Bankruptcy Filing Changes That Could Affect You

by Diane Hamilton, Ph.D (Contact Author | Biography)

It isn't much of a surprise that when the economy suffers a downturn, the number of people filing bankruptcy increases. Since 2005, there have been several changes to U.S. bankruptcy laws that may make it harder to file than it used to be. As changes are implemented, it is important to know what your options are if you are considering filing.

Changes to the Laws in 2005

In 2005, the new bankruptcy laws made changes to filing Chapter 7 (liquidation) and Chapter 13 (repayment). These changes made it harder for higher income filers to file for Chapter 7. The filer's income now had to be measured vs. the median income for others in the filer's state in order to qualify. Those who hoped to file for bankruptcy also had to pass the "means test", which examined disposable income. This is the income that is left after paying required debt. Credit counseling also became a requirement. Those considering bankruptcy would need to attend counseling sessions with an approved agency from the United States Trustee's office.

Chapter 7 is about liquidating rather than repayment. It used to be that filers could choose whether they wanted Chapter 7 or 13. Now, if their income is high, they may not have a choice and will have to file Chapter 13. In order to file Chapter 7, a filer would have to prove (through the above-mentioned means) that he or she falls below a certain low sum of money. For Chapter 7, assets are sold and the proceeds go to the filer's creditors. (To learn more, read *What Are The Differences Between Chapter 7 And Chapter 11 Bankruptcies?*)

Chapter 13 is about repayment. All income goes into paying off debt. If available income is greater than that of the median in the filer's home state, the filer's allowable expenses will be determined by the IRS. This amount must come out of the filer's income during the six-month period before filing.

Once a person has filed for bankruptcy, only debt that was applied for will be forgiven. Remember that bankruptcy does not eliminate student loans or taxes due. And a bankruptcy is not an easy way to get rid of debt - it will stay on a credit report for 10 years and make borrowing very difficult (if not impossible) during this period.

Many question if they will be able to buy a home after a bankruptcy. They will be eligible for a mortgage two years after the bankruptcy has been discharged. They will probably find that once they are able to establish credit again, the rate they will be paying may be higher than they would have paid had they not filed for bankruptcy. This is because they are now a higher risk to the lender. (To avoid the perils of bankruptcy, see *9 Ways To Go Bankrupt*.)

Obama and the Bankruptcy Act of 2009

The Bankruptcy Act of 2009 was designed to make changes to the original Act of 2005. Because it became more difficult to file under the 2005 act, this new act was designed to make it easier. In August of 2009, John Rao (attorney for the National Consumer Law Center) testified before the United States Senate, questioning the role of the bankruptcy courts. Rao noted that there have been efforts to help borrowers with loan modification through the Home Affordable Modification Program (HAMP) announced in the spring of 2009 by the Obama administration. However, not all who have requested loan modification have been successful in obtaining it. That is where loosening bankruptcy restrictions could help.

A new term you may be hearing throughout all of this is "cram down." Part of filing Chapter 13 is that you can lower the amount you owe, or "cram down" debt. The bill proposed by Obama was referred to as the "cram down" bill. This bill was designed to help reduce interest rates and mortgage balances. It could have increased the number of Chapter 13 filings. However, the senate shot down this legislation. It needed 60 votes to have it pass and only received 45.

FAQs

There may be many questions someone still has after filing bankruptcy. If you owned a home before filing Chapter 7, your home may be exempt, which means you will get to keep it. If you filed Chapter 13, you also get to keep your assets because you have paid off your debt. Although the bankruptcy will stay on your credit report for 10 years, you can still begin to re-establish credit in the meantime.

Often, people are concerned about who will find out about their bankruptcy. Your employer and your landlord will not be notified. You can technically file for bankruptcy every eight years under Chapter 7. Under Chapter 13, you can file as many times as is necessary as long as you have paid at least 70% of your unsecured debt under your last Chapter 13 filing. (For more, check out *Bankruptcy Protection For Your Accounts*.)

As noted previously, taxes are not wiped out from filing bankruptcy. However, under Chapter 13, you will not have to pay interest or penalties. Under Chapter 7 some taxes may be discharged. A good bankruptcy attorney could help you distinguish between those that may qualify and those that do not.

Myths

The following are some of the common myths involved in bankruptcy:

- You will lose everything you own.
  Each state has different laws, but certain assets are protected such as your home, car (depending on value), retirement money and certain clothing and personal items.

- You will never get credit again.
  Although getting a home or a car may be difficult for a while, there will be lenders who will offer you credit (usually at a higher rate than before your bankruptcy).

- You will get rid of back taxes.
  Usually you cannot get rid of taxes. However, you might want to check out something called

tax bankruptcy if you have taxes that are more than three years overdue.

- You can use bankruptcy as an excuse to max out your credit cards.
  It is considered fraud to do this before you file.

The Bottom Line
Even though it has become harder to file bankruptcy since the 2005 act, when the economy is down more people continue to file. Bills such as the "cram down" bill have been shot down by the Senate. However, creditors are actually being hurt by the 2005 act, due to record default rates. (For more, see *What You Need To Know About Bankruptcy*.)

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