

BANKRUPTCY

Most military personnel and their families handle their financial affairs in a responsible and timely manner. Those who have problems usually seek timely assistance from financial counselors. Occasionally, however, due to a catastrophic event or even just bad management, an individual will be so far in debt that bankruptcy becomes the only solution. Bankruptcy is a federal court proceeding that only a few soldiers or family members will find necessary.

Bankruptcy has long-term consequences on an individual's credit. Bankruptcy should only be considered if: (1) all attempts to control spending have failed and credit counseling has been unsuccessful, (2) current debt payments exceed current income, and (3) attempts to restructure repayment plans with creditors have been unsuccessful. A Chapter 13 bankruptcy remains on your credit report for 7 years. A Chapter 7 bankruptcy remains on your credit report for 10 years. Most individuals find it difficult to obtain a mortgage or other credit for years after a bankruptcy filing. If credit is offered, the lender will usually charge a much higher interest rate and a larger deposit or down payment. Both landlords and employers have access to credit reports, and may choose not to hire or rent to an individual with a bankruptcy on their record.

Bankruptcy is a serious decision with ramifications that will last for years. Anyone considering this step should research their options and the consequences. This article provides guidance on the basics of bankruptcy law.

WHAT IS BANKRUPTCY?

Bankruptcy is a legal proceeding under federal law that allows a debtor who is having serious financial difficulties to obtain financial relief. Bankruptcy allows debtors to either eliminate their debts or repay them under the protection of the bankruptcy court.

When filing for bankruptcy a debtor should be familiar with unsecured debt and secured debt. Unsecured debts are credit cards, medical bills or anything else that is not attached to or secured by collateral. Secured debts are those that have collateral attached to them such as your house or car. Unsecured debts can be discharged in bankruptcy while secured debts cannot. For example, if you obtain a mortgage on your house, your house is considered collateral for your loan. In the event your loan is not paid back, the lender may foreclose on your house to recover the owed money.

Individuals considering bankruptcy should focus on two chapters of the Bankruptcy Code: Chapter 13 (the wage-earner plan) and Chapter 7 (straight bankruptcy).

AUTOMATIC STAY

Once a person files for bankruptcy, an "automatic stay" is put in place that prevents creditors from attempting to collect on any debts incurred before filing. Creditors may petition the court

for relief from the automatic stay and permission to continue. Often, creditors whose loans are secured by a pledge of property are permitted to take possession of that property.

DISCHARGE

After the bankruptcy proceedings are completed, the bankruptcy adjudication (a finding that a person is "bankrupt") results in a discharge of the personal debts. The discharge acts as a forgiveness of personal liability for all debts incurred prior to filing for bankruptcy. In most instances, creditors are prohibited from suing or attempting to collect debts that have been discharged. Once discharge is granted, former creditors also have no claim on future income.

In exchange for the discharge, a debtor must turn over all non-exempt property to a court-appointed trustee (see Chapter 7 below). The trustee is required to sell the property and distribute the proceeds to creditors. A debtor can be denied a discharge for certain "bad acts" such as concealing or fraudulently transferring assets prior to filing. Even if a discharge is granted, certain debts can never be discharged. These include: alimony and child support, government student loans, taxes, debts not listed on the documents filed with the court, debts for willful and malicious injuries to a person or property, debts to governmental units for fines and penalties, debts for personal injury caused by the debtor's operation of a motor vehicle while intoxicated, and any debt incurred through the debtor's fraud or theft.

YOUR OPTIONS

Individuals may choose several different types of bankruptcy based upon the amount and nature of the debts, the exemptions available, and the types of assets owned by the debtor. The different bankruptcies are named after a corresponding chapter in the code.

CHAPTER 7

Chapter 7 is referred to as "straight" or "liquidation bankruptcy." In liquidation, the debtor turns all of his or her assets over to a trustee who then liquidates (sells) all the assets and distributes the proceeds to the debtor's creditors.

A chapter 7 case begins with the debtor filing a petition with the bankruptcy court serving the area where the individual lives. The debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a statement of financial affairs; and (4) a schedule of executor contracts and unexpired leases. Debtors must also provide the assigned case trustee with a copy of the tax return for the most recent tax year as well as tax returns filed during the case.

In order to complete the Official Bankruptcy Forms that make up the petition, statement of financial affairs, and schedules, the debtor must provide the following information:

1. A list of all creditors and the amount and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and

4. A detailed list of the debtor's monthly living expenses, *i.e.*, food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

A debtor is required to attend credit counseling from an accredited credit counseling agency prior to filing for Chapter 7 bankruptcy. Generally during that credit counseling session, the debtor will create a debt repayment plan. Upon completion of the credit counseling session, the debtor will be issued a certification of completion. The debtor must file that certificate completion along with any debt repayment plan to the court.

The courts must charge a \$245 case filing fee, a \$39 miscellaneous administrative fee, and a \$15 trustee surcharge. Normally, the fees must be paid to the clerk of the court upon filing. However, if you obtain the court's permission the individual debtor may pay in installments. If the debtor's income is less than 150% of the poverty level, and the debtor is unable to pay the Chapter 7 fees, the court may waive the requirement that the fees be paid.

Among the schedules that an individual debtor will file is a schedule of "exempt" property. The Bankruptcy Code allows an individual debtor to protect some property from the claims of creditors because it is exempt under federal bankruptcy law or under the laws of the debtor's home state. A debtor should contact an attorney to determine what is exempt under his state's law. A few examples are: a portion of real estate equity of the debtor's principal residence; Social Security benefits, unemployment compensation, pension plans, veterans benefits, disability, illness or unemployment benefits, alimony; some equity in vehicles, some jewelry, household furnishings and clothing; some professional implements, books and tools of the trade; some cash plus any unused portion of the residence exemption. The allowable property differs with each state.

When a chapter 7 petition is filed, the U.S. trustee appoints an impartial case trustee to administer the case and liquidate the debtor's nonexempt assets. If all the debtor's assets are exempt or subject to valid liens, the trustee will normally file a "no asset" report with the court, and there will be no distribution to unsecured creditors. However, all non-exempt property may be used to pay unsecured creditors.

Commencement of a bankruptcy case creates an "estate." The estate technically becomes the temporary legal owner of debtor's property. It consists of all legal or equitable interests of the debtor in property as of the commencement of the case, including property owned or held by another person if the debtor has an interest in the property. Generally speaking, the debtor's creditors are paid from nonexempt property of the estate. The primary role of a chapter 7 trustee in an asset case is to liquidate the debtor's nonexempt assets in a manner that maximizes the return to the debtor's unsecured creditors. The trustee accomplishes this by selling the debtor's property if it is free and clear of liens or if it is worth more than any security interest or lien attached to the property and any exemption that the debtor holds in the property.

Between 20 and 40 days after the petition is filed, the case trustee (described below) will hold a meeting of creditors. During this meeting, the trustee puts the debtor under oath, and both the

trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding the debtor's financial affairs and property.

The person is then discharged of all debts. Creditors must look solely to the assets held by the trustee for payment. Creditors are thereafter prohibited from attempting to collect their claims from the discharged debtor. A debtor can receive a Chapter 7 discharge once every six years.

The individual debtor's primary concerns in a Chapter 7 case are to retain exempt property and to receive a discharge that covers as many debts as possible.

CHAPTER 13

Chapter 13 offers individuals a number of advantages over liquidation under Chapter 7. Chapter 13 offers individuals an opportunity to save their homes from foreclosure. By filing under this chapter, individuals can stop foreclosure proceedings and may cure delinquent mortgage payments over time. Nevertheless, they must still make all mortgage payments that come due during the chapter 13 plan on time. Another advantage of Chapter 13 is that it allows individuals to reschedule secured debts and extend them over the life of the Chapter 13 plan. Doing this may lower the payments. Finally, chapter 13 acts like a consolidation loan under which the individual makes the plan payments to a Chapter 13 trustee who then distributes payments to creditors. Individuals will have no direct contact with creditors while under Chapter 13 protection.

Chapter 13 debtors pay their debts through future income rather than liquidation or foreclosure of present assets. This chapter usually allows the debtor to keep much of his or her property. To qualify for a Chapter 13 bankruptcy a debtor must (1) reside, have a domicile, or have a place of business within the United States; (2) have a source of regular income; and (3) on the date the petition is filed, owe less than \$307,675 in unsecured debts (usually credit cards) and less than \$922,975 in secured debts (home mortgages and car loans). The case filing fee is \$235. The courts also charge a \$39 miscellaneous administrative fee. Normally fees must be paid to the clerk of the court when you file your petition. However, the fees may be paid in installments with the court's permission. These fees will never be waived under Chapter 13.

Before a debtor can file Chapter 13 bankruptcy he must undergo credit counseling from an approved credit counseling agency either in an individual or group briefing. If a debt management plan is developed during required credit counseling, it must be filed with the court.

A chapter 13 case begins by filing a petition with the bankruptcy court serving the area where the debtor has a domicile or residence. Unless the court orders otherwise, the debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a schedule of executory contracts and unexpired leases; and (4) a statement of financial affairs.

When an individual files a chapter 13 petition, an impartial trustee is appointed to administer the case. The chapter 13 trustee both evaluates the case and serves as a disbursing agent, collecting payments from the debtor and making distributions to creditors. Filing the petition under chapter 13 “automatically stays” (stops) most collection actions against the debtor or the debtor’s property. Unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a “consumer debt” from any individual who is liable along with the debtor.

Individuals may use a chapter 13 proceeding to save their home from foreclosure. The automatic stay stops the foreclosure proceeding as soon as the individual files the chapter 13 petition. The individual may then bring the past-due payments current over a reasonable period of time.

Nevertheless, the debtor may still lose the home if the mortgage company completes the foreclosure sale under state law before the debtor files the petition. The debtor may also lose the home if he or she fails to make the regular mortgage payments that come due after the chapter 13 filing.

The debtor must provide the chapter 13 case trustee with a copy of the tax return or transcripts for the most recent tax year as well as tax returns filed during the case. The debtor must also compile the following information:

1. A list of all creditors and the amounts and nature of their claims;
2. The source, amount, and frequency of the debtor’s income;
3. A list of all of the debtor’s property; and
4. A detailed list of the debtor’s monthly living expenses, *i.e.*, food, clothing, shelter utilities, taxes, transportation, medicine, etc.

Under Chapter 13, the debtor presents a plan for repayment, which is reviewed by the trustee, the creditors and the Bankruptcy Court. Over time, the plan must provide creditors with an amount at least equal to what they would receive under a Chapter 7 and must be feasible in light of the debtor's income. If the plan is approved, then the debtor makes payments to the trustee who in turn pays the creditors. The plan may provide for payment for three to five years depending on the monthly income of the debtor. While a debtor under Chapter 13 gets to keep much of his or her property, there are certain disadvantages such as:

1. Debtors remain under court supervision for the life of the plan and are forbidden to make new debts or sell assets without court permission.
2. Debtors who propose less than full payment to unsecured debtors will be forced to live on a budget for the life of the plan and pay all excess income to the creditors.
3. Even if the debtor pays all of the creditors in full, the bankruptcy will still appear on the debtor's credit record.
4. If the debtor is unable to complete the plan payments, then any creditor may petition to have the court convert the case to a Chapter 7 liquidation.

TAXES

Filing bankruptcy under Chapter 7 will stop all IRS or state tax collection activities. But if a Chapter 7 is filed, the tax collection activities resume shortly after filing because the tax obligation cannot be discharged in bankruptcy. Furthermore, interest and penalties continue to accrue. Under Chapter 13, on the other hand, filing halts the accumulation of interest and penalties and taxes may be paid over the life of the plan.

CO-DEBTORS

A bankruptcy filing often involves other persons (such as the debtor's spouse) who have cosigned notes or mortgages with the debtor. The filing of a Chapter 13 plan can be used to stop all creditor actions against certain co-debtors. This is true even if the co-debtors are solvent and do not join the Chapter 13 petition. This protection can become permanent if the plan provides for payment of the cosigned debt in full and is fully performed.

OVERSEAS RESIDENCE PROBLEM

When filing bankruptcy while living overseas, it may be difficult to find an attorney willing to represent a client who can only communicate by mail or telephone. Nevertheless, a stateside attorney is essential. A military legal assistance attorney cannot represent a debtor at a bankruptcy proceeding. The stateside civilian attorney must be licensed in the state where the debtor is legally domiciled. Domicile can often be hard to prove for military members who are stationed overseas. The court will look to whichever state the debtor has the most ties (i.e. owns real estate, registered to vote, bank account, pays state income tax, etc.) The debtor must attend at least one hearing and possibly more. Attorney's fees may be set by the court and are usually not excessive. Additional fees may also apply.

FAMILY SUPPORT CENTER

Most Air Force communities offer financial counseling through the Family Support Center (FSC). An airman or family member can seek help through the FSC when financial problems become apparent. Often, the financial counselor can help the debtor restructure obligations, manage the checkbook, and solve other related problems. One of the most important functions provided by the FSC is education: teaching basic financial skills, explaining how to consolidate debts, making the debtor consumer conscious, and explaining how to improve credit reliability and reputation. More specifically, the services provided are checking account maintenance, budget planning, debt liquidation, and act as a consumer advocate. Most FSCs also maintain a library of resource materials and free information.

EFFECT ON MILITARY CAREER

While a bankruptcy discharge plan itself does not trigger adverse action, airmen who fail to meet their financial obligations may be processed for an administrative discharge. Therefore it is important for a service member who has financial difficulties to consult an attorney. A military discharge board could conclude from the number of debts and the general inability to manage financial affairs that the airman should be discharged from the service.

CONCLUSION

Your individual financial situation may alter the generalities and conclusions set forth in this article. For your specific situation, you should seek counsel from an attorney before filing for bankruptcy relief. If you have any questions, please call our legal office for an appointment.