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CHAPTER 7 BANKRUPTCY IN A NUTSHELL

Bankruptcy laws provide individuals with two main avenues to debt relief: Chapter 7 and Chapter 13. Chapter 7 bankruptcy discharges or eliminates the most common types of debt that cause problems for consumers such as credit card debt, personal loans, utility bills, and money owed for medical treatment.

The Chapter 7 process usually lasts no longer than three to four months. Although some Chapter 7 filers will need to surrender some property to repay creditors, most people are able to keep all or most of their assets. An experienced bankruptcy attorney will be able to use the exemptions available in your state to protect as much as possible.

Why Should You Consider Chapter 7 Bankruptcy?

There are numerous reasons why you might want to file Chapter 7, but it is a big commitment and not a decision that should be made without consulting an attorney. Sometimes the only way to get out of debt and get your creditors off your back is to file bankruptcy.

One event that often precipitates a Chapter 7 bankruptcy is a loss of income. Whether due to a layoff, salary reduction, divorce, or death in the family, a drop in income can put you in a precarious financial position and make it impossible for you to keep up with your debts.

Serious health problems in your family can also lead to Chapter 7. Medical care is enormously expensive if you are not covered by insurance, have maxed out your benefits, or have high deductibles. If the family wage earner is the one who falls ill, the situation is compounded by loss of income.

If you find yourself in any of these situations, Chapter 7 could be a good option for you.

Qualifying for Chapter 7: The Means Test

Qualification for Chapter 7 is based on your family's household income. To be eligible, your household income from all sources is subject to a "means test." The "means test" compares your household income to the state median income for families the same size as yours. If your household income is lower than the median state income, you automatically pass the means test and qualify for Chapter 7.

If your household income is over the state median income, you may still qualify for Chapter 7, but further calculations are necessary. These reduce your income by certain expenses the court allows for housing, childcare, and other pre-determined categories. After this second analysis, if your income is still too high to qualify, you may be able to file for bankruptcy under Chapter 13, which will require you to fund a Chapter 13 repayment plan. Passing this second calculation can be tricky. An experienced bankruptcy attorney may be able to get you through the means test even if your income seems a little too high.

Credit Counseling Requirement

Before you can file for bankruptcy you must take a credit counseling class. It will give you tips on how to balance your budget going forward. It is normally an hour long and can be taken online. At the end of the course, you will be given a certificate that must be filed with the court.

Filing the Chapter 7 Petition and Other Papers

If you pass the means test and decide to proceed with Chapter 7 bankruptcy, the next step after you take the credit counseling class is to prepare your papers. You will meet with your attorney and go over details regarding your assets, debts, and recent financial transactions. Once this review is complete, your attorney will prepare and review with you a packet of papers called the Petition and Schedules. Your attorney will file this packet with the bankruptcy court. These papers list information about you, your debts and creditors (both secured and unsecured), your real and personal property, and income and expenditures. You must list all your debts and all your assets.

The Automatic Stay

The moment the Petition is filed, the “automatic stay” becomes effective. This stops (stays) most collection actions against you or your property during the pendency of your case. There are exceptions for certain types of debts (child support, for example) that can be collected while your case is pending.

Chapter 7 Trustee and Meeting of Creditors

After your Petition is filed, the bankruptcy court will send a notice to all your creditors, other interested parties, and you. This notice will identify the trustee assigned to your case and the date on which the meeting of creditors (also called the 341 meeting) will be held. The meeting of creditors is usually held approximately 20 to 40 days after the bankruptcy petition is filed. At this meeting, the trustee will ask you a series of questions, which you must answer under oath, about the information contained in your petition, your assets, debts and additional information that may be related to your case. Your creditors are entitled to appear and also ask you questions, but they rarely do unless it's a personal debt, such as to a former spouse, business partner.

The Bankruptcy Estate and Exemptions: What property can you keep?

The filing of your Petition creates a bankruptcy “estate.” The estate includes all your property listed in your Petition. However, all states have exemptions that allow you to keep certain types of property up to certain values (that vary by state). Many people who file for Chapter 7 are able to claim exemptions for all of their property, in which case their bankruptcy estates essentially have no value (a “no assets” case).

If you have property that exceeds the value allowed for exemptions, then the estate technically becomes the temporary legal owner of this property. The bankruptcy trustee oversees the estate property and has the ultimate say in how to handle the property.

There are exemptions, within certain limits, for your homestead, a vehicle, retirement accounts, jewelry, household goods, tools used in your trade, and other personal property, including bank accounts. Before filing for Chapter 7 you want to make sure you understand which assets you will be able to protect and which, if any, you may have to give up. Your bankruptcy attorney can help you better understand what property you may be able to protect in your bankruptcy.

Vehicles are the asset most commonly seized by the trustee for the bankruptcy estate. While most people owe money on their vehicles and don’t have much, if any, equity in them, some people own their cars outright. Most states have a vehicle exemption that ranges from \$1,000 to \$10,000. If you own your vehicle or your loan is nearly paid off, the exemption might not be enough to fully protect the vehicle. In this situation, you will have to make a decision on whether you can afford to make payments to “buy” the vehicle from the bankruptcy estate or in the alternative, surrender the vehicle.

Real property is also commonly seized by the trustee. As with cars, most states have exemptions that will protect your homestead (but not other real estate) up to a particular amount of equity. If your equity in your home exceeds the applicable exemption, you may lose it in Chapter 7. If you own your home and want to keep it, the safest route is for you to consult with an attorney before filing Chapter 7 to ensure your home will be protected by an exemption. If not, Chapter 13 bankruptcy is likely a better alternative for you.

Chapter 7 and Foreclosure?

Some people file Chapter 7 because they are facing imminent foreclosure on their homes. The bankruptcy will automatically freeze the foreclosure case and buy some time to either vacate the property or work out a solution with the mortgage company.

While Chapter 13 is the safer route for homeowners who want to save their homes, sometimes Chapter 7 is the better option. Some people cannot afford Chapter 13 payments while others are just trying to buy some time before they leave the home. It is important that debtors in this position have a plan when they are filing Chapter 7 bankruptcy for the purposes of halting a foreclosure. The timeline is short and creditors can maneuver quicker in a Chapter 7 than in a Chapter 13 to get the automatic stay lifted and proceed with the foreclosure.

Secured Debt and the Property Securing It

Secured debt is a debt where collateral, such as a car or house, is provided in exchange for a loan. The collateral is used so that a creditor can recover some value if the borrower defaults. Although a Chapter 7 bankruptcy, will wipe out your personal liability on dischargeable debts, including your mortgage and car loans, bankruptcy will not remove a lien on your property. If you want to keep secured property after bankruptcy, the lender may require you to reaffirm the debt. Reaffirming a debt is signing a new agreement that makes you liable for the debt again. Debt reaffirmation should be considered only after you have carefully evaluated all your options and understand the pros and cons of reaffirmation. We don't often recommend reaffirmation to our clients.

Chapter 7 Discharge

In most routine cases, a Chapter 7 filer's debts are discharged 60 to 120 days after the meeting of creditors. Before you receive a discharge, you must take a debtor education course from an approved provider and file proof with the court. The filing of the discharge does not close the case. A case may remain open after discharge for a short or long period of time depending on the facts. However, the discharge order releases you (and your spouse if a joint filing) from personal liability for most debts.

Conclusion

Chapter 7 Bankruptcy can be a complicated process. If you intend to file, you should consult an attorney first to ensure you are making the right decision, you qualify for the relief requested, and you understand what assets can and can't be protected.

If you are properly prepared and informed, Chapter 7 bankruptcy can provide genuine relief from your financial problems. Without that knowledge, you could find yourself navigating a minefield that results in being transferred to a Chapter 13 or losing property you did not want or need to lose. Make sure you are well-prepared so that you can have a smooth bankruptcy and receive that fresh start that is the goal of every debtor who files Chapter 7 bankruptcy.