



RESOLVING INSOLVENCY

Lesson 18

In the old days when someone couldn't pay their debts they could be sent to debtor's prison or forced into indentured servitude until the creditor was repaid. Others could be forced to sell off everything and were left penniless and destitute. Thankfully, times have changed.

If we tossed people who couldn't pay their loans or other debts into prison, or forced them into service, what would happen? Who would risk starting a business if you could go to prison if it failed? Would you risk buying something on credit if your inability to repay it meant being left penniless and forced to live on the street? Wouldn't that have a chilling effect on the economy?

I. WHY BANKRUPTCY?

- *Bankruptcy*: People, businesses, and even local governments like cities or counties, can find themselves in the unfortunate position of having too much debt and too little income.
- **The Economic Benefits of Bankruptcy**
 1. Avoids Destitution.
 2. Manages Risk.
 3. Provides Uniformity.

II. TYPES OF BANKRUPTCY CASES

- I. There are six bankruptcy chapters: **7, 9, 11, 12, 13, 15**

III. DISCHARGEABLE VS. NON-DISCHARGEABLE DEBT

| Dischargeable Debt (can be eliminated) | Non-Dischargeable Debt (can't be eliminated) |
|---|--|
| <ul style="list-style-type: none"> • consumer debt (credit card debt fees and late charges) • medical bills • personal loans • utility bills • unpaid rent | <ul style="list-style-type: none"> • child support and alimony payments • criminal fines and orders of restitution • most income taxes (particularly if the debtor never filed their tax return.) • fraudulently obtained loans • debts resulting from "willful and malicious" harm • student loans • debts not listed in the bankruptcy petition • mortgages and liens (personal responsibility for the loan can be discharged, but the creditor retains the right to the collateral) |

IV. EXEMPT VS. NONEXEMPT PROPERTY

| Exempt Property (can't be sold by trustee) | Nonexempt Property (can be sold by trustee) |
|---|--|
| <ul style="list-style-type: none"> • car or motor vehicle (up to a certain value) • necessary clothes • necessary household goods and furnishings • household appliances • jewelry up to about \$1500 • Pensions and Retirement Accounts up to about \$1,200,000 • Some equity in their home, which is called the <i>Homestead Exemption</i> • Things they need for their job, like carpentry tools, dental or tech equipment | <ul style="list-style-type: none"> • a vacation home • a second (or third) car • collections of value like stamps or coins • investments such as stocks, bonds and other accounts • sports equipment • jewelry • electronics • designer clothing that is not a necessity for living (Sorry, your Gucci purse will be sold by the trustee.) |

V. BANKRUPTCY'S LIMITATIONS AND ALTERNATIVES

Limitations to Bankruptcy

- Can't Abuse the System.
- Won't Discharge Co-Debtor.
- Won't Fix a Credit Score.

Alternatives to Bankruptcy

- Credit Counseling.
- Debt Management Plans.
- Debt Consolidation Companies.

THE BIG PICTURE

- Overall, bankruptcy is a sad and difficult event. However, society benefits from laws that make financial risk more manageable and impartially represent the interests of debtors and creditors alike. The three chapters of bankruptcy you are most likely to encounter in your life are 7, 11 or 13. Chapter 7 is a straight bankruptcy with the liquidation of assets to pay creditors. Chapter 11 allows a business to discharge some debts while continuing to operate. Chapter 13 enables people with a steady income to eliminate or reduce debt and work out a repayment plan with creditors. Some debts, like criminal fines and penalties, most taxes, and student loans cannot be eliminated in bankruptcy. A bankruptcy case stays on a credit report for seven to ten years. A qualified credit counselor can help get debt under control.