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# CONSUMER BANKRUPTCY

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## **Q: What is bankruptcy?**

A: Bankruptcy laws are federal laws and are the same in every state, although some interpretations of the laws are regional. These laws are found in title 11 of the U.S. Code. The bankruptcy laws are divided into chapters. There are two chapters relevant to consumer cases:

(1) Chapter 7 - “straight bankruptcy” - the person owing money (called the “Debtor”) submits information to show all assets and all liabilities; a Trustee is appointed to determine if the Debtor has any assets which can be taken and sold. If no assets are available (as in most of the cases we file under this Chapter), and no bad acts have been committed by the Debtor, most debts are forgiven (a few exceptions are discussed below); liens on assets have to be paid if the property is to be kept.

(2) Chapter 13 - “wage earner” - the Debtor submits information to show all assets and all liabilities; a Trustee is appointed to oversee the restructuring of debts. Creditors are paid back in whole or in part as requested by the Debtors, and as approved by the court.

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## **Q: How does someone know whether to file a Chapter 7 or 13?**

A: The decision to have debts forgiven under Chapter 7 or to formulate a plan for repayment under Chapter 13 is made after careful attention is given to the types of debts owed, the property owned, and the income of the Debtor. Almost everyone wants to pay his or her debts, but some people cannot afford to do what they want to do, and a Chapter 7 might serve their interests better. In South Carolina, approximately 50% or more of consumer bankruptcy cases filed are Chapter 13. Every situation is different, and can best be analyzed by an attorney, based upon your specific circumstances.

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## **Q: How is an action filed in bankruptcy court?**

A: A petition, indicating whether the case will be a Chapter 7 or 13, and notice is filed with the clerk of the bankruptcy court in Columbia. A Debtor must pay a filing fee, and attach a list of all creditors with addresses. There is no additional filing fee for a husband and wife filing a joint petition. After the petition is filed, no creditor is permitted to contact the Debtor directly, but must do so through the Debtor’s attorney. Notice of the filing is sent to each creditor, advising the creditor of the filing and the information concerning how to contact the Debtor's attorney. After that, or along with the petition, the Debtor must supply all of the information required by the Court, listing all assets, all debts, and giving other, detailed information including a specific explanation of monthly income and expenditures.

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**Q: How does the filing of a petition in the bankruptcy court affect creditors?**

A: Immediately upon filing with the bankruptcy court, whether under Chapter 7 or 13, all actions by creditors must stop; this includes pending court suits, claim and delivery actions, foreclosures, threatening correspondence, visits from collectors, and telephone calls. This prohibition on creditors is called the bankruptcy stay, and is an important element of the bankruptcy laws.

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**Q: Would I have to make a court appearance?**

A: Yes. There is at least one appearance, although not technically in “court,” that is required whether under Chapter 7 or 13. It is an initial meeting held about 30 days after filing. The appointed Trustee presides over this meeting; it is not attended by the Judge, and it is designed to permit creditors and interested persons to ask questions concerning the Debtor's assets or financial affairs. Unless there are complications in a case, this initial meeting, attended by the Debtor and counsel, is generally uneventful and brief, and might be the only court appearance by the Debtor.

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## CHAPTER 7

**Q: Why is a Chapter 7 the best option for some people?**

A: As mentioned earlier, sometimes people simply cannot repay their creditors, no matter how good their intentions. A Chapter 7 forgives a Debtor of most, if not all, of their debts. A few exceptions are

- ! most taxes
- ! child support and/or alimony
- ! most student loans
- ! court fines and criminal restitution
- ! debt arising out of personal injury caused by driving drunk or under the influence of drugs
- ! debt relating to money or property received by fraud

These exceptions either do not apply in a Chapter 13, or the debt that cannot be forgiven can be repaid in the plan of reorganization. That is discussed in more detail below. If a creditor has a mortgage on your house, or a lien on your car or other property, it is a secured creditor. Chapter 7 seems to work best for those people who have their secured creditors under control, who are willing to give up property attached to debt that they cannot afford, or who have very little secured debt, but who cannot pay their other creditors. A Debtor may struggle every month to pay the only secured creditor, the bank holding title to the Debtor's vehicle, but after paying living expenses, may have no money to pay to finance companies and unsecured creditors. Under Chapter 7, the Debtor would be required to continue paying the regular payment on the car loan, but would have all other debts discharged. If the Debtor did not want to keep the vehicle, or could not continue making the regular payment, the car would be returned to the secured creditor. This creditor would then hold an unsecured claim which would be discharged (forgiven).

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**Q: What am I allowed to keep under Chapter 7?**

A: The types of assets which you are allowed to keep are defined in the South Carolina Code. The Code puts certain dollar limits on the value of property which you can keep (called “exemptions”). If an asset is worth more than the amount listed, then it is subject to be sold by the Trustee, but that does not necessarily mean that it would be sold. This is a complicated topic, which would be most easily explained in the context of your particular assets, when you list them for the attorney, who will then be able to give you specific recommendations.

The values for an exemption are in the equity of an asset, so that, for example, if you owe \$5000 on a car worth \$6,200 or less, you fall within the exemption amount. Many people do not have assets above the exemption amounts, as the court looks at the liquidation value of these items, and not the replacement cost. Some examples of exemption amounts are listed at the end of this document.

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**Q: Can any taxes be forgiven in a Chapter 7?**

A: Yes. The interplay of the tax codes and the Bankruptcy Code is complex, but in somewhat oversimplified terms, if a tax return creating a tax debt was filed *more* than three years before the filing of the Chapter 7 petition, the tax debt *can* be discharged. Stated another way, if a Chapter 7 petition is filed *within* three years of the filing of the tax return creating the tax debt, the tax debt *cannot* be discharged, and the Debtor will still owe the taxing entity when the Chapter 7 is completed. Certain taxes, such as employer withholding taxes, will not be forgiven, however, even if they are older than three years, and if you have not filed your income tax returns, even older taxes may not be forgiven. Even then, however, a *Chapter 13* filing can allow more time to pay in accordance with a plan, without additional penalties and interest to accrue.

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**Q: How are cosigners affected by a bankruptcy filing?**

A: Cosigners remain responsible for debts that are discharged in another's bankruptcy. In Chapter 13, as discussed below, you may protect cosigners if a plan is filed which proposes paying the cosigned claim in full. This is true of debts guaranteed by others, whether you signed first or the other did.

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**Q: How does filing a Chapter 7 action affect my credit?**

A: Credit reporting institutions can report the fact that an individual filed a Chapter 7 for 10 years from the date the petition was filed. Even though this is reported, however, creditors may lend money to individuals who have filed bankruptcy—it is not illegal for creditors to loan money to you after bankruptcy, but it may be harder to find creditors willing to give loans. Rebuilding your credit usually requires obtaining credit to buy a specific item, perhaps with a meaningful down payment, and then hard work and timely payments to seek more credit. Generally, people needing to file a Chapter 7 have already tarnished their good credit standing, so that getting a low interest loan was not possible before. You may find it true that the fact that you would be debt free (or only indebted to a car and/or house creditor) will make you more attractive to lenders, despite the adverse effects of the bankruptcy filing.

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**Q:** Exactly how are **student loans** treated in Chapter 7?

**A:** The legislature has determined that society has an interest in persons being able to obtain government guaranteed assistance for education, and the automatic forgiveness of these debts after filing bankruptcy endangers this system. Under current law, unless the Debtor can show, in a separate lawsuit filed within the bankruptcy case, that an undue hardship would result, government-backed student loans *cannot* be discharged.

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## CHAPTER 13

**Q:** What is Chapter 13?

**A:** Chapter 13 is entitled "Adjustment of Debts of an Individual With Regular Income." The desired result of a plan in Chapter 13 is an adjustment, or a restructuring, of the debts of an individual or couple. Typically, the plan is used to restructure debts that a Debtor could not afford, so that the Chapter 13 plan actually can have the effect of reducing a car payment that is high and/or making up house payments that are behind.

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**Q:** Does the Chapter 13 Trustee take over my assets?

**A:** In the typical Chapter 13 plan, you keep your assets and enter into a payment plan in exchange for being able to keep all of your assets. That plan is monitored and administered by a Chapter 13 trustee. Among other duties, the trustee serves as a disbursing agent.

The Debtor pays the trustee a certain payment amount each month. The trustee is allowed to retain his fees of up to 10% (this amount changes from time to time, sometimes more than once a year) of the payment to cover his fees and expenses, and the rest is distributed to creditors according to the plan.

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**Q:** Does the trustee keep the Debtor informed as to payment progress?

**A:** No coupons are issued for each payment due, nor are monthly statements sent, but twice a year a computerized statement is sent to the Debtor and Debtor's attorney setting out how much money has been received and paid out under the plan. Each creditor's running balance is set out so that the Debtor can follow his or her progress in satisfying the debts owed.

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**Q:** How long can a Chapter 13 plan last?

**A:** A Chapter 13 plan cannot exceed 60 months. The Debtor has to pay for at least 36 months, unless all creditors are paid *in full* in less time.

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**Q: Who decides what kind of plan is filed?**

A: The Debtor's attorney should be aware of what kinds of plans can be confirmed under Chapter 13. Different kinds of creditors are treated differently in Chapter 13, and all cases differ. The attorney determines what type of plan would best serve the client's interests, discusses it with the client, and files such a plan with the court. Typically, a plan would provide for secured creditors to be paid for the value of items under lien, plus interest, for taxes and back support payments in full, without interest, for mortgage payments to be brought up to date and resumed at a particular date, and for a low percentage of the rest of debts to be paid, all over the course of time.

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**Q: How are secured creditors treated in a Chapter 13?**

A: Assuming the Debtor wants to keep the asset on which a creditor holds a lien, the plan must provide that the creditor is paid for the value of the item or for the balance owed, whichever is less. For example, if GMAC is owed a payoff of \$4,000 on a vehicle worth \$3,000, which the Debtor wants to keep, the plan must provide GMAC monthly payments so that it is paid \$3,000, plus interest. Oftentimes, the Debtors and secured creditors disagree on the value of such property. The court then needs to decide what the value is. The debts that cannot be reduced in this way would be your house mortgage, or any debt that is secured by a property which has a value greater than an amount which could be paid out affordably over a five-year period.

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**Q: What about secured creditors that have a list of my exempt household goods? How are they treated in a Chapter 13?**

A: These creditors, often finance companies, are generally treated as unsecured in Chapter 13. It is very helpful to the Debtors to have as many creditors and as much debt as possible classified as unsecured. In formulating a plan, the Debtor does not have to provide that unsecured creditors are paid monthly or be paid in full.

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**Q: How is mortgage debt treated in Chapter 13?**

A: Mortgages on principal residences must be paid directly. A plan would require payments each month direct to the mortgage company, in addition to the payment to the trustee to cover all other debts.

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**Q: Can Chapter 13 save my home?**

A: Yes. Unfortunately, with few exceptions, regular payments to creditors holding home mortgages cannot be lowered. But past due payments on mortgages can, however, be made up over a long period of time through payments into the Chapter 13 plan. A plan would typically provide for you to pay the trustee, plus restart your regular payment to the mortgage company beginning the month after the case is filed, or possibly two months— the mortgage payments are made directly by the Debtor to the mortgage holder.

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**Q: Can I save my house if the mortgage holder has started a foreclosure action?**

A: As long as there has not been a foreclosure *sale*, even after foreclosure paperwork has been sent to you, the foreclosure action would be stopped with the filing of the bankruptcy case, and the mortgage default could be made up. If you are able to formulate a plan that meets the tests below, and would provide for resuming the payments and making up the default, then a bankruptcy filing would still save the house.

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**Q: How can you figure out what a monthly payment will be?**

A: There are really four tests that are used by courts in deciding whether to confirm a Chapter 13 plan. The Debtor needs favorable rulings on *all* of the following issues, and may have other criteria to consider:

- (1) Are the unsecured creditors getting as much over the life of the plan as they would have received if the Debtor had filed a Chapter 7 and property was sold?
- (2) Does the plan pay all secured creditors in full, plus interest, to the extent of the value of collateral, and pay all past due support and taxes in full?
- (3) Does the monthly amount equal the amount available from all of the Debtor's income after reasonable expenses, for at least three years?
- (4) Does the overall effect of the plan suggest the Debtor is acting in good faith?

The Debtors sometimes have to propose more than one plan in order to convince the trustee and the Court that the plan meets all of the criteria above.

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**Q: Is it true that even if a Chapter 7 won't forgive certain debts, a Chapter 13 might?**

A: Yes. A Chapter 13 discharge is greater, because it forgives more debt in exchange for pledging your income to the Court for at least three years. As long as the plan meets the tests above, the potentially nondischargeable debt could merely be an unsecured claim subject to the same treatment as all other unsecured claims. Taxes less than three years old (from the date the return was due) are not forgiven, but the interest and penalties can be frozen, so that only the debt owed at the time of filing would have to be paid, and an extended period of time could be granted within the plan to pay it. Back child support and alimony can be cured through a plan, as well, as long as future payments resume immediately after filing. Student loans, unfortunately, cannot be paid in full through a plan, and are also not forgiven in a Chapter 13, unless the Debtor, in a separate lawsuit filed in the bankruptcy case, can show undue hardship.

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**Q. Can a Chapter 13 Debtor sell any of his or her assets while in Chapter 13?**

A: Yes, after applying for obtaining court permission. The Debtor can keep the funds generated from the sale if the funds would have been exempt in a Chapter 7. If an asset is sold and the sale results in payment of a secured creditor that had been receiving money from the trustee, the Debtor may also seek to have the trustee payment lowered.

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**Q: How are cosigned debts treated in Chapter 13?**

A: If a Chapter 13 plan proposes full payment of a claim where a cosigner is responsible for a consumer debt, the creditor cannot attempt to collect such debt from the cosigner. If the payment to the creditor is reduced, and the creditor is still paid in full, the creditor has to be content with getting payments from the trustee in such circumstances. It is possible, however, that, unless the plan pays the contract rate of interest, the balance of the interest not paid could be sought after the completion of the case from the cosigner.

If the Chapter 13 plan does not propose to pay the claim in full, then to the extent that it does not, the affected creditor can petition the bankruptcy court for permission to collect this money from the cosigner.

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## GLOSSARY OF TERMS

**Discharge** - The forgiveness or cancellation of the debt or debts.

**Exemption** - assets which are outside the reach of the trustee. The assets are defined by the type of property and the value which they can have, after liens are paid, before they are subject to the reach of the trustee. Here are some examples of exemption amounts in South Carolina:

**Residence (Homestead) or burial plot:** Each Debtor can claim \$5,000 equity in a house or mobile home used by the Debtor or a dependent of the Debtor as a principal residence. A husband and wife, therefore, get \$10,000.

**Motor vehicle:** Each Debtor is allowed \$1,200 equity in one vehicle.

**Household goods:** Each Debtor is entitled to \$2,500 in household goods such as furniture, appliances, furnishings, wearing apparel, books, musical instruments, animals, and other items held for personal or family use.

**Liquid assets:** If the Debtor does not use the homestead exemption, he or she can claim as exempt \$1,000 in liquid assets such as cash, bank deposits or stocks.

**Jewelry:** Each Debtor is permitted to have jewelry worth \$500.

**Tools of trade:** The Debtor can claim as exempt \$750 in tools or implements of the Debtor's trade. These items can include hand tools, books, computer hardware or software, and other items used in work.

**Life insurance:** The Debtor is permitted to have cash value in life insurance in an amount not to exceed \$4,000.

**Health aids:** The Debtor can retain all professionally prescribed health aids no matter how valuable.

**Secured creditor** - one who has lent money to enable someone to buy (purchase money) property, such as furniture or appliances, or a creditor with collateral, such as a lien on the title to a vehicle, or mortgage on land/house.

**Nonpurchase money secured creditor** - if a creditor has a list of household items for collateral, where money was not lent to the Debtor to buy the items listed, the Bankruptcy Code permits avoidance (or cancellation) of such liens, subject to some limitations. Such creditors are often finance companies.

**Unsecured creditor** - A creditor with no collateral is an unsecured creditor. Most department store charge cards (except where "big ticket" items such as appliances are purchased), credit cards, such as American Express, Visa and MasterCard, signature loans and open accounts are unsecured. Outside of bankruptcy, if these creditors are not paid, they can file suit and obtain a judgment, however, they have no collateral to repossess if they do not obtain a judgment.