The Law On Debt

The Federal Bankruptcy Code provides consumers with two forms of debtor relief.

Chapter 7 of the code is the straight bankruptcy provision and provides for liquidation (conversion into cash) of the debtor's assets.

With bankruptcy under Chapter 7, you give up the property you put up for collateral when using credit, unless the debts are reaffirmed by court permission and you continue to pay the creditor.

Chapter 13 is the wage-earner's plan. With Chapter 13, you promise to pay existing debts with part of the income you will earn in the next few years. While paying the debts, you will be able to keep the things you bought on credit if your plan is approved by the courts.

Chapter 7 Bankruptcy

Chapter 7 allows a person overburdened with debts to make a fresh start by discharging most of the claims against him or her.

The granting of a discharge after the filing of a bankruptcy petition in federal court releases or discharges you from the legal responsibility of your debts once the petition is approved. Once the petition is filed, garnishments and lawsuits can be stopped if proper papers are filed with the court; you are protected by the automatic stay provision of the bankruptcy code.

Your attorney will file the petition with the clerk of the United States Bankruptcy Court in the area in which you have been living for the past six months. A filing fee must be paid to file. This fee is in addition to fees charged by your attorney for his or her services. You must file a list of all your debts and creditors.

A detailed list of all property you own, money owed you, insurance policies owned, and property that may be inherited within six months also must be filed. You must also file a detailed statement of your financial affairs.

Once the bankruptcy petition has been filed, a trustee will be appointed by the court. The trustee presides over the first meeting of creditors in the bankruptcy proceeding. The trustee liquidates certain non-exempted assets and non-reaffirmed debts and these proceeds are distributed to your creditors.

All your listed creditors are notified and given the option to attend a meeting, at which you will be present, to file claims on the debts you owe them. The court-appointed trustee takes administrative control of your property that is to be sold and delivers property to the secured creditors. Once property has been sold, administrative costs are paid and the remaining cash is paid proportionately to all creditors.

The bankruptcy court holds a hearing to inform you that your debts have been discharged or gives you a reason they were not discharged. You may reaffirm certain debts with the court's approval if you desire to keep the collateral and if it is in your best interest.

For instance, if you wish to keep your car, you can reaffirm the debt and continue to make payments. You do not have to reaffirm the debt; however, if you do, you become legally liable for the reaffirmed debt. The bankruptcy process takes a number of months from date of filing until date of discharge.

Bankruptcy claims may be voluntary or involuntary; most are voluntary. The only requirement for filing is that the debtor owe one or more debts.

The following debts cannot be eliminated in bankruptcy:

- State and federal taxes owed within the past two years before filing bankruptcy
- Money or items received by fraud or false pretenses
- Unlisted debts, unless creditor had knowledge of bankruptcy filing
- Child support or alimony
- Debts incurred by embezzlement, fraud or larceny
- Willful or malicious injury to another person or person's property by the debtor
- Government-imposed fines or penalties, such as tax penalties

- Student loans guaranteed by the government or a non-profit educational institution (unless paying back the loan causes undue hardship on the debtor or the debtor's dependents or if the loan came due 5 years before filing for bankruptcy)

Chapter 7 can only be declared every six years. However, if you get into financial trouble before the end of six years, you can file Chapter 13.

Chapter 13 Wage-Earner's Plan

Chapter 13, or the wage-earner's plan, is a voluntary repayment plan. When you complete the plan, you have the satisfaction of keeping your assets, paying your creditors and discharging your debts.

When filing Chapter 13, you agree to pay approximately 25 percent of your income to the court. The court appoints a trustee to handle your money and pay your debts. The trustee also provides advice and counsel when necessary.

To file Chapter 13, first contact an attorney who has experience in filing Chapter 13 petitions.

The attorney then files the petition with the federal court. A court-appointed trustee is responsible for reviewing the petition, confirming the petition, paying the debts and advising and counseling the debtor. After that, the court clerk sends notice of court action to creditors and the employer.

The employer sends a portion of your paycheck to the court trustee, who pays creditors. Secured debts are paid first, followed by unsecured debts. The debtor cannot borrow more money without approval of the court trustee.

The actual amount of money that is paid to creditors depends on the amount owed, the debtor's salary and the payback timeframe. Chapter 13 payment plans may not be proposed for longer than 36 months, unless you can show reason for extending the plan. The maximum time allowed is five years.

Administrative costs may be high. They include the court costs, filing fee, the attorney's fee and the trustee's fee for paying off the debts. The trustee also may receive a fee for expenses such as a computer and supplies.