Most Families Keep Most of Their Property Even in a Chapter 7. A chapter 7 bankruptcy case is often called a “liquidation,” but that is inaccurate because most families keep most of their property in a chapter 7 bankruptcy. While the bankruptcy trustee will try to sell property for the benefit of creditors, federal and state law exempt much of your property from this sale.

Property that the bankruptcy trustee cannot sell and that you get to keep is called “exempt.” In most consumer bankruptcies, nearly all your assets are exempt. If property is partly exempt and partly nonexempt, the trustee may sell it and pay you the value of the exempt part in cash. Or, if you have the money, you may pay the trustee the amount of the nonexempt value and keep the property.

Exemption laws vary from state to state and may be fairly complicated. You cannot make a final choice about bankruptcy without understanding the exemption laws for your particular state. While it is possible to research these on your own, the best course it to rely on a bankruptcy attorney.

The dollar amount that is exempt goes much further than you think because the dollar value refers not to the property’s value, but the property’s value over and above any loan you have that is secured by that property. This difference is called your “equity” in the property.

Consider, for example, if the state exemption for your home is $50,000, the home’s value is $150,000, and you have a $100,000 mortgage. The home’s equity or value over and above the $100,000 mortgage is $50,000, so that the home is totally protected by the state homestead exemption. The trustee cannot sell your home to pay off your other creditors, such as medical or credit card debt. Your mortgage lender (as opposed to the trustee) though can foreclose on the home if you do not keep up on your mortgage payments.

The trustee also is unlikely to sell your home for the benefit of other creditors if there is only a small amount of equity in the home. After deducting the exemption amount and realtor or other sales expenses, there will be nothing left to send to creditors. In the above example, the trustee is unlikely to sell your home even if it is worth $165,000 or even slightly more.

At the end of a chapter 7 case, you obtain a “discharge” of most of your unsecured debts. This means that you will no longer have a legal obligation to pay those debts. Generally, the discharge will include credit card debts, medical bills, utility arrearages, and other similar debts for which the creditor does not have collateral. Some unsecured debts, such as most student loans, debts based on fraud or malicious conduct, drunk driving debts, most tax debts, government fines, alimony, and child support are not likely to be discharged.

Chapter 7 bankruptcies rarely help with large secured debts, such as home mortgages, because the creditor keeps its rights in the collateral. The exemption does not apply to the secured creditor. While bankruptcy cancels your legal obligation to pay most personal debts, even secured debts, it does not prevent secured creditors from recovering their collateral if a debt is not repaid. This means that a chapter 7 case will not affect, except temporarily, the rights of a bank to foreclose on a home or repossess a car that is loan collateral. However, if you have received a chapter 7 discharge and a creditor later sells its collateral, the creditor may not sue you for any balance still owed.

Who Can File a Chapter 7 Bankruptcy? A “means test” makes it more difficult for wealthy consumers to file a chapter 7 bankruptcy. This test does not even apply to you if your income is below the median family income in your state. For 2019, for a family of four, the median family income ranged from a low of $68,341 in Arkansas to a high of $130,695 in Massachusetts.

A consumer with income above the median must fill out a form that compares the consumer’s monthly income with actual and assumed expenses in a variety of categories. If this form shows, based on standards in the law, that the consumer should have a certain amount left over to pay unsecured creditors, the bankruptcy court may decide that the consumer cannot file a chapter 7 case, unless there are special circumstances. But chapter 7 should be available for virtually all Americans who are unable to pay all their bills.

What Are the First Steps? The first step in a chapter 7 bankruptcy is completion of a few basic forms, including an initial “petition” and a certificate from an approved credit counseling agency. At that time or shortly thereafter, with the assistance and direction of your attorney, you file your statement of financial affairs, statement whether you intend to keep your secured property, statement of monthly income and means test calculations, copies of any pay stubs you received from an employer during the sixty days before filing your bankruptcy case, and a set of schedules listing all your debts, assets, income, and expenses.
These forms should be filled out completely and accurately. Frequently overlooked assets include tax refunds, child support arrearages, security deposits, pledged goods at pawnbrokers, personal injury claims, other legal claims, and the cash value of life insurance policies. Often missed debts include debts that you cosigned, debts owed to friends or family members, student loans, public benefit overpayments, payday loans, and utility bills.

If requested, you must provide copies of certain tax returns, or a shorter version of the returns called “transcripts.” Due to privacy concerns, no tax returns filed with the bankruptcy court will be available to the public and cannot be viewed on the internet.

At the beginning of the case you file a mailing list of all of your creditors. Bankruptcy courts often require that these forms be filed electronically in a particular format, but most courts allow consumers without an attorney to file in paper form or provide scanning and other equipment at the court that consumers can use to convert the forms for electronic filing. You should check with a bankruptcy specialist or your local bankruptcy court for a full list of filing requirements.

**What Will Happen After Filing?** Filing the petition triggers the “automatic stay.” With few exceptions, this stops any creditor from taking collection action, pursuing a court case against you, or seizing your property based on debts that arose before you filed your bankruptcy petition. While the stay is automatic, if you are worried about a creditor action like a foreclosure or repossession, make a special effort to notify that creditor so that the action is stopped before it occurs.

If a creditor does take action against you other than in the bankruptcy court, including making collection calls or sending letters, you should politely inform the creditor about the bankruptcy. If you have an attorney, you should also tell your attorney about the contact. You may start a process to obtain damages for certain violations of the stay.

Within a few weeks after filing, the bankruptcy court or the trustee mails a notice of the stay and of the date and place for a “meeting of creditors.” This notice will be mailed to all creditors, to you, and to your attorney, if you have one.

**What Is a Bankruptcy Trustee?** After you file a chapter 7 bankruptcy, a trustee is appointed to represent the interests of creditors. The trustee collects any property that can be sold, handles the sale, distributes the property to creditors with valid claims, and makes a final accounting to the court.

**What Is the Meeting of Creditors?** The trustee conducts a meeting of creditors, usually not at the courthouse, but rather at a separate government or office building. The meeting of creditors gives the trustee and others a chance to ask questions about your financial affairs.

Despite the name, few creditors will actually appear at the meeting. You, however, must attend. If you file jointly, your spouse must also attend. The meeting consists of a series of routine questions by the trustee and lasts from two minutes to half an hour. Beforehand, review the papers you or your attorney have filed with the court and bring any requested documents with you to the meeting, such as a copy of your most recent bank statements, a picture form of identification, or your most recent pay stub.

**The Education Course Requirement.** As part of the bankruptcy, and in addition to the credit counseling requirement before you file for bankruptcy, you must complete an approved educational course on personal finances. The fee is usually $20 to $50. If you cannot afford the fee, ask the agency to provide the course free of charge or at a reduced fee.

The course typically takes about two hours, and most course providers give you a choice whether to take the course in-person, over the internet, or over the telephone. The course generally covers budget development, money management, wise use of credit, and consumer information.

**What Happens After the Meeting of Creditors and the Education Course?** Unless there is an objection to the exemptions you have claimed, after the meeting of creditors you keep the property listed as exempt in your schedules. Property that is mostly, but not totally, exempt is usually abandoned by the trustee, which means that you also get to keep it.

If larger nonexempt assets remain, they are turned over to the trustee. You will usually be offered the option of paying the nonexempt value of the assets to the trustee in cash instead of turning over those assets. The trustee then sells any property collected, converts it to cash, and distributes it among the creditors.

During a chapter 7 bankruptcy, you will have to take steps to deal with your secured debts. You can surrender the collateral to the secured creditor or keep the collateral by paying the creditor in a lump sum the value of the collateral. You also have the option of “reaffirming” the debt to protect the collateral. In some situations, you can even keep your property by continuing to make scheduled payments.
What Is Reaffirmation and When Should I Consider It? Reaffirmation is your agreement during bankruptcy to remain legally obligated on some or all of a debt which you could have otherwise eliminated through the bankruptcy.

- If a creditor pressures you to reaffirm, you can say no. No law requires you to reaffirm a debt.
- Never reaffirm a debt just because a creditor offers to advance you some new credit or to keep your account in good standing. There are easier ways to obtain new credit than to agree to the expense of repaying a debt which bankruptcy can eliminate.
- If you really want, you can always pay any debts you want to pay after bankruptcy without signing a reaffirmation agreement. That way you cannot be sued if you stop paying.
- If for some reason you decide to reaffirm, negotiate the terms—the terms do not have to be the same as the original credit terms or the amount due.
- The court must approve any reaffirmation agreement. If the creditor tricks you into signing something, it has no effect until approved by the court.
- You can for any reason cancel any reaffirmation agreement for sixty days after it is filed with the court or any time before your discharge order.

You should never agree to reaffirm if:

- The debt is totally unsecured;
- The creditor cannot provide paperwork showing you that the debt is secured;
- The debt is secured and you have no interest in keeping the collateral;
- The debt is secured and you are hopelessly behind on payments, so that the property will be repossessed in any event.

You might consider reaffirmation if:

- The creditor gives you something valuable in return, such as an agreement to let you get caught up on a default in a manageable way or a reduction of a secured debt to the value of the property;
- You want to keep property used as collateral for a secured debt and your bankruptcy court will not allow you to keep it without reaffirming (and you cannot afford the better alternative of paying the creditor the value of the property in a lump sum); or
- You can easily afford the payments on secured debt which will be required after bankruptcy.

What About Reaffirming Credit Card Debt? It is almost never a good idea to reaffirm a credit card debt. Generally ignore any offers the card company makes involving reaffirmation. You are better off eliminating that debt and getting a new card from another company. For some store credit cards, the company may threaten that it can seize purchases made on the card. Even if true, such threats are almost never carried out. Do not reaffirm a debt to protect property they will never seize.

A Bankruptcy Discharge Ends the Bankruptcy. The final step in most chapter 7 bankruptcy cases is the discharge that will eliminate many of your debts. In most places, if no one objects, the court enters the discharge without a hearing. You get the discharge order in the mail.

The discharge in chapter 7 covers all unsecured debts, including most credit card debt, medical bills, and back utility debts. Your discharge may not include:

- Certain taxes;
- Debts not listed in your schedules;
- Debts for alimony, child support, and family court property settlements;
- Most fines and penalties owed to government agencies;
- Student loans unless you can prove to the court that repaying them will be an “undue hardship”;
- Debts incurred by driving while intoxicated;
- Debts incurred to pay taxes which cannot be discharged; and
- Debts you have formally agreed to reaffirm.

If a creditor asks the court within a strict time limit, the court may except from discharge:
? Debts incurred by certain types of fraud;
? Debts incurred while acting as a trustee for someone else’s property;
? Debts for purposely causing injuries to individuals or property; and
? Certain debts for luxury goods or services or cash advances a few months before filing bankruptcy, unless you can show that you had good reason to incur the debt and that you were not intending to take advantage of the bankruptcy filing.

A few creditors (mainly credit card companies) make accusations of fraud even when consumers have done nothing wrong, intending to scare honest consumers to reaffirm the debt. Never agree to reaffirm if you have done nothing wrong.

It is illegal for a creditor to try to collect a debt discharged in bankruptcy. Contact your lawyer if you have been subject to collection efforts and you may be able to recover any damages.

Source: National Consumer Law Center, Surviving Debt [50th NCLC Anniversary Edition], updated at www.nclc.org/library
Source URL: https://library.nclc.org/sd/2507