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QUESTIONS AND ANSWERS ABOUT CHAPTER 7 BANKRUPTCIES

1. What is a chapter 7 bankruptcy case and how does it work?

A chapter 7 bankruptcy case is a proceeding under federal law in which the debtor seeks relief under chapter 7 of the Bankruptcy Code. Chapter 7 is that part (or chapter) of the Bankruptcy Code that deals with liquidation. The Bankruptcy Code is a federal law that deals with bankruptcy. A person who files a chapter 7 case is called a debtor. In a chapter 7 case, the debtor must turn his or her nonexempt property, if any exists, over to a trustee, who then converts the property to cash and pays the debtor's creditors. In return, the debtor receives a chapter 7 discharge, if he or she pays the filing fee, is eligible for the discharge, and obeys the orders and rules of the bankruptcy court.

2. What is a chapter 7 discharge?

It is a court order releasing a debtor from all of his or her dischargeable debts and ordering the creditors not to attempt to collect them from the debtor. A debt that is discharged is a debt that the debtor is released from and does not have to pay.

3. How does a person obtain a chapter 7 discharge?

A chapter 7 discharge is obtained by filing and maintaining a chapter 7 bankruptcy case and being eligible for a chapter 7 discharge. However, not all debts are discharged by a chapter 7 discharge. Certain types of debts are by law not dischargeable under chapter 7 and debts of this type will not be discharged even if the debtor receives a chapter 7 discharge.

4. Who is permitted to file and maintain a chapter 7 case?

Any person who resides in, does business in, or has property in the United States is permitted to file a chapter 7 bankruptcy case except a person who has intentionally dismissed a prior bankruptcy case within the last 180 days. To be permitted to maintain a chapter 7 bankruptcy case a person must qualify for chapter 7 relief under a process called means testing.

5. What is means testing?

Means testing is a method of determining a person's eligibility to maintain a chapter 7 case. Under means testing a person whose current monthly income from all sources multiplied by 12 exceeds the median annual income, as reported by the U.S. Census Bureau, for the person's state and family size, must show that he or she is not able to pay a minimum of \$109.58 per month for 60 months to his or her unsecured creditors from his or her disposable monthly income in order to be eligible to maintain a chapter 7 case. Disposable monthly income is a person's current monthly income from all sources less the person's permitted current monthly expenses. The chapter 7 case of a person whose disposable monthly income is such that he or she is deemed to be able to pay \$109.58 per month or more to unsecured creditors for 60 months will be dismissed or converted to chapter 13 unless special circumstances exist.

6. How is means testing carried out?

Every person who files a chapter 7 case must file a document called Statement of Current Monthly Income and Means Test Calculation. This document, when completed and filed, shows the person's current monthly income and the current monthly expenses that a person is allowed to claim. The person may also be questioned about his or her income and expenses at the meeting of creditors. From these sources a person's current monthly disposable income is calculated. This figure is then used to determine the amount of the monthly payment that the person can afford to make to his or her unsecured creditors. If the amount of this monthly payment is above a certain figure (usually \$100), the person will almost always be disqualified from maintaining a chapter 7 case and the case will be dismissed or, with the person's consent, converted to chapter 13.

7. How is it decided whether a person is ineligible for chapter 7 under means testing?

The Statement of Current Monthly Income and Means Test Calculation filed by the person will initially show whether the person is able to make monthly payments to unsecured creditors in the amount required for ineligibility. If so, the clerk of the bankruptcy court will send a notice to all creditors that a presumption of abuse has arisen in the case. The United States trustee then has until 10 days after the meeting of creditors to file a statement as to whether a presumption of abuse exists in the case. Then the United States trustee or any creditor can move to dismiss the case. The bankruptcy judge will ultimately decide whether the case should be dismissed.

8. What is a presumption of abuse and how does it affect the case?

When a chapter 7 case is filed by an ineligible person, under bankruptcy terminology that person is said to have abused the chapter 7 laws. When a person whose current monthly disposable income is such that he or she can afford to make monthly payments to unsecured creditors in the required amount, a presumption of abuse is said to arise in the case. If a presumption of abuse arises in a case, the case will be dismissed or converted to chapter 13 unless the person filing the case can prove the existence of special circumstances, such as a serious medical condition.

9. Who is eligible for a chapter 7 discharge?

Any person who is qualified to file and maintain a chapter 7 case is eligible for a chapter 7 discharge except the following:

- (1) A person who has been granted a discharge in a chapter 7 case that was filed within the last 8 years.
- (2) A person who has been granted a discharge in a chapter 13 case that was filed within the last 6 years, unless 70 percent or more of the debtor's unsecured claims were paid off in the chapter 13 case.
- (3) A person who files and obtains court approval of a written waiver of discharge in the chapter 7 case.
- (4) A person who conceals, transfers, or destroys his or her property with the intent to defraud his or her creditors or the trustee in the chapter 7 case.
- (5) A person who conceals, destroys, or falsifies records of his or her financial condition or business transactions.
- (6) A person who makes false statements or claims in the chapter 7 case, or who withholds recorded information from the trustee.
- (7) A person who fails to satisfactorily explain any loss or deficiency of his or her assets.
- (8) A person who refuses to answer questions or obey orders of the bankruptcy court, either in his or her bankruptcy case or in the bankruptcy case of a relative, business associate, or corporation with which he or she is associated.
- (9) A person who, after filing the case, fails to complete an instructional course on personal financial management.
- (10) A person who has been convicted of bankruptcy fraud or who owes a debt arising from a securities law violation.

10. What types of debts are not dischargeable in a chapter 7 case?

All debts of any type or amount, including out-of-state debts, are dischargeable in a chapter 7 case except for the types of debts that are by law nondischargeable in a chapter 7 case. The following is a list of the most common types of debts that are not dischargeable in a chapter 7 case:

- (1) Most tax debts and debts that were incurred to pay nondischargeable federal tax debts.
- (2) Debts for obtaining money, property, services, or credit by means of false pretenses, fraud, or a false financial statement, if the creditor files a complaint in the bankruptcy case.
- (3) Debts not listed on the debtor's chapter 7 forms, unless the creditor knew of the bankruptcy case in time to file a claim.
- (4) Debts for fraud, embezzlement, or larceny, if the creditor files a complaint in the bankruptcy case.
- (5) Debts for domestic support obligations, which include debts for alimony, maintenance, or support, and certain other divorce-related debts, including property settlement debts.
- (6) Debts for intentional or malicious injury to the person or property of another, if the creditor files a complaint in the bankruptcy case.
- (7) Debts for certain fines or penalties.
- (8) Debts for most educational benefits and student loans, unless a court finds that not discharging the debt would impose an undue hardship on the debtor and his or her dependents.
- (9) Debts for personal injury or death caused by the debtor's operation of a motor vehicle, vessel or aircraft while intoxicated.
- (10) Debts that were or could have been listed in a previous bankruptcy case of the debtor in which the debtor did not receive a discharge.

11. Who should not file a Chapter 7 case?

A person who is not eligible for a chapter 7 discharge should not file a chapter 7 case. Also, in most instances a person who has substantial debts that are not dischargeable under chapter 7 should not file a chapter 7 case. In addition, it is not usually advisable for a person with disposable income sufficient to make the required minimum payments to unsecured creditors to file a chapter 7 case, because a presumption of abuse will arise and the case will probably be dismissed or converted to chapter 13.

12. Is there anything that a person must do before a chapter 7 case can be filed?

Yes. A person is not permitted to file a chapter 7 case unless he or she has, during the 180-day period prior to filing, received from an approved nonprofit budget and credit counseling agency an individual or group briefing that outlined the opportunities for available credit counseling and assisted the person in performing a budget analysis. This briefing may be conducted by telephone or on the internet, if desired, and must be paid for by the person. When the chapter 7 case is filed, a certificate from the agency describing the services provided to the person must be filed with the court. A copy of any debt repayment plan prepared for the person by the agency must also be filed with the court. In emergency situations, the required credit counseling may be conducted after the case is filed.

13. How much is the filing fee in a chapter 7 case and when must it be paid?

The filing fee is \$299 for either a single or a joint case. The filing fee is payable when the case is filed. However, if the person filing can show that his or her income is less than 150 percent of the official poverty line and that he or she is unable to pay the filing fee, the court can waive payment of the filing fee. If the person filing is unable to pay the entire filing fee when the case is filed, it may be paid in up to four installments, with the final installment due within 120 days. The period for payment may later be extended to 180 days by the court, if there is a valid reason for doing so. Unless payment is waived by the court, the entire filing fee must ultimately be paid or the case will be dismissed and no debts will be discharged.

14. Where should a chapter 7 case be filed?

A chapter 7 case is filed in the office of the clerk of the bankruptcy court in the district where the debtor has resided or maintained a principal place of business for the greater portion of the last 180 days. The bankruptcy court is a federal court and is a unit of the United States district court.

15. May a husband and wife file jointly under chapter 7?

Yes. A husband and wife may file a joint case under chapter 7. If a joint chapter 7 case is filed, only one set of bankruptcy forms is needed and only one filing fee is charged. However, both husband and wife must receive the required credit counseling before the case is filed and both must complete the required financial management course after the case is filed.

16. Under what circumstances should a joint chapter 7 case be filed?

A husband and wife should file a joint chapter 7 case if both of them are liable for one or more significant dischargeable debts. If both spouses are liable for a substantial debt and only one spouse files under chapter 7, the creditor may later attempt to collect the debt from the nonfiling spouse, even if he or she has no income or assets. In community property states it may not be necessary for both spouses to file if all substantial dischargeable debts are community debts. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington.

17. When is the best time to file a chapter 7 case?

The answer depends on the status of the person's dischargeable debts, the nature and status of the person's nonexempt assets, and the actions taken or threatened to be taken by creditors. The following rules should be followed:

- (1) Don't file the case until all anticipated debts have been incurred, because only debts that have been incurred when the case is filed are dischargeable and it will be another six years before the person is again eligible for a chapter 7 discharge. For example, a person who has incurred substantial medical expenses should not file a chapter 7 case until the illness or injury has been either cured or covered by insurance, as it will do little good to discharge, say, \$100,000 of medical debts now and then incur another \$100,000 in medical debts after the case has been filed.
- (2) Don't file the case until the person filing has received all nonexempt assets to which he or she may be entitled. If the person is entitled to receive an income tax refund or a similar nonexempt asset in the near future, the case should not be filed until after the refund or asset has been received and disposed of. Otherwise, the refund or asset will have to be turned over to the trustee.
- (3) Don't file the case if the person filing expects to acquire nonexempt property through inheritance, life insurance or divorce in the next 180 days, because the property may have to be turned over to the trustee.
- (4) If an aggressive creditor has threatened to attach or garnishee a person's assets or income, the case should be filed immediately to take advantage of the automatic stay that accompanies the filing of a chapter 7 case (see Question 18, below). If a creditor has threatened to attach or garnishee the person's wages or if a foreclosure action has been filed against his or her home, it may be necessary to file the case immediately in order to protect the person's interest in the property.

18. How does the filing of a chapter 7 case by a person affect collection and other legal proceedings that have been filed against that person in other courts?

The filing of a chapter 7 case by a person automatically suspends virtually all collection and other legal proceedings pending against that person. A few days after a chapter 7 case is filed, the court will mail a notice to all creditors ordering them to refrain from any further action against the person. This court-ordered suspension of creditor activity against the person filing is called the automatic stay. If necessary, notice of the automatic stay may be served on a creditor earlier by the person or the person's attorney. Any creditor who intentionally violates the automatic stay may be held in contempt of court and may be liable in damages to the person filing. Criminal proceedings and actions to collect domestic support obligations from exempt property or property acquired by the person after the chapter 7 case was filed are not affected by the automatic stay. The automatic stay also does not protect cosigners and guarantors of the person filing, and a creditor may continue to collect debts from those persons after the case is filed. Persons who have had a prior bankruptcy case dismissed within the past year may be denied the protection of the automatic stay.

19. How does filing a chapter 7 case affect a person's credit rating?

Contrary to popular belief, if you have already fallen behind on your payments, your credit rating may actually improve in the year following your bankruptcy. This is because you no longer are carrying large amounts of debt and delinquent balances. Some financial institutions openly solicit business from persons who have recently filed under chapter 7, apparently because it will be at least 8 years before they can file another chapter 7 case. If there are compelling reasons for filing a chapter 7 case that are not within the person's control (such as an illness or an injury), some credit rating agencies may take that into account in rating the person's credit after filing.

20. Are the names of persons who file chapter 7 cases published?

When a chapter 7 case is filed, it becomes a public record and the names of the persons filing may be published by some credit-reporting agencies. However, newspapers do not usually report or publish the names of consumers who file chapter 7 cases.

21. Are employers notified of chapter 7 cases?

Employers are not usually notified when a chapter 7 case is filed. However, the trustee in a chapter 7 case often contacts an employer seeking information as to the status of the person's wages or salary at the time the case was filed or to verify a person's current monthly income. If there are compelling reasons for not informing an employer in a particular case, the trustee should be so informed and he or she may be willing to make other arrangements to obtain the necessary information.

22. Does a person lose any legal or civil rights by filing a chapter 7 case?

No. Filing a chapter 7 case is not a criminal proceeding, and a person does not lose any civil or constitutional rights by filing.

23. May employers or governmental agencies discriminate against persons who file chapter 7 cases?

No. It is illegal for either private or governmental employers to discriminate against a person as to employment because that person has filed a chapter 7 case. It is also illegal for local, state, or federal governmental agencies to discriminate against a person as to the granting of licenses (including a driver's license), permits, student loans, and similar grants because that person has filed a chapter 7 case.

24. Will a person lose all of his or her property if he or she files a chapter 7 case?

Usually not. Certain property is exempt and may not be taken by creditors unless it is encumbered by a valid mortgage or lien. A person is usually allowed to retain his or her unencumbered exempt property in a chapter 7 case. A person may also be allowed to retain certain encumbered exempt property (see Question 34, below). Encumbered property is property against which a creditor has a valid lien, mortgage or other security interest.

25. What is exempt property?

Exempt property is property that is protected by law from the claims of creditors. However, if exempt property has been pledged to secure a debt or is otherwise encumbered by a valid lien or mortgage, the lien or mortgage holder may claim the exempt property by foreclosing upon or otherwise enforcing the creditor's lien or mortgage. In bankruptcy cases property may be exempt under either state or federal law. Exempt property typically includes all or a portion of a person's unpaid wages, home equity, household furniture, and personal effects. Your attorney can inform you as to the property that is exempt in your case.

26. When must a person appear in court in a chapter 7 case and what happens there?

The first court appearance is for a hearing called the "meeting of creditors," which is usually held about a month after the case is filed. The person filing the case must bring photo identification, his or her social security card, his or her most recent pay stub and all of his or her bank and investment account statements to this hearing. At this hearing the person is put under oath and questioned about his or her debts, assets, income and expenses by the hearing officer or trustee. In most chapter 7 consumer cases no creditors appear in court; but any creditor that does appear is usually allowed to question the person. For most persons this will be the only court appearance, but if the bankruptcy court decides not to grant the person a discharge or if the person wishes to reaffirm a debt, there may be another hearing about three months later which the person will have to attend.

27. What happens after the meeting of creditors?

After the meeting of creditors, the trustee may contact the person filing regarding his or her property and the court may issue certain orders to the person. These orders are sent by mail and may require the person to turn certain property over to the trustee, or provide the trustee with certain information. If the person fails to comply with these orders, the case may be dismissed, in which case his or her debts will not be discharged. The person must also attend and complete an instructional course on personal financial management and file a statement with the court showing completion of the course.

28. What is a trustee in a chapter 7 case, and what does he or she do?

The trustee is a person appointed by the United States trustee to examine the person who filed the case, collect the person's nonexempt property, and pay the expenses of the estate and the claims of creditors. In addition, the trustee has certain

administrative duties in a chapter 7 case and is responsible for seeing to it that the person filing performs the required duties in the case. A trustee is appointed in a chapter 7 case, even if the person filing has no nonexempt property.

29. What are the responsibilities to the trustee of the person filing the case?

The law requires the person filing to cooperate with the trustee in the administration of a chapter 7 case, including the collection by the trustee of the person's nonexempt property. If the person does not cooperate with the trustee, the chapter 7 case may be dismissed and the person's debts will not be discharged. At least 7 days before the meeting of creditors the person filing must give the trustee and any requesting creditors copies of his or her most recent Federal income tax returns.

30. What happens to property that is turned over to the trustee?

It is usually converted to cash, which is used to pay the fees and expenses of the trustee, to pay the claims of priority creditors, and, if there is any left, to pay the claims of unsecured creditors.

31. What if a person has no nonexempt property for the trustee to collect?

If, from the bankruptcy forms filed, it appears that the person filing has no nonexempt property, a notice will be sent to the creditors advising them that there appears to be no assets from which to pay creditors, that it is unnecessary for them to file claims, and that if assets are later discovered they will then be given an opportunity to file claims. This type of case is referred to as a no-asset case. Most chapter 7 cases that are filed by consumers are no-asset cases.

32. How are secured creditors dealt with in a chapter 7 case?

Secured creditors are creditors with valid mortgages or liens against property of the person filing. Property that is encumbered by a valid mortgage or lien is called secured property. A secured creditor is usually permitted to repossess or foreclose on its secured property, unless the value of the secured property greatly exceeds the amount owed to the creditor. The claim of a secured creditor is called a secured claim and secured claims are collected from or enforced against encumbered property. Secured claims are not paid by the trustee. A secured creditor must prove the validity of its mortgage or lien and must usually obtain a court order before repossessing or foreclosing on encumbered property. Encumbered property should not be turned over to a secured creditor until a court order to do so has been obtained, unless the property is encumbered only to finance its purchase. The debtor may be permitted to retain certain types of encumbered personal property (see Question 34, below).

33. How are unsecured creditors dealt with in a chapter 7 case?

An unsecured creditor is a creditor without a valid lien or mortgage against property of the person filing. If the person filing has nonexempt assets, unsecured creditors may file claims with the court within 90 days after the first date set for the meeting of creditors. The trustee will examine these claims and file objections to those deemed improper. When the trustee has collected all of the person's nonexempt property and converted it to cash, and when the court has ruled on the trustee's objections to improper claims, the trustee will distribute the funds in the form of dividends to the unsecured creditors according to the priorities set forth in the Bankruptcy Code. Domestic support obligations, administrative expenses, claims for wages, salaries, and contributions to employee benefit plans, claims for the refund of certain deposits and tax claims, are given priority, in that order, in the payment of dividends by the trustee. If there are funds remaining after the payment of these priority claims, they are distributed pro rata to the remaining unsecured creditors. In chapter 7 cases filed by consumers, unsecured creditors usually get nothing.

34. What encumbered property may a person retain in a chapter 7 case?

A person may retain (or redeem) certain encumbered personal and household property, such as household furniture, appliances and goods, wearing apparel, and tools of trade, without payment to the secured creditor, if the property is exempt and if the mortgage or lien against the property was not incurred to finance the purchase of the property. A person may also retain without payment to the secured creditor any encumbered property that is both exempt and subject only to a judgment lien that is not divorce-related. Finally, a person may retain certain encumbered exempt personal, family, or household property by paying to the secured creditor an amount equal to the replacement value of the property, regardless of how much is owed to the creditor.

35. How may a person minimize the amount of money or property that must be turned over to the trustee in a chapter 7 case?

In a chapter 7 case the person filing is required to turn over to the trustee only the nonexempt money or property that he or she possessed at the time the case was filed. Many nonexempt assets are liquid in nature and tend to vary in size or amount from day to day. It is wise, therefore, to engage in some estate planning so as to minimize the value or amount of these liquid assets on the day and hour that the chapter 7 case is filed. The most common nonexempt liquid assets, and the assets that the trustee will be most likely to look for, include the following:

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| (1) cash, | (5) accrued earnings and benefits, |
| (2) bank accounts, | (6) tax refunds, and |
| (3) prepaid rent, | (7) sporting goods. |
| (4) landlord and utility deposits, | |