

# TWIN CITY ATTORNEYS

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## FACTS ABOUT BANKRUPTCY

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### CHAPTER 7 OR CHAPTER 13?

There are a number of "Chapters" in the Bankruptcy Code designed to protect different types of debtors. The overwhelming number of debtors will file under either Chapter 7 or under Chapter 13. A small number of debtors may wish to use one of the other Chapters, such as Chapter 12, which provides protection to family farmers and fishermen, or Chapter 11 which is used to reorganize a business and give it time to pay creditors. Chapter 11 can also be used by an individual, although Chapter 11 cases generally cost much more than Chapter 7, 13 or 12 cases.

There are advantages and disadvantages of both Chapter 7 and Chapter 13. Under Chapter 13 the debtor will make regular payments on a plan to pay all or part of the debts. Under Chapter 7 there is no plan to repay creditors and all debts that are "dischargeable" are simply discharged. The absence of regular payments is a powerful inducement for many debtors, which may explain why there are more Chapter 7 cases than Chapter 13 cases. Under both Chapters 7 and 13 most debtors lose no property when they file. Under Chapter 7 a debtor will generally lose "non-exempt" property, while under Chapter 13 debtors are often able to keep both "exempt" and "non-exempt" property. Of course, this is of no concern if a debtor has little or no property or only property which is "exempt" - moreover, the exemptions have been liberalized over the years and many debtors keep property of significant value. A Chapter 13 discharge is also broader than a Chapter 7 discharge in that it covers certain types of debts not "dischargeable" under a Chapter 7. However, the 2005 Bankruptcy Law did add several categories of debts that are no longer dischargeable in a Chapter 13. The debts dischargeable in a Chapter 7 are discussed below. All Debts dischargeable under Chapter 7 are also dischargeable under Chapter 13, but several categories of debts can be discharged in a Chapter 13 but not under a Chapter 7 such as debts for willful and malicious injury to property, debts incurred to pay nondischargeable tax bills and certain debts arising from property settlements in divorce of marital separation cases.

Secured debts, even when the debtor is behind on payments, can be managed in a Chapter 13, giving the debtor additional time to come up with money to save the secured property. Chapter 13 can also be used to protect

co-signers, who cannot be protected through a Chapter 7.

## **CHAPTER 7**

### **What is Chapter 7?**

Chapter 7 is the most popular type of bankruptcy. It is a legal proceeding in a special federal court, the United States Bankruptcy Court. At the end of this proceeding, certain debts are said to be discharged. [11 U.S.C. §727]. "Discharged" means, among other things, that the debtor no longer has to pay the debt. However, not all debts are dischargeable under Chapter 7. Most Chapter 7 cases are "no assets" cases. In a no assets case, none of the assets of the debtor are used to pay creditors. Assets are unavailable to pay creditors if they are already encumbered by liens at least equal to the value of the asset. An asset is unavailable if it does not become part of the bankruptcy estate [11 U.S.C. §541] — many, but not all, pensions may fall into this category. Also, an asset is unavailable if the debtor is able to claim it is "exempt".

### **How does Chapter 7 protect debtors?**

As soon as a bankruptcy is filed a debtor is protected by a part of the Bankruptcy Code called the "**Automatic Stay**". [11 U.S.C. §362]. This stay functions as an Order or injunction from the Bankruptcy Court and can be enforced by proceedings in the Bankruptcy Court. The stay stops most legal proceedings against the debtor. The Automatic Stay prohibits almost all attempts to collect debts owed by the debtor while the bankruptcy is pending. Most Chapter 7 cases will remain pending for three to four months. The 2005 Bankruptcy law created some new exceptions to the Automatic Stay, dealing with serial filers of repeat bankruptcies, and some actions against tenants involved in eviction actions. The law also changed to permit certain actions such as setoffs of tax refunds and withholding of wages to repay loans from retirement funds.

The Automatic Stay provision is a very important part of the Bankruptcy Code. It can be even more important than the discharge of debts. It will stop harassment by creditors over the phone or by letter. And it can be used to stop, at least temporarily, a foreclosure and give a debtor more time to come up with a mortgage arrearage.

However, this protection is not absolute. For instance, a secured creditor who is found to be by the Bankruptcy Court to be inadequately protected can be granted permission to repossess or foreclose on secured property. In most cases the Automatic Stay expires when the debts of the debtor are discharged. The discharge provisions of the Bankruptcy Code will then

generally prohibit almost all attempts to collect debts which have been discharged. However, after the discharge, creditors will be free to pursue debts which have not been discharged and debts which have been reaffirmed.

### **Who qualifies for Chapter 7?**

Any person who resides in the United States, or is domiciled here or who has business or property in the United States can be a debtor under Chapter 7. [11 U.S.C. §109]. A special exception to this rule prohibits some people whose bankruptcy case was involuntarily dismissed in the previous 180 days from refiling. A person who has received a discharge in another Chapter 7 (or Chapter 11) case filed within the preceding 8 years cannot be granted a Chapter 7 discharge. [11 U.S.C. §727(a)(8)]. Also, a Chapter 7 discharge cannot be granted to someone until 6 years after a Chapter 13 discharge.

The 2005 Bankruptcy Law created an additional barrier for some who seek Chapter 7 protection. A presumption of abuse is created unless a debtor can meet a new means test. This change will not affect most people who wish to file a Chapter 7 case. A "safe harbor" is created if a debtor's income is below the statewide median income for the debtor's family size. For instance, in Minnesota the median income for a 1 wage earner household is \$48,097 per year or if the family size is four people it is \$89,121. [The amounts are based on the debtor's income over the last six months before filing]. People who have incomes below this amount or disabled veterans will not be prevented from filing a Chapter 7.

Even a debtor with income over the median may still qualify by showing an inability to repay creditors. In this case, IRS standards for various normal expenses such as food, clothing, personal care, etc. are compared to the debtor's income. Deductions of standard amounts from IRS tables are permitted for transportation. Other necessary expenses from the IRS list of necessary expenses may also be deducted. These expenses include costs as child care, alimony, medical/dental care, expenses to avoid being a victim of domestic violence, taxes, or support of elderly and disable family members and various other expenses. Obviously, if your income is over the statewide median, your attorney may have to help you determine if a Chapter 7 filing is feasible.

Being able to file does not mean it is advisable to file under Chapter 7. A person who has substantial bills that are not dischargeable often will not benefit from Chapter 7. A person who owns substantial assets that would not be exempt may not benefit unless the debt that could be discharged would be substantially in excess of the assets that would be lost. Also, the Court

may dismiss the case of someone who could repay a substantial portion of his or her debt within a reasonable time it found the case amounted to an abuse of Chapter 7. There are other instances in which the filing of a Chapter 7 case would not benefit a debtor. It is important for people to seek competent legal advice before filing a bankruptcy petition.

### **How much does it cost to file a Chapter 7 Bankruptcy?**

The filing fee for a Chapter 7 case is \$306. While it is possible for a debtor to file without the help of an attorney or professional preparer, unassisted "pro se" filings are unusual. The amount charged for attorney fees normally reflects the difficulty of the case. Such factors as a large number of creditors, a debtor engaged in business or a unique legal situation requiring additional legal research will probably increase the attorney fee.

### **What property will a debtor lose in a Chapter 7 case?**

In most Chapter 7 cases, the debtor does not lose any property. The debtor is allowed to keep all property that does not become part of the bankruptcy estate or that is exempt. Also, property of little value may be abandoned by the trustee. The debtor's attorney first divides the property into various classifications such as the debtor's homestead, household goods or tools of the debtor's trade. The value of property in each classification is then determined. It is sometimes difficult to figure the exemptions a debtor is entitled to. In Minnesota the debtor is entitled to select one of two sets of exemptions sometimes called "federal" or "state" exemptions. Amounts in some classifications of property are not specified in exact terms but rather in terms such as "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." Classification of the debtor's property is important as well as the value of the property in each classification. Even though two debtors may have property worth the same total value, one debtor may keep a substantial amount of property and the other may lose valuable property.

However, some generalizations are possible. If the total value of the debtor's property is \$12,725.00 or less (\$25,450.00 for a married couple when both file) the debtor may not lose any property. A debtor may always keep his or her homestead if the debtor's equity in the real estate is \$22,975.00 or less (federal exemption) or \$390,000.00 or less assuming the land does not exceed an acreage limitation in Minnesota, (state exemption), but taking this exemption may reduce other exemptions the debtor is entitled to. If the homestead is agricultural the exemption is \$975,000.00. However, the new Bankruptcy Law will limit the amount of the state exemption to \$125,000 if

the property was acquired within 1215 days of filing, or if the debtor has been convicted of certain crimes or fiduciary or securities wrongful conduct. Depending on which set of exemptions the debtor uses, there is an exemption of up to \$3,675.00 (federal) or \$4,600.00 (state - Minnesota) for one motor vehicle (in a joint filing for a married couple each debtor would be entitled to one such exemption, but the vehicle must be titled in the name of the spouse who claims the exemption). The exemption for household goods is \$12,250.00 (federal) provided that no single item has a value in excess of \$575.00 or the debtor may elect a similar state exemption of \$10,350.00 for "personal goods" Some of the other exemptions permitted are for personal jewelry, tools of the trade and professional books, some life insurance, health aids, social security, unemployment comp, local public assistance, veterans benefits, alimony, child support, stock benefits, profitsharing annuities, crime victims reparations, certain wrongful death claims, wearing apparel, farm machines or implements, claims for property that would be exempt, mobile homes serving as a home, certain earnings of children and employee benefits and pensions. The 2005 Bankruptcy Law created a blanket (100%) exemption for certain types of retirement funds. Chapters 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code deal with pension, profit sharing and stock bonus plans, employee annuities, IRAs (including Roth IRAs), deferred compensation plans of state and local governments, tax exempt organizations and certain trusts.

There are many exemptions not discussed above. Ask your lawyer about any property you are concerned about. These exemptions all have various limitations and are broad categories often requiring more exact definitions.

Finally, valuation of property is sometimes a problem. The current value of the property is used, not the value of the time of purchase or at some future date when the debtor might sell. Also, only the debtor's interest in property is valued. If the debtor owns property along with someone else, only the debtor's part is valued. Also, if there is a lien on property the debtor's interest in the property is reduced by the amount of the lien. For instance, the debtor's interest in a home with a market value of \$100,000 and a mortgage of \$90,000 is \$10,000. If the amount of the lien is greater than the property the debtor may elect to keep the property but it may be in the debtor's interest to give up the property (see the next section).

### **Liens and Secured Debts.**

Secured creditors are those protected by a lien or mortgage against the debtor's property (often referred to as the "collateral"). The collateral is pledged to secure payment of a debt. Secured creditors have an interest in a specified item of property in the amount of their lien. A secured creditor will

generally be permitted to repossess or foreclose on the secured property unless the debtor elects to retain the property and reaffirm the debt. If the debtor reaffirms the debt, the secured creditor will be allowed to retain its rights to the collateral but the debtor will be permitted to retain the property subject to the terms and conditions of the security agreement. In some cases the amount of the lien will exceed the value of the collateral. In many of these cases the debtor will want to return the property to the secured creditor and discharge the debt. In some cases a debtor may wish to retain collateral even though the amount of the lien exceeds its value. This situation may be somewhat more complicated and debtors are advised to seek their lawyer's advice.

### **What debts can be discharged in a Chapter 7 case?**

All debts are discharged unless they are excepted from discharge by a section of the Bankruptcy Code. [11 U.S.C. §523]

The major **EXCEPTIONS TO DISCHARGE** are these:

1. Most taxes, but if enough time has passed the tax debt may be discharged. If a property tax has been owed for more than one year or you have an income tax debt more than three years old ask your lawyer if your tax debt can be discharged;
2. Debts for money, property or related to the extension, renewal or refinancing if procured through false pretenses, false representations or fraudulent financial statement; included are certain debts for luxury goods or services within 90 days before the bankruptcy was filed or certain cash advances within 70 days before filing;
3. Unlisted debts, IF the failure to notify the creditor prevented the creditor from filing a claim or objecting to the discharge of the debt.
4. Debts for fraud or embezzlement by a debtor in a position of trust;
5. Most domestic support obligations (including alimony, spousal maintenance or child support);
6. Debts for willful and malicious injury by the debtor;
7. Fines, penalties or forfeitures owed to a government;
8. Student loans and educational benefits, unless the debt poses an undue hardship on the debtor and debtor's dependents;
9. Debts for death or personal injury caused by the debtor's use of a motor vehicle while intoxicated by alcohol, a drug or other intoxicant;
10. Debts which were or could have been listed in a previous bankruptcy and were not discharged;
11. Certain debts owed to a spouse or ex-spouse arising in a divorce or separation, including property settlements;
12. Certain fees or assessment connected to membership associations (of condominiums or cooperative entities related to the debtor's interest in his

or her dwelling;

13. Debts incurred to pay non-dischargeable state or local taxes;
14. Federal election law fines and penalties;
15. Property settlements owed to a former spouse or to a child;
16. Certain fees imposed on prisoners by a court.
17. Loans on pensions; and
18. Certain debts arising from securities violations or wrongful acts of a fiduciary.

### **Objections to discharge.**

A creditor can object to discharge of a given debt, and may also object to the grant of a discharge to the debtor. These cases are fairly rare. The most common grounds for objecting to discharge are [11 U.S.C. §727]:

1. Intentional concealment, transfer or destruction of property by the debtor;
2. Failure to keep books or financial records;
3. Dishonesty in connection with the bankruptcy;
4. Unexplained loss of assets of the debtor;
5. Refusal to cooperate, obey court orders or to testify in a bankruptcy proceeding;
6. The debtor has been involved in prohibited transactions with insiders (persons closely related to the debtor);
7. A prior discharge was granted to the debtor in another Chapter 7 case within eight years; and
8. A prior discharge was granted to the debtor in a Chapter 13 case within six years – but a discharge may be granted if more than 70% of the unsecured claims were paid and the debtor made a good faith best effort to pay creditors in the Chapter 13 case.

Moreover, once granted a discharge may be **revoked** if the debtor obtained his or her discharge through fraud and the party requesting revocation was unaware of the fraud prior to the discharge or if the debtor fraudulently failed to report the acquisition of property that may have been part of the bankruptcy estate.

## **CHAPTER 13**

### **What is Chapter 13?**

Chapter 13 is sometimes called a repayment or wageearner's plan. The debtor is required to submit a **plan** to repay all or part of his or her debts. When the plan is confirmed (approved) by the Bankruptcy Court, creditors are not allowed to attempt to collect their debts from the debtor while the

Chapter 13 is pending.

At the end of the Chapter 13 plan, the dischargeable debts are discharged as in a Chapter 7 case. However,

### **What debts can be discharged under Chapter 13?**

Debts covered by the Plan will be discharged unless the debt is specifically excepted from discharged by the Bankruptcy Code. Discharge means that the debt is liquidated or terminated. The creditor is permanently prohibited from attempts to collect the debt. [11 U.S.C. §§ 524 & 1328] The discharge is granted at the end of the Chapter 13 Plan payments, which ordinarily last three to five years unless the debts are paid earlier. In unusual circumstances an early discharge can be granted. Debts paid outside the Plan are not discharged. Debts paid in installments are not discharged if the last payment is due after the last Plan payment.

The discharge offered under Chapter 13 is broader since it covers some classes of debts that are not covered by a Chapter 7. These debts can be discharged in a Chapter 13 case: debts for willful and malicious injury to property; marital property settlements and other obligations in a divorce decree or stipulation; debts from a prior chapter 7 case in which a discharge was denied; restitution, if not convicted of a crime; debts incurred to pay income taxes which cannot be discharged; and some other debts as well - ASK US.

Other debts **not** discharged are those owed for alimony (spousal maintenance), child support, most student loans (although under certain circumstances a student loan may be dischargeable - ask your lawyer), drunk driving personal injury or wrongful death claims, and fines or restitution ordered in a criminal case.

However, a few debtors will not be eligible for a discharge. If a Chapter 7, 11 or 12 discharge was received by the debtor, no discharge can be granted unless the Chapter 13 case was filed more than 4 years after the filing of the earlier case in which a discharge was granted. A discharge also can NOT be granted if the debtor received another Chapter 13 discharge and less than 2 years has elapsed between the filings of the two cases. [11 U.S.C. §1328(f)]

### **Why would a debtor make payments on a plan for debts that cannot be discharged?**

There may be important benefits even in the absence of a discharge. The automatic stay can still protect the debtor during the pendency of the case: cosigners can still be protected while a debt is paid; some mortgages can be

modified or the claim against a parcel of real estate can be 'stripped off'; a debtor behind on mortgage payments on his or her home may be able to use the Plan to allow extra time to pay off arrears; some car loans can be written down to the present value of the vehicle; and high interest rates on car loans (or certain other secured debts) can be reduced.

Moreover, payments on a Plan will often be less than the creditor could take from the debtor if the creditor used collection remedies available to it such as wage garnishment or execution on the debtor's property. Chapter 13 filings are sometimes made to prefer payment of one creditor over another. For instance, a debtor may prefer that money of property subject to seizure by creditors be used to pay back taxes, alimony or child support in preference to other creditors. It may also be possible to protect a co-signer of a debt incurred by the debtor by making payments on such a debt before other debts are paid under the plan. Also, if a creditor has seized a substantial asset, the debtor should ask his attorney whether bankruptcy could be used as a means to retrieve the seized property.

### **Is Chapter 13 like debt consolidation services?**

Chapter 13 is generally superior to debt consolidation plans worked out with private companies because the Bankruptcy Court can force creditors to accept the plan and often can require them to accept a smaller payment. Chapter 13 can stop repossessions or foreclosures whether or not the creditor agrees to the payments in the plan. Debt consolidation companies have no legal powers to force creditors to accept a plan and if one large creditor insists on full payment there often will not be adequate funds to pay the remaining creditors.

### **Who qualifies for a Chapter 13?**

The Bankruptcy Act limits Chapter 13 to natural individuals (excluding artificial entities such as corporations). The person must also reside in, do business in or own property in the United States, have regular income, unsecured debts of less than \$383,175, secured debts of less than \$1,149,525 [11 U.S.C. §109(e)], not be a stockbroker or commodity broker and not have another bankruptcy dismissed on certain grounds within the previous 180 days. Some individuals who cannot file under Chapter 7 may file under Chapter 13 - for instance, those who have received a Chapter 7 discharge within the preceding 8 years. However, in some cases a discharge may not be available as explained above.

### **How does Chapter 13 protect debtors?**

As in a Chapter 7, when a Chapter 13 Petition is filed the debtor is protected by an automatic stay. A discussion of this stay appears above in the discussion of Chapter 7. This stay stops creditors from taking any action to collect their debts existing when the Petition is filed (with only a few exceptions). Actions against property of the debtor are also generally prohibited. If a creditor violates the stay by attempting to collect its debt, the Bankruptcy Court can impose sanctions such as fining the creditor or in very serious cases imprisoning those responsible for violating the stay. The stay lasts until the Chapter 13 case is dismissed, until the debtor is granted (or denied) a discharge or until the Court grants a creditor permission to act to protect itself by taking various actions against the debtor or debtor's property. These actions by a creditor to set aside the stay apply only to a limited number of situations when it is necessary for a creditor to adequately protect its interest in the debtor's property. The stay generally does not cover claims which arose after the Chapter 13 case is filed.

### **What property will a debtor lose under Chapter 13?**

In most cases a Chapter 13 debtor will not lose any property. However, if the debtor is unable to make substantial payments on secured debts to protect collateral and also make payments on the Chapter 13 Plan, the debtor may have to decide whether the property is more important than Chapter 13 protection. Also, in a small number of cases the debtor may have insufficient income to make adequate payments to creditors. In this case it might be necessary to sell property in order to pay creditors.

### **Does Chapter 13 cover secured debts?**

Secured debts are those protected or "secured" by liens or mortgages on property. A debt is only secured through the value of the property. For instance, if \$5,000 is owed on a "secured" debt on a car worth only \$3,000, the creditor has a secured claim of \$3,000 and an unsecured claim of \$2,000. There are several ways to handle secured debts under Chapter 13. The most common way is to pay the secured debt "outside the plan". The debtor would simply make normal payments as they come due and retain the debtor's interest in the secured property. Since the Trustee charges a small fee based on the money paid out through the plan, paying outside the plan may save a small amount. If the debtor is behind in payments, it may be advisable to pay the arrears along with the ordinary monthly payments under the plan. For instance, the plan may provide for payments of \$100 per month on a loan secured by an automobile.

In some cases, it may be necessary to provide in the plan for "adequate protection payments" to compensate the creditor for potential declining

value in the secured property while the debt is paid off under the plan. However, all these payments are credited against the secured debt owed by the debtor.

Home mortgages may be treated slightly differently. Normally, payments in a plan can be made on only the mortgage arrears, with regular house payments made outside the plan. Generally, interest and late fees stop on the mortgage arrears, but the arrears must be paid within a reasonable time. For all secured property, the debtor may choose to give up the collateral to the secured creditor; and treat any remaining debt owed to that creditor as an unsecured debt. If special treatment is required and the secured creditor is agreeable, the secured creditor and the debtor may simply design their own mutually agreeable plan for payment of the creditor.

In some cases it is possible to "strip off" a secured claim. If a secured claim, such as the second mortgage on a home, is wholly unsecured it may be stripped off — that is it will no longer be a secured claim on the home. For instance, if a home is worth \$150,00 and there are a first mortgage of \$175,00 and a second mortgage of \$100,000, the second mortgage will no longer be a charge against the property. The second mortgage would, in essence, become an unsecured claim — and be treated like any other unsecured claim in the debtor's plan. The plan might pay such a claimant 5% or up to 100% of such a claim. In a few cases the claimant might receive nothing at all.

With car loans and other secured claims it may be possible to "cram down" the value of a secured loan and, if the interest rate is too high, reduce the interest on the claim as well. For instance, if a debtor owed \$15,000 on a car with interest of 24% and the car's present value was \$10,000 the value of the secured claim could be crammed down to \$10,000 and the interest to typically 4.25% to 6.25%. [11 U.S.C. §1322(b)(2)] The remainder of the claim (\$5,000) would be treated as an ordinary unsecured claim. This treatment is not available for all secured claims or for all car loans. Ask your lawyer if your loan(s) can be handled in this way.

### **How much is the Chapter 13 payment?**

In most cases the "disposable" income of the debtor must be applied to plan payments. Disposable income is the money left over after the debtor pays reasonable and necessary expenses. The debtor is required to report regular monthly income and expenses by categories such as taxes, rent, food, insurance or transportation.

### **How long does the Plan last?**

Unless all the debts can be paid off sooner, a Plan must last at least three years and may not last more than five years. Even if the plan could be paid off sooner, the trustee may demand that at least 36 payments be made.

### **What happens if all the debts cannot be paid during the plan?**

If the debt is not entirely paid but is still dischargeable, it is simply discharged at the end of the Plan. At the end of the Chapter 13 proceeding, secured debts and installment debts not discharged on which payments remain due will be treated just as they were prior to the filing. The automatic stay expires with the termination of the Chapter 13 action.

### **What debts can be included in the plan?**

A plan may be used to pay almost any debt. However, not all debts can be discharged at the end of the plan.

**We are a debt relief agency. We help people to file for Bankruptcy under the Bankruptcy Code.**

## **OTHER INFORMATION**

### **Debtor Education Agencies:**

[http://www.justice.gov/ust/eo/bapcpa/ccde/DE\\_Files/DE\\_Approved\\_Agencies\\_HTML/de\\_minnesota/de\\_minnesota.htm](http://www.justice.gov/ust/eo/bapcpa/ccde/DE_Files/DE_Approved_Agencies_HTML/de_minnesota/de_minnesota.htm)

### **Credit Counseling Agencies:**

[http://www.justice.gov/ust/eo/bapcpa/ccde/CC\\_Files/CC\\_Approved\\_Agencies\\_HTML/cc\\_minnesota/cc\\_minnesota.htm](http://www.justice.gov/ust/eo/bapcpa/ccde/CC_Files/CC_Approved_Agencies_HTML/cc_minnesota/cc_minnesota.htm)

### **BKY filing fees (current):**

<http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyResources/BankruptcyFilingFees.aspx>

### **Filing fees increase June 1, 2014:**

Chapter 7 filing fees will increase to \$335.00 (from \$306.00)  
Chapter 11 filing fees will increase to \$1,717.00 (from \$1,213.00)  
Chapter 13 filing fees will increase to \$310.00 (from \$281.00)