

USAACE & Fort Rucker Preventative Law Program

Bankruptcy

THIS PAMPHLET contains basic information on this particular legal topic for your general information. If you have specific questions, contact the Legal Assistance Office.



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WHAT IS THE MAIN PURPOSE OF BANKRUPTCY?

Bankruptcy is a legal proceeding governed by Federal law for people who cannot meet their financial obligations after they have honestly made a diligent effort to pay their debts. The person seeking a bankruptcy proceeding or filing for bankruptcy is called the “debtor.” “Creditors” are those to whom a debtor owes money. The bankruptcy proceeding allows debtors to go to court to get debts modified or forgiven. Therefore, a debtor must file for bankruptcy in a federal bankruptcy court rather than in state court.

Bankruptcy has a wide variety of purposes, one of which is to relieve an honest debtor of certain debts, thereby providing an opportunity for a *fresh start*. Filing for bankruptcy is not necessarily a “free ride” to dispose of debt—there are long term consequences which are discussed below. Bankruptcy also benefits creditors by allowing them an opportunity to possibly collect a portion of the debtor’s debt once bankruptcy is filed.

WHY FILE FOR BANKRUPTCY?

Filing for bankruptcy immediately (but only temporarily) stops all creditors from trying to collect debts from you. Once you file for bankruptcy, creditors may not collect debts from you (or harass you about debts due to them) until the bankruptcy court has reviewed your case and made a decision as to how and when your creditors will be paid. Filing for bankruptcy may also stop the foreclosure on your home, help you catch-up on missed payments, prevent repossession of your property, and stop some wage garnishments.

CONSIDERATIONS BEFORE FILING FOR BANKRUPTCY

1. Ability to Make Payments

If you are only eligible to file a Chapter 13 or would rather file a Chapter 13, you must make a realistic assessment of your ability to make payments on the debt. You must have a regular income and you must have some income left over after paying for essential living expenses in order for a Chapter 13 to work.

2. Desire to Pay Creditors

The debtor must show a desire that he or she wants to pay his or her creditors to the fullest extent possible.

3. Co-Debtors/Guarantors

If members of your family co-signed a loan for you and you want to protect them (i.e. prevent them from being responsible for the entire amount of the loan), you should file for a Chapter 13. Even if you are eligible for Chapter 7, there are no provisions in Chapter 7 that protect co-signers on a loan.



4. Desire to Re-establish Credit

You should note that debtors filing for bankruptcy may not be able to get credit from major lenders or if they do receive credit, it may involve stricter terms or higher interest rates. Additionally, a debtor's credit report may show the bankruptcy for up to 10 years.

If possible, it may be better to file a Chapter 13 bankruptcy rather than a Chapter 7 bankruptcy because creditors may look more favorably on a debtor who makes an attempt to repay at least some of his or her debts.

ALTERNATIVES TO FILING BANKRUPTCY

Before filing for bankruptcy, you should consider other means of solving your financial problems. You can make an appointment with Army Community Service (ACS) to speak with a financial counselor by calling (334) 255-9631/2594. The counselor can help you establish a monthly budget and explain other money-saving techniques. This service is provided free-of-charge to Soldiers and their Families.

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

2. Negotiate a Payment Plan with Creditors: 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 you owe. They may be willing to settle for much less than the full amount. A credit counseling agency may provide you with assistance in this area, but they often charge a fee.

3. Debt-Consolidation Loan: Sometimes obtaining a loan from a financial institution will be beneficial; by paying off your debts in one lump sum, you avoid the individual high-interest payments you usually make on all your debts. If you cannot obtain a loan from a bank, you may consider asking family members for a loan. If you obtain a loan from a family member, make sure your agreement is in writing and that you define how much interest (if any) you will pay them.

PREREQUISITE FOR FILING FOR BANKRUPTCY

All persons planning to file for bankruptcy must attend a credit counseling class or meeting within 180 days prior to filing for bankruptcy. The credit counseling agency must be an approved, non-profit counseling agency, and must provide a certificate to the debtor stating the type of meeting he or she attended and the type of information that was received. The debtor will be required to pay for the credit counseling.



WHAT ARE THE DIFFERENT TYPES OF BANKRUPTCIES?

The two types of bankruptcies that individual debtors are eligible for are Chapter 7 bankruptcies and Chapter 13 bankruptcies. In 2005, the federal bankruptcy laws changed significantly making it more difficult for people to file a Chapter 7 bankruptcy and essentially wipe the slate clean (i.e. discharge all of their debt).

WHAT IS A CHAPTER 7 BANKRUPTCY (STRAIGHT BANKRUPTCY)?

A Chapter 7 bankruptcy is often referred to as a “liquidation” bankruptcy. In a Chapter 7 case, the Bankruptcy Court appoints a trustee, and the trustee is required to collect all non-exempt property from the debtor’s estate, reduce it to cash, and pay the debtor’s creditors in a prescribed manner. After this process is complete, the debtor will receive a discharge from the Court, resulting in the debtor being “debt-free.” Thus, the term “liquidation” refers to the process of reducing a debtor’s estate to cash and distributing the proceeds to the creditors in order to satisfy any existing debt. Not all of a debtor’s property is available for liquidation, as some of the property will be exempt. Exempt property will be discussed in more detail below.

WHAT IS A CHAPTER 13 BANKRUPTCY (REORGANIZATION PLAN)?

A Chapter 13 bankruptcy, referred to as “reorganization” bankruptcy, is designed for a debtor who has a regular source of income, and who desires to repay all or a percentage of his or her debts pursuant to a plan that the debtor proposes to the Bankruptcy Court. Chapter 13 is different than a Chapter 7, inasmuch as the Chapter 13 debtor usually remains in possession of the property of the estate and makes payments to creditors, through the Chapter 13 trustee, based on anticipated income over the life of the Chapter 13 plan.

WHO IS ELIGIBLE TO FILE A CHAPTER 7 AND CHAPTER 13 BANKRUPTCY?

The bankruptcy code applies to individuals, partnerships, and corporations that reside or have domicile, a place of business, or property in the United States. Generally, if the debtor’s monthly income is below or slightly above the median income of the state, the debtor is eligible to file for Chapter 7 bankruptcy. If the debtor’s monthly income is above the median, the debtor must file for Chapter 13.

WHAT ARE THE PROCEDURES TO FILE A CHAPTER 7 OR CHAPTER 13 BANKRUPTCY?

The following procedures must be followed in order for the debtor to be eligible for either Chapter 7 or 13 bankruptcy: First, the debtor must take an approved financial counseling course 180 days prior to filing. Second, the debtor must compare his/her monthly income with the median income of the state in which he/she lives. Finally, the debtor must take an approved educational course on financial management.



WHAT TYPE OF BANKRUPTCY MAY I FILE?

1. Is the family earning above the median income for their state (The Means Test)?

The median incomes for each of the 50 states can be found at http://www.usdoj.gov/ust/eo/bapcpa/20150401/bci_data/median_income_table.htm. In Alabama, the 2015 median family income for a two-person family was \$50,614.00 and the 2015 median family income for a four-person family was \$66,442.00.

If your family does NOT earn above the median income for the state, you may file a Chapter 7 or Chapter 13 bankruptcy. (*Chapter 7 is more beneficial because debt will actually be discharged meaning you will not have to pay it rather than Chapter 13 where you will be required to make payments on the debt over time.*)

2. If the family earns above the median income for their state, do they have an excess monthly income of more than \$166.66 per month to pay \$10,000.00 of debt over five years?

If your family has more than \$166.66 per month left after paying any secured debt (such as car loans or mortgages where the creditor can actually take the property if you fail to pay the loan), priority debts (such as child support, alimony, or tax debts), and necessary living expenses, you may NOT file a Chapter 7 bankruptcy. However, you may still file a Chapter 13 bankruptcy.

3. If the family does not have \$166.66 excess per month, does the family have \$100 or more a month of excess income? If so, if the family made payments of at least \$100 a month for five years, would that eliminate at least 25% of the unsecured debt?

If your family has more than \$100.00 but less than \$166.66 left after paying secured debts, priority debts, and necessary living expenses, you have to determine whether you would be able to pay off at least 25% of your unsecured debts (credit cards, etc.) over the course of five years if you used the monthly excess to make monthly payments towards that debt.

If you are able to pay off at least 25% of the unsecured debt over five years, you may NOT file a Chapter 7 bankruptcy. However, you are still eligible to file a Chapter 13 bankruptcy.

WHAT IS “PROPERTY OF THE BANKRUPTCY ESTATE”?

The creation of the bankruptcy estate occurs automatically upon the filing of a bankruptcy petition. The bankruptcy estate, often referred to as Section 541 property, includes all the debtor’s property, real or personal, tangible or intangible, at the time the petition is filed. This property is the subject matter of the estate and may be available for disposition to creditors. Remember, however, that certain property may be excluded from the bankruptcy estate, and, therefore, it is important to consult an attorney regarding these issues.





STEPS IN THE BANKRUPTCY FILING PROCESS (CHAPTERS 7 AND 13)

1. Filing

To initiate the bankruptcy process, you must file the petition in the appropriate federal court. Pursuant to 28 U.S.C. 1408, the petition must be filed in the bankruptcy court in the district where the debtor is domiciled or has resided for the past 180 days or where the principal assets of the debtor have been located for the greater part of the 180 days preceding the filing of the petition.

2. Schedules

Along with the petition for bankruptcy, you are required to file schedules listing all your creditors as well as any property you own, your income and expenditures, and any other financial assets or liabilities you may have.

****If you fail to list a debt on the schedule submitted with your petition, you will remain liable for that debt regardless of the outcome of your bankruptcy proceeding.****

3. Appointment of Bankruptcy Trustee

Once the Office of the Clerk of the Bankruptcy Court has received your petition, the Clerk will appoint a disinterested member from a panel of individuals approved to be Trustees to serve as an “interim Trustee” in your case. The trustee will then collect all of the debtor’s property (except the few things that are exempt) and manage it on behalf of the creditors until the bankruptcy proceedings are terminated and/or complete.

4. Granting of an Automatic Stay

The automatic stay is a device that protects the debtor, the property of the estate and the property of the debtor from certain actions by creditors *after a bankruptcy petition is filed*. In essence, the automatic stay halts most actions against the debtor so as to give the debtor “breathing room” in order to properly administer the case. Once the bankruptcy petition has been filed, the automatic stay prohibits the following acts:

- a. Any lawsuit against the debtor to recover any debt or claim that occurred before the bankruptcy petition was filed.
- b. The enforcement of a pre-petition judgment against the debtor or against property of the estate.
- c. Any act to obtain possession of estate property or property in the estate’s possession, regardless of whether the underlying claim arose before or after the filing of the bankruptcy petition.
- d. Any act designed to create, perfect or enforce a lien against estate property or the debtor’s property, such as a mortgage foreclosure.





e. Creditors may not bother, intimidate or harass the debtor about repayment of pre-petition obligations. The classic example is when a creditor constantly calls or writes a debtor for the purpose of collecting a debt.

f. The commencement or continuation of a case in the United States Tax Court is specifically stayed.

There are also exceptions to the automatic stay. Thus, the filing of a bankruptcy petition **does not** operate as a stay of the following actions:

- a. Criminal proceedings
- b. Alimony and/or child support
- c. Modification orders to spousal or child support and/or paternity suits
- d. Enforcement of judgments by governmental units
- e. Mortgage foreclosures where the mortgage is secured by the Housing and Urban Development (HUD) agency
- f. Transfer of real property without consent from the secured creditor or the court
- g. Eviction proceedings between a landlord and tenant if the eviction proceeding occurred prior to filing the bankruptcy petition, or if there is endangerment to the property or illegal use of a controlled substance on the property within 30 days prior to filing the petition for bankruptcy
- h. There are others that are rare and do not usually concern Servicemembers, Retirees, and their Families.

In addition to appointing a Trustee, once the Office of the Clerk of the Bankruptcy Court has received your petition, the Clerk will issue a notice to all of the creditors you listed in your petition/schedule informing them that they are prohibited from attempting to collect their debts. An automatic stay is a very valuable form of relief because it can block foreclosure on a mortgage, repossession by secured creditors, and it can even block actions by the IRS. If a creditor violates the stay order, the debtor can petition the court for damages, costs, attorney's fees, and punitive damages.

The creditor may request the court lift the automatic stay when there is a lack of adequate protection for the creditor. This can occur when the debtor is holding property which is collateral for a secured creditor's claim and the property is depreciating or is inadequately insured or cared for, and the debtor is not making any payments.

Generally, if the stay is not lifted, the protection of the automatic stay lasts until the bankruptcy proceedings are over.



5. The Creditor's Meeting

The court will schedule a meeting of the creditors (341 meeting) between 20 and 40 days following the filing of the bankruptcy petition. This meeting allows the creditors to examine the debtor under oath regarding the petition or schedules filed by the debtor. Generally, the Trustee begins by asking the debtor to confirm he or she read the petition and was truthful as to all matters. After the Trustee asks questions, the creditors may ask questions if they attend the meeting. Also at this meeting the creditors can elect a permanent Trustee.

6. Classifying Debts and the Payment of Creditors

Creditors are generally paid in the following order:

1. Priority Claims/Non-dischargeable Debts (ex. child support)
2. Secured Creditors (ex. mortgage or car loan)
3. Unsecured Creditors (ex. credit cards)

Priority claims cannot be discharged in bankruptcy. This means that if you have any priority claims, you will still be responsible for paying them, even if you file for bankruptcy. Secured debts are paid first after all your assets have been liquidated and then unsecured debts are paid if there is any money left.

A debtor with secured debts must tell the court after filing the initial petition for bankruptcy how he or she will deal with those debts throughout the bankruptcy proceeding. Generally, the debtor has four options: 1) surrender the property to the creditor; 2) redeem the property (i.e. pay the balance owed on the property to the creditor); 3) reaffirm the debt by entering into a reaffirmation agreement with creditor; or 4) enter into an informal agreement with the creditor where the debtor agrees to keep payments up to date and the creditor agrees not to repossess the property during the bankruptcy proceedings.

7. Discharge

The debts the debtor listed in the petition will be discharged (i.e. forgiven) when the debtor successfully completes the Chapter 7 or Chapter 13 bankruptcy plan. In a Chapter 7 case, a discharge order is usually entered a little over 60 days after the first date the creditors meet, assuming that no objection to the discharge has been filed by that time. In a Chapter 13 case, the discharge is granted after the debtor completes payments under a confirmed plan or upon application by the debtor for a hardship discharge.

The following debts are some of the debts considered by the Bankruptcy Code to be non-dischargeable:

1. Taxes
2. Child Support



3. Maintenance or Alimony (Spousal Support)
4. Property obtained by false pretenses (includes credit cards)
5. Student Loans (student loans are not dischargeable unless the continued payment of the loan will impose an undue hardship on the debtor and his or her dependents)
6. Debts that Caused Willful or Malicious Injury
7. Death or Personal Injury (judgments against the debtor for causing death or personal injury by the operation of a motor vehicle if the operation was unlawful because the debtor was intoxicated)
8. Fraud or Defalcation (embezzlement, larceny, etc.)
9. Debts scheduled or that could have been scheduled by the Debtor in a prior bankruptcy (if debtor waived or was denied discharge)
10. Debts not scheduled in the petition

EXEMPTIONS

In most circumstances, an individual debtor does not lose all assets as a result of bankruptcy. A debtor is entitled to certain exemptions which allow the debtor to keep property of the estate. These exemptions will vary depending on the state in which the debtor lives. In general, under the Bankruptcy Code, the maximum exemptions of a debtor's interest in property are as follows:

a. **Homestead:** The debtor may exempt up to \$20,200.00 in real or personal property of the debtor or dependent that is used as a residence. This exemption is applied to the equity in the residence. Thus, the exemption may only cover the difference between the amount of the loan or mortgage and the value of the home.

b. **Motor Vehicle:** There is a maximum exemption of \$3,000.00 allowed for one motor vehicle. This exemption works like the homestead exemption, where the exemption is only applied toward the equity in the vehicle. Thus, if there is a loan on the vehicle, the debtor must continue to make payments if he or she wishes to keep the vehicle.

c. **Household Goods:** There is an exemption of up to \$525.00 on any particular item, or \$10,775.00 in aggregate value of household goods.

d. **Jewelry:** There is generally a \$1,000.00 exemption in jewelry for the debtor or dependent.

e. **Wildcard exemption:** There is an exemption of up to \$1,075.00, plus up to \$10,125.00 of any unused portion of the homestead exemption, *on any property*. This





exemption is designed primarily for the benefit of non-homeowners. There is no wildcard exemption in Colorado.

f. **Tools of the trade:** The debtor may exempt \$2,025.00 in professional books or tools of a trade.

g. **Life insurance:** Any unmatured life insurance contract owned by the debtor may be exempted.

h. **Loan value or accrued interest of life insurance:** Up to \$10,775.00

i. **Health aids:** Such as wheelchairs, hearing aids, kidney dialysis machines, etc.

j. **Government benefits:** There is an exemption for the debtor's right to receive social security benefits, Veteran's benefits, local public assistance, unemployment benefits or compensation, or disability or illness benefits.

k. **Alimony, support or maintenance received from another**

l. **Pension benefits**

m. **Crime Victim awards**

n. **Wrongful Death awards**

o. **Personal Injury awards:** Up to a maximum of \$20,200.00.

WILL FILING FOR BANKRUPTCY AFFECT MY SECURITY CLEARANCE?

Yes. Filing for bankruptcy, under most circumstances, may prevent you from keeping or obtaining a security clearance. Pursuant to AR 380-67, the criteria for determining eligibility for a security clearance includes "excessive indebtedness, recurring financial difficulties, or unexplained affluence." Therefore, filing for bankruptcy is one factor that may be considered in deciding whether a security clearance should be issued or suspended. For more information regarding this issue, please contact a legal assistance attorney or the security manager.

BANKRUPTCY AND THE SERVICEMEMBER

The Bankruptcy Code provides that no governmental unit may discriminate with respect to employment because an individual has filed for bankruptcy. While a Servicemember has the right to file for bankruptcy, a member can be prosecuted under Article 134 of the UCMJ 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. However, loss of access is not automatic and is based on each individual case.





HOW MANY TIMES MAY I FILE FOR BANKRUPTCY?

A debtor may file a Chapter 7 bankruptcy petition again no sooner than six years after he/she was discharged from a previous Chapter 7 filing. This rule applies to people who have been granted a discharge under Chapter 13 bankruptcy and wish to then file Chapter 7 bankruptcy. It must be noted that if an individual tried filing bankruptcy over and over again, creditors might allege that it was a pattern that showed a preconceived plan to defraud creditors, which, of course, is a violation of criminal law.

WILL I NEED TO APPEAR IN COURT AFTER I FILE BANKRUPTCY?

Yes. A “meeting of creditors” is conducted at a reasonable time after the order of relief is issued by the Bankruptcy Court. The debtor must attend this meeting. Also known as the Section 341 meeting, its primary function is to allow creditors and the trustee an opportunity to examine the debtor under oath about issues related to the bankruptcy case. Generally, creditors and the trustee use this meeting to question the debtor regarding information contained in the bankruptcy petition.

HOW WILL FILING BANKRUPTCY AFFECT MY CREDIT?

A bankruptcy filing appears on the debtor’s credit report for a period of **ten years**. This can prevent the debtor from obtaining credit; such as certain personal loans, credit cards, and private student loans, just to name a few. For that reason, one must treat bankruptcy as an absolute last resort, because the consequences of bankruptcy are far-reaching and last a long time.

HOW TO LOSE A BANKRUPTCY

1. Falsification, Concealment, or Failure to Preserve Financial Records
2. Fraudulent Transfer, Concealment, or Wasting of Property within a Year Before Filing Petition
3. Fraud, Misrepresentation, or Misconduct Involved in the Filing of the Bankruptcy
4. Failure to Explain Satisfactorily Any Loss of Assets or Deficiency of Assets
5. Refusal to Obey Any Lawful Order of the Court
6. Refusal to Cooperate
7. Failure to List All Creditors

DOES MY SPOUSE HAVE TO FILE, AND WHAT IS THE EFFECT IF HE/SHE DOES OR DOES NOT FILE?

A debtor’s spouse does not have to file with the debtor if the debts are solely in the debtor’s name. If any of the debts are also in the spouse’s name, the spouse must file for





that debt to qualify for a discharge. Generally, debts will only be in the spouse's name if he/she personally signs the agreement or contract. In certain states, called "community property" states, either spouse can sign an agreement for a debt and both the debtor and the spouse are obligated to pay that debt. Of course, if the spouse does file, his or her credit will be affected in the same manner.

WHAT ARE THE FILING FEES FOR A CHAPTER 7 AND CHAPTER 13?

\$335.00 for a Chapter 7 and \$310.00 for a Chapter 13 (effective 1 June 2014).

Do I need an attorney or can I represent myself?

Technically, a debtor may represent him or herself, **but it is strongly discouraged.** The procedure for filing a bankruptcy case is complicated and very time-sensitive. The consequences of a late filing could result in the case being dismissed and potentially barring a subsequent filing for six years, or incurring you additional expense in order to file the case again. Therefore, it is in the debtor's best interest to hire an experienced bankruptcy attorney to handle his or her case.

HOW MUCH ARE ATTORNEY'S FEES?

Typically, attorneys charge a flat fee for most Chapter 7 and Chapter 13 cases and the payment is expected to be made "up-front" before the bankruptcy petition is filed. The debtor must contact the attorney regarding the amount of fees as they vary widely from attorney to attorney, but expect to pay anywhere from \$500.00 to \$1,500.00.

WHAT IF I HAVE OTHER QUESTIONS?

Bankruptcy is a very complicated area of law. Most attorneys who practice bankruptcy specialize in this area of the law. Military legal assistance attorneys do not practice bankruptcy and we are prohibited by regulation from representing individuals in civilian courts, including bankruptcy courts. While we can assist with limited general advice, it would be best to contact an experienced bankruptcy attorney for more detailed information.

1. Legal Services of Alabama (LSA): LSA is a state agency which provides free legal representation to individuals who fall below the poverty level. For more information, please contact them at 1-866-456-4995.

2. Lawyer Referral Service (provided by the Alabama Bar Association): This service provides referrals to lawyers in your area that specialize in bankruptcy. You may contact them at 1-800-392-5660. When you contact a lawyer, ask if they provide free consultations. Some may provide free consultations to everyone or reduce their fee for people with lower incomes.





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