



Legal Insurance



Bankruptcy Basics

For most people, the idea of filing for bankruptcy doesn't sound like a very appealing or proactive financial plan to tackle debt. However, those who are buried in unmanageable debt may find that filing for bankruptcy protection can offer a lifeline – and hopefully a fresh start – if they fully understand the ins and outs of how it works.

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Reasons Why People File for Bankruptcy

With American households amassing more than \$1.316 trillion in revolving debt¹ – one could argue that U.S. consumerism plays a large role in the overspending that causes people to file for bankruptcy. But there are also other scenarios where people face potential bankruptcy:



Medical costs. If you have an accident or face critical illness, your medical insurance may not provide complete coverage, leaving you with high out-of-pocket costs or large medical bills.



A job loss. A loss of employment can quickly take away your ability to make mortgage or car payments, pay utility bills or cause you to fall behind on monthly credit card debt.



A divorce. In many cases, a divorce may involve lengthy legal proceedings and costly attorney fees, along with the added costs of relocating and starting two separate households.

Ironically, many times these situations force people to rely more and more on credit cards for purchasing essential items like food or clothing or paying bills, which in turn leads the person to file for bankruptcy because of runaway monthly credit card debt.



Understanding What Bankruptcy Is...and Isn't

Bankruptcy isn't a quick-fix or easy solution; rather, it should be considered a last resort. That's why before deciding to file in federal bankruptcy court, most individuals and businesses will first try credit counseling and debt consolidation. But if you've tried everything you can think of to resolve your debt and the load is still too heavy to manage, it may be time to consider bankruptcy.

So what is bankruptcy?

Simply put, it's a legal process through which the federal bankruptcy court looks over an individual or business's assets and liabilities, and either reduces, restructures or eliminates debts.² When you're drowning in debt and see no other way out, bankruptcy can provide a second chance.

What About Debt Relief Services?

If you're struggling to repay significant credit card debt, and can't work out a repayment plan with your creditors on your own, debt relief services like credit counseling or a debt management or settlement program may offer assistance. Depending on the type of service, you might get advice on how to deal with your mounting bills or create a plan for repaying your creditors.

Before you do business with any debt relief service, the Federal Trade Commission recommends checking it out with your state Attorney General and local consumer protection agency. Also find out what services an organization or business provides, the terms of the agreement and how long it may take to get the results they promised. Get everything in writing and read your contracts carefully.³

What Filing Costs You

It's important to be aware of the costs associated with filing for bankruptcy. Beyond the obvious attorney fees and court costs, bankruptcy also carries long-term financial and legal consequences – affecting your credit and potential access to money for years to come. Bankruptcy typically remains on your credit report for 7-10 years, depending on which chapter you file. Bankruptcy can even cause issues when you apply for jobs down the road.

Still, if you're considering bankruptcy, your credit score likely is damaged already. As long as you pay your bills consistently and on time after filing, your credit report may not suffer much more.



Types of Bankruptcy

A bankruptcy case normally begins when a debtor files a petition with the bankruptcy court. A petition may be filed by an individual, by spouses together or by a business.⁴

All bankruptcy cases are handled in federal courts under rules outlined in the U.S. Bankruptcy Code.

Although there are several different types of bankruptcy – referred to by their chapter in the U.S. Bankruptcy Code – individuals and businesses most commonly file for Chapter 7 (liquidation) and Chapter 13 (reorganization) bankruptcy.

Chapter 7 bankruptcy

When you file for Chapter 7 bankruptcy, the judge or court trustee will require that some of your property be liquidated (sold) and will then use the proceeds to pay back debt to your creditors. However, state law protects or “exempts” certain key assets. In addition, part of the property may be subject to liens and mortgages that pledge it to specific creditors.

Examples of exempt property include: Your house, the car you use for work, equipment you use specifically at work, Social Security checks, pensions, veteran’s benefits, welfare and retirement savings accounts. It’s unlikely the court would allow any of these to be sold or used to repay debt.

Non-exempt property would include: Cash, bank accounts, stock investments, coin or stamp collections, other valuable collections, a second car or home, etc. Non-exempt items will be liquidated, and the proceeds used to repay creditors.

Chapter 13 bankruptcy

Chapter 13 bankruptcy allows you to keep your property, develop a payment plan and repay all or part of your debts over a period of time – usually three to five years. Sometimes called a “wage earner’s plan,” Chapter 13 bankruptcy offers advantages that the liquidation-focused Chapter 7 bankruptcy doesn’t, such as:

- Potentially saving your home from foreclosure
- Rescheduling secured debts for lower payments
- Financial protection of any co-signers

Individuals can only file for Chapter 13 bankruptcy if their debts do not exceed a certain amount. Because you’ll need to stay current on your monthly payments, Chapter 13 works best for those with higher, steady incomes.

Other types of bankruptcy include:

- Chapter 9 bankruptcy – For cities and towns only, Chapter 9 bankruptcy protects municipalities from creditors while the city comes up with a plan for handling its debt.
- Chapter 11 bankruptcy – Geared toward reorganizing businesses, Chapter 11 bankruptcy provides companies with the opportunity to remain open for business while they restructure debts and assets.
- Chapter 12 bankruptcy – Designed for “family farms” and “family fishermen.”
- Chapter 15 bankruptcy – Applies to debtors with assets in both the U.S. and in another country. (The U.S. courts are applicable only to those assets and individuals within the U.S.)

What Debts Can (and Can't) Be Forgiven

Because bankruptcy can have serious long-term effects on credit, many experts recommend that you only file if you have more than \$15,000 in debts. And it's critical to note that while bankruptcy will eliminate some debt, it won't get rid of all debt. Take a look at a few examples of how Chapter 7 and Chapter 13 bankruptcies normally treat certain types of debt.

- Consumer debt – bankruptcy will eliminate most consumer debt, such as credit cards and medical bills
- Secured debt – for mortgages or car loans, you'll have the choice of having the property repossessed and the proceeds used to pay down debt, or keeping the property and continuing to make scheduled payments
- Other unsecured loans or debts may be forgiven
- Property considered "essential" to work and maintain a home (clothes, home furnishings, equity in a car, etc.) is usually exempt.

Bankruptcy typically won't discharge:

- Child support
- Alimony
- Federal student loans
- Taxes
- Other secured loans

Additionally, bankruptcy can't stop a creditor from repossessing property.



How Bankruptcy Works (When You're Ready to File)

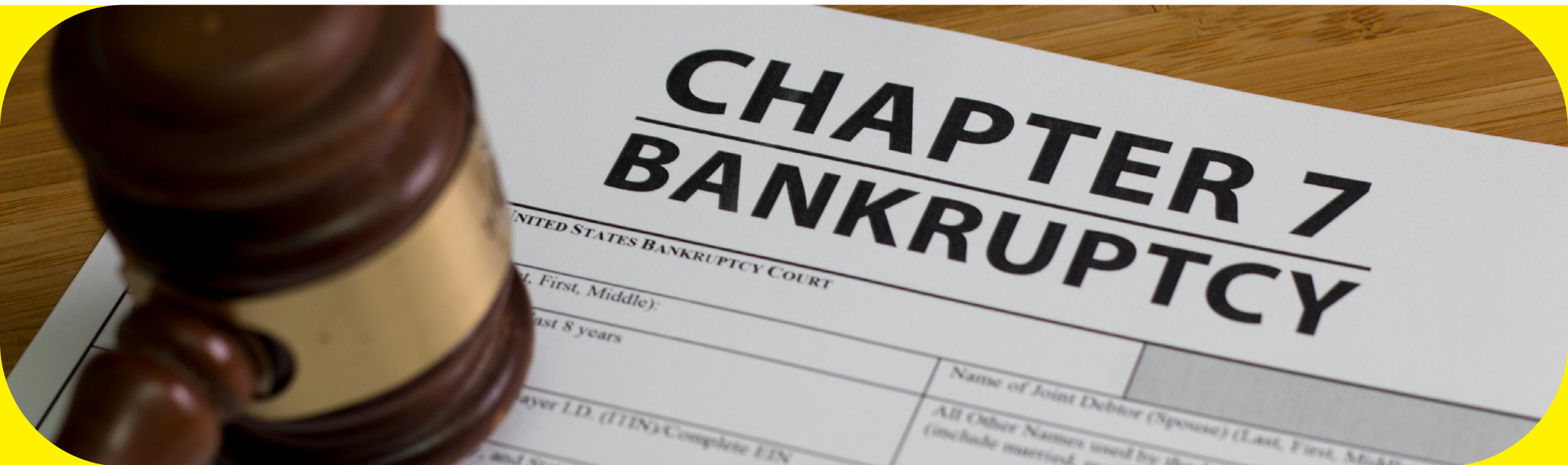
If you're to the point of filing bankruptcy, you've likely already compiled your financial records – income, expenses, debts, assets, etc. The next step is a required one: You must undergo credit counseling within 180 days of filing your case, and it must be from an approved provider listed on the [United States Courts website](#).² Most counseling agencies provide this service online or over the phone.

The next step is to file a petition for bankruptcy. You can choose to represent yourself, and it's not required that you have bankruptcy lawyers for Chapter 7 or Chapter 13 bankruptcy. But it's important to note that bankruptcy attorneys can help steer you through the often-confusing federal and state bankruptcy laws that may (or may not) apply to your case – especially when it comes to which debts can be discharged. Keep in mind, judges and court employees are not permitted to offer advice or opinions.

Once the court accepts your petition, the case will be assigned to a court trustee. He or she is responsible for making sure you and your creditors are able to meet to discuss the details of your case. Even if all creditors are unable to attend such meetings, you are required to be there.



If you can't afford to hire an attorney, you may still have options for legal counsel. Check with the American Bar Association's free [FindLegalHelp.org](#) for information and resources.



Other Resources

- USA.gov, [Bankruptcy Basics](#)
- Debt.org, [What Happens When You File Bankruptcy?](#)
- Federal Trade Commission, [Coping with Debt](#)

¹Federal Reserve. "Consumer Credit – Historical Data." Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/releases/g19/hist/cc_hist_sa_levels.html.

²Debt.org. "Bankruptcy." Debt.org, <https://www.debt.org/bankruptcy/>.

³Federal Trade Commission. "Dealing with Debt." Federal Trade Commission Consumer Advice, <https://consumer.ftc.gov/node/78376>.

⁴U.S. Courts. "Bankruptcy." UScourts.gov, <https://www.uscourts.gov/court-programs/bankruptcy>.



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