan, the debtor is entitled to receive a discharge of any remaining debt.

## Who may file Chapter 13 bankruptcy?

Chapter 13 is limited to individuals and unincorporated businesses that have a regular source of income, and whose secured debts are less than \$1,081,400 with unsecured debts of less than \$360,475. The term “regular source of income” has been interpreted to mean income that is sufficiently definite and certain to enable the debtor to assign it to the trustee on a regular basis for payment by the trustee to creditors.

## What are some of the advantages and disadvantages of Chapter 13 bankruptcy?

### Advantages:

- Bars post-filing creditor actions against co-debtors if the creditor will be paid in full under the plan;
- Debtor retains all desired property, provided creditors obtain at least as much under the plan as they would under Chapter 7;
- Debtor may have the ability to “write-down” secured non-homestead debts to the value of the collateral;
- Debtor may be able to modify interest rates on some loans and extend the payment term on non-homestead debts to make them more affordable;
- Debtor may cure loan defaults by making installment payments, and reinstate accelerated mortgage and other notes;
- The Chapter 13 discharge is broader than under Chapter 7, so that more types of debts are dischargeable; and
- Debtor may be able to force (“cram-down”) affordable payments on secured and tax creditors that cannot be done under Chapter 7.

### Disadvantages:

- Debtor’s future income is subject to administration by the trustee for up to three and possibly as long as five years;
- Under the plan, the debtor must establish and live under a firm, but potentially adjustable budget during the repayment period;
- The trustee is entitled to a commission on payments paid to creditors which reduces the value of what is paid to creditors; and
- Still appears as a bankruptcy on credit reports.

## What procedures are involved in filing bankruptcy?

Bankruptcy involves a series of steps that usually include the following actions:

1. The debtor gathers financial information for use in preparing the petition for bankruptcy and the schedules of assets, debts, income and expenses, the statement of financial affairs, and statement of intentions concerning secured debts;
2. Obtaining the required pre-filing credit counseling;
3. The debtor files the petition, schedules, statement of financial affairs, and pays the filing fee to the bankruptcy court;
4. The court notifies scheduled creditors of the case filing, the meeting of creditors, the injunctive stay against creditor actions, the last date for creditors to file challenges to the debtor’s discharge or the dischargeability of a particular debt, the initial status of assets available in the case, and other pertinent information;
5. The debtor appears under oath and on record before the trustee to be examined at the meeting of creditors and submits to creditors’ questions;

6. The debtor completes the reaffirmation, redemption, or surrender of secured collateral according to the Statement of Intentions filed with the case; and
7. All parties receive the discharge notice approximately 90 days after filing a Chapter 7 case or at the conclusion of payments in a Chapter 13 case.

A discharge will not be issued unless the debtor has completed a prescribed course in financial management.

## Do I need a lawyer to file bankruptcy?

As with most other legal matters, any person may represent himself or herself before the bankruptcy court. Bankruptcy, however, is a highly refined procedure that is full of detail and interpretations based on prior case law. Each case is different, as are the consequences to the debtor. Proper planning in anticipation of bankruptcy may save a debtor money or property and countless hours of revising improperly completed documents. After a thorough analysis, bankruptcy may be unnecessary. A lawyer skilled in bankruptcy law can assist a debtor so that the process is as effective for the debtor as the specific circumstances allow. ◀

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