

# **Bankruptcy FAQ (Chapter 7 and Chapter 13)**

**Chapter 7 bankruptcy and Chapter 13 bankruptcy: what you need to know.**

» **What exactly is bankruptcy? Will it wipe out all my debts?**

What is the difference between Chapter 7 and Chapter 13 bankruptcy? Which one lets me keep my property?

Am I free to choose between Chapter 7 bankruptcy and Chapter 13 bankruptcy? Which type of bankruptcy should I use?

**What exactly is bankruptcy? Will it wipe out all my debts?**

Bankruptcy is a federal court process designed to help consumers and businesses eliminate their debts or repay them under the protection of the bankruptcy court. Bankruptcies can generally be described as "liquidation" (Chapter 7) or "reorganization" (Chapter 13). Under a Chapter 7 bankruptcy, you ask the bankruptcy court to wipe out (discharge) the debts you owe. Under a Chapter 13 bankruptcy, you file a plan with the bankruptcy court proposing how you will repay your creditors. You must repay some debts in full; others may be repaid only partially or not at all, depending on what you can afford.

When you file either kind of bankruptcy, a court order called an "automatic stay" goes into effect. The automatic stay prohibits most creditors from taking any action to collect the debts you owe them unless the bankruptcy court lifts the stay and lets the creditor proceed with collections.

Certain debts cannot be discharged in bankruptcy; you will continue to owe them just as if you had never filed for bankruptcy. These debts include back child support, alimony, and certain kinds of tax debts. Student loans will not be discharged unless you can show that repaying the debt would be an undue burden, which is a very tough standard to meet. And other types of debts might not be discharged if a creditor convinces the court that the debt should survive your bankruptcy.

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## What is the difference between Chapter 7 and Chapter 13 bankruptcy? Which one lets me keep my property?

In Chapter 7 bankruptcy, you ask the bankruptcy court to discharge most of the debts you owe. In exchange for this discharge, the bankruptcy trustee can take any property you own that is not exempt from collection (see below), sell it, and distribute the proceeds to your creditors.

In Chapter 13 bankruptcy, you file a repayment plan with the bankruptcy court to pay back all or a portion of your debts over time. The amount you'll have to repay depends on how much you earn, the amount and types of debt you owe, and how much property you own.

You lose no property in Chapter 13 bankruptcy, because you fund your repayment plan through your income. In Chapter 7 bankruptcy, you select property you are eligible to keep from a list of state exemptions. Although state exemption laws differ, states typically allow you to keep these types of property in a Chapter 7 bankruptcy:

- *Equity in your home, called a homestead exemption.* Under the Bankruptcy Code, you can exempt up to \$20,200 of equity. Some states have no homestead exemption; others allow debtors to protect all or most of the equity in their home.
- *Insurance.* You usually get to keep the cash value of your policies.
- *Retirement plans.* Most retirement benefits are protected in bankruptcy.
- *Personal property.* You'll be able to keep most household goods, furniture, furnishings, clothing (other than furs), appliances, books and musical instruments. You may be able to keep jewelry only worth up to \$1,000 or so. Most states let you keep a vehicle as long as your equity doesn't exceed several thousand dollars. And many states give you a "wild card" amount of money -- often \$1,000 or more -- that you can apply toward any property.
- *Public benefits.* All public benefits, such as welfare, Social Security, and unemployment insurance, are fully protected.
- *Tools used on your job.* You'll probably be able to keep up to a few thousand dollars worth of the tools used in your trade or profession.
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- **Am I free to choose between Chapter 7 bankruptcy and Chapter 13 bankruptcy? Which type of bankruptcy should I use?**
- If you meet the eligibility requirements for both types of bankruptcy, then you can choose the type of bankruptcy that makes the most sense for your situation. However, you may not have a choice.
- Under the new bankruptcy law, filers whose incomes are higher than the median income for a family of their size in their state may not be allowed to file for Chapter 7 bankruptcy if their disposable income, after subtracting certain allowed expenses and required debt

payments, would allow them to pay back some portion of the unsecured debt over a five-year repayment period.

- Also, if you have secured debts of more than \$1,010,650 and unsecured debts of more than \$336,900, for example, then you cannot use Chapter 13 bankruptcy.
- Most people who file for bankruptcy choose to use Chapter 7, if they meet the eligibility requirements; Chapter 7 is a popular choice because, unlike Chapter 13, it doesn't require filers to pay back any portion of their debts.
- However, Chapter 13 might be a better choice, depending on your situation. For example, if you are behind on your mortgage and want to keep your house, you can include your missed payments in your Chapter 13 plan and repay them over time. In Chapter 7, you would have to make up the whole past due amount right away -- and you might lose your house, if your equity exceeds the exemption amount available to you.