# GUERRILLA GUIDE TO BANKRUPTCY

## **13 Pointers** for Deciding Whether Bankruptcy is Right for You

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by Richard Kistnen, Esq.

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## I. What does bankruptcy do?

When a party files for bankruptcy (the "Debtor"), it does several things. First, and often most critical, is that in many (but not all) cases, the AUTOMATIC STAY (which is comparable to a standing court order) goes into effect. By a Debtor filing for bankruptcy, all actions to enforce and collect a debt against that Debtor must cease. The AUTOMATIC STAY is integral when dealing with events such as foreclosure auction sales, repossessions, and garnishments.

There are certain occasions where the commencement of a bankruptcy case does NOT invoke the AUTOMATIC STAY or limits the scope of the AUTOMATIC STAY, such as the case where there are prior filed cases within a certain time, or a prior court order has limited the AUTOMATIC STAY with respect to a debtor and/or property.

Presuming the debtor moves along with their bankruptcy case, the ultimate goal is often to obtain a DISCHARGE OF DEBTS. When the case reaches the point where all time obligations have passed, if the Debtor is entitled to a discharge, the judge assigned to the case will sign an Order of Discharge that will be entered in the case. The entry of the DISCHARGE ORDER is the formal memorialization by the Court indicating that, unless the debt is non-dischargeable (by law or by court order), then from that point on, the debts included in the bankruptcy case may no longer be enforced or collected upon. That is, the DISCHARGE terminates and extinguishes personal liability of a debt.

The DISCHARGE OF DEBTS, however, does NOT apply to every debt, so be sure that you understand what would be discharged in a bankruptcy case, and what debts would survive the bankruptcy case. For example, unless modified by a court order, most judgment liens that attach to property of the debtor survive bankruptcy (while, in many jurisdictions, a judgment recorded against a person is voided by the entry of a discharge order).

Having a thorough understanding of what benefits and drawbacks you may inure from the filing of a bankruptcy case is integral to grasp BEFORE you file. Make sure to understand the purpose of filing, and whether moving forward with a bankruptcy case would help you achieve that purpose.

*Once while I was sitting in state court waiting for my case to be called, I was watching a conference on a post-judgment divorce case. The wife had filed papers against her former husband alleging that he was breaching the terms of the settlement agreement because he was not cooperating with her with respect to a loan modification application. The husband's response was pretty clear: he signed the deed to the house over to her, as per the divorce, and then he filed for bankruptcy. Plain and simple, his ties to the house, other than still being a name on the mortgage, were done. The parties involved in that conference, including the court attorney, were a little unsure how the bankruptcy affected the house and loan and what the wife was trying to do. The confusion is a result of having to navigate several different areas of law at once.*

## II. Laws governing bankruptcy

Bankruptcy cases are governed and controlled by a delicate dance by and between federal and state laws. The bulk of the federal laws that govern bankruptcy can be found at 11 U. S. C. § 101, et seq. (the "Bankruptcy Code"). The Bankruptcy Code went through a major overhaul in 2005 that increased the paperwork and disclosures that many debtors have to submit in a bankruptcy filing. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), most notably, set forth a "means test," whereby a consumer debtor's bankruptcy filing may be deemed abusive if their income over the six months prior to filing is greater than median standards and allowances set forth by the IRS. The intention was to weed out consumer debtor filings that were abusive under the circumstances, and intended to delay and/or defraud creditors.

Other federal laws operate within the bankruptcy context. Federal laws not found within the sections of the Bankruptcy Code, such as those governing Social Security, taxes, and retirement accounts, all operate within the bankruptcy case, as well.

State laws also contribute a lot to a bankruptcy case. State laws often control the rights debtors and creditors may have within the bankruptcy case. Another important area in bankruptcy that federal laws and state laws intertwine is in the area of EXEMPTIONS. To understand what an EXEMPTION is, first let us understand what happens when a bankruptcy case is filed.

When a bankruptcy case is filed, the debtor essentially gives up any and all interests in any property whatsoever, wherever in the world such property may be located, into a theoretical 'estate of the debtor.' In every case, a trustee is appointed by the bankruptcy court to oversee and administer the estate of the debtor. Property may not come into, nor may property leave, the estate of the debtor without the trustee being involved. Certain property NEVER enters the estate of the debtor (such as property defined by federal or state law as never being part of a bankruptcy estate). Other property may be EXEMPTED from the estate – that is, taken out of the estate by reference to a federal or state law. The EXEMPTIONS are intended to prevent a debtor from becoming destitute and a public charge upon the filing of bankruptcy. Thus, the EXEMPTIONS often dictate that a debtor may exempt small amounts of money, equity in real property, equity in a car, and so on. The values of the exemptions – and the exemptions, themselves – vary wildly from state to state. Certain states ONLY allow a debtor to elect state exemptions if they file for bankruptcy. A debtor may only elect to use one set of exemptions in a bankruptcy case.

The importance of understanding how federal and state laws operate in a bankruptcy case cannot be overstated. Filing a bankruptcy case while misunderstanding how these laws work with a bankruptcy estate can cost the debtor money and, in some cases, property.

## III. How to prepare and file for bankruptcy

Preparing and filing for bankruptcy is just like preparing and filing any other case – it can be simple and streamlined if you are familiar with practices and well-prepared. On the other hand, if you are not familiar with practices, or you do not feel you are adequately prepared, the experience can be horrendous.

There are a number of ways you can prepare a bankruptcy case. One option is to head to your local bankruptcy court, or to your local bankruptcy court's website, and pick up a copy of a filing checklist along with documents to be completed and filed. (It is encouraged that the bankruptcy filing is completed by typing so that all numbers and characters may be easily read and understood.) In addition to the required petition, schedules and documents, each court may have its own rules and requirements for other documents to be filed. Be sure to check with the clerk of your bankruptcy court to determine if there are any local forms that must be completed and submitted.

Another way to prepare a bankruptcy case is with the use of software on a computer. There are a number of vendors that sell software programs similar to tax preparation programs. You run through a questionnaire, and at the end of the questionnaire, the program populates forms that you can then file. Keep in mind, though, that these programs cannot understand the law for you. Some of them flash warnings if something seems amiss, but if you do not understand what the warning means or how it impacts a case, the result could be very time-consuming and costly.

The final, and probably best, way to prepare a bankruptcy case is to retain an attorney. An attorney would be familiar with the practices of the court in which you will be filing. An attorney has the tools to prepare and manage the document requirements. An attorney has the knowledge and understanding of how the laws apply to your case. Of course, there is the dreaded "attorney's fees" involved, but just as most people would not try to change the timing belt on their own car, legal matters are not something that should be left to 'winging it.'

*I was recently at a 341 meeting and observed a hearing for a pro se debtor. The debtor had failed to bring a copy of her documents to the 341 meeting to review with the trustee. Additionally, the debtor never sent the trustee any documents relating to a motor vehicle that she had, and how she intended to treat that in bankruptcy.*

*Obviously, in this case, she was unfamiliar with the practices of moving a bankruptcy case along in this particular court.  These are relatively small things, but enough of an issue that the trustee had to adjourn the 341 meeting.  Now, unfortunately, that pro se debtor would have to reappear for a hearing - maybe take another day off from work, maybe have to spend more money on a babysitter - because of an unfamiliarity in practice that would have been a non-issue had she retained an attorney.*

## IV. Chapter 7 vs. Chapter 13

Most consumer debtors that file for bankruptcy relief either file a chapter 7 case, or they file a chapter 13 case. The goal of both is the same - to obtain a discharge of debts. How each case goes about accomplishing that end is very different.

I like to tell people that are unfamiliar with bankruptcy that a chapter 7 case is whatever you would imagine a bankruptcy being like. You surrender your interests in any and all interests in property of any kind - money, bank accounts, real property, cars, lawsuits, accounts receivable, etc. All of these interests in property go into your bankruptcy estate. The trustee appointed to your case is in charge of your estate. Property that, by law, never enters the bankruptcy estate remains your property. Additionally, property that you appropriately exempt is taken out of the bankruptcy estate and remains your property. Anything that is property of the estate and is not exempt may be collected and sold by the trustee to generate monies to pay to creditors.

Chapter 13, on the other hand, is a payment plan with creditors. Chapter 13 bankruptcy is, generally, a good fit when people have property (such as real estate or motor vehicles) that have excessive equity that cannot be exempted. Chapter 13, additionally, is only for debtors that have "regular income." There are, on the other hand, debt limits to chapter 13 cases, so not everyone may qualify to file. If you do qualify for a chapter 13 case, you will generally offer a plan to pay back creditors over the course of three or five years. The practice of chapter 13 cases vary wildly across courts (and in some cases, even within the same court). Just as in a chapter 7 case, a trustee is assigned to every chapter 13 case. Be sure to reach out to the trustee assigned to your case to work with them to successfully move your case forward. Additionally, and something to keep in mind, is that the discharge obtained in a chapter 13 case is slightly broader and more encompassing than the discharge obtained in a chapter 7 case. If the purpose of filing a bankruptcy case is to obtain a discharge of a particular debt, be sure you know whether the discharge obtained will, in fact, discharge that debt.

## V. Real Property and Bankruptcy

It has happened a number of times to me. A client comes in inquiring about bankruptcy. Often, one of the specific motivations for inquiring about bankruptcy is that the potential debtor owns real property somewhere that is underwater. They have tried short selling the property, to no avail. The lender will not offer a deed in lieu. They want to walk away from the property and have that be the end of that. While bankruptcy can help with that, it is not the complete story. I always explain that a discharge in bankruptcy terminates the person's PERSONAL liability with respect to the note, but that the lender's rights to collect and enforce against the PROPERTY remain unaltered (unless something else happens during the bankruptcy case). The potential debtor usually nods and acknowledges that they understand. The bankruptcy gets filed, discharge is entered, case is closed. Without fail, I get the worried phone call where the debtor receives a mortgage statement and wants to know why the bank is still naming them as the property owner - "I filed for bankruptcy." Then I have to explain again, and again, they will nod and acknowledge.

When you buy a house or a car, you sign a whole bunch of papers. One of those documents will, inevitably, be a note. That is the contract between you and the lender where you promise to pay, personally, the amount of the loan. Another of those documents, inevitably, will be a mortgage or lien. That agreement is one where you agree that you will put the house/car as collateral for the loan, and that the lender may repossess/foreclose on the property if you fail to pay the loan. Bankruptcy discharges and terminates the rights of the lender in the FIRST of these documents, and NOT the second.

*A recent case out of the United States District Court, District of Minnesota, addressed these issues. In this case, a property owner obtained 100% interest in the real property from a divorce, though she never signed the loan nor assumed the loan. The ex-spouse then filed for bankruptcy relief.*

*This case came along when the wife, now 100% owner of the property, sought to obtain a judgment from the court indicating that, since she received the property, was never a party to the loan, and her ex filed for bankruptcy, that the bank has no enforceable rights against the property. The court disagreed. It held that the* *bankruptcy of the ex-spouse did not alter the lender's ability to enforce it's rights against the property, and that those rights remain intact through and beyond a bankruptcy. For those of you interested in this fun and interesting opinion, the case is Duncan v. Bank of America, NA, 14-901-DWF-SER (D. Minn., June 18, 2015).*

If you have thought about bankruptcy, especially because of falling behind on a house or a car, remember that bankruptcy terminates the lender's ability to enforce the debt against you PERSONALLY, but (assuming no other facts) the lender remains free to enforce its rights against the PROPERTY.

## VI. Cars and Bankruptcy

One traditional notion concerning filing for bankruptcy is that you are left with nothing - no money, no house, no cars and no belongings. This belief is inaccurate. The Bankruptcy laws were designed to try and find a balance between giving a debtor a fresh start, and giving creditors an opportunity to satisfy obligations owed to them. To avoid debtors becoming public charges, the Bankruptcy laws provide a minimum that a debtor may retain when filing. A vehicle is one of these items. The law provides that a person filing for bankruptcy may keep the equity in a car owned by them, provided the equity is not more than a certain amount.

What does this mean for you? For instance, let us say your state law allows an exemption of $4,500.00 in a motor vehicle, and you own a car worth $4,000.00. In this case, you may exempt the car in its entirety since all of the equity is exemptible. Next, let us assume the same state law exemption of $4,500.00 in a motor vehicle, but the car is worth $10,000.00. In this case, $5,500.00 in equity is not exempt. In most cases, you will either have to surrender the car to the trustee, who will sell it at market value and pay to you the exempted value from the proceeds of sale, or you may negotiate with the trustee to pay that $5,500.00 so that you may keep the car.

If you own the car outright, you have to analyze its value. If you lease or finance a car, we have to work with the finance company to keep the car. Ultimately, the goal is to give a debtor the means to continue transportation to live his or her life - traveling to work, school and other household necessities.

## VII. Bank Accounts and Bankruptcy

People thinking about filing for bankruptcy will, invariably, ask the following question: what happens to my bank account if I file? The answer (not surprisingly, in the legal industry) is, "it depends."

When a person files for bankruptcy, a theoretical estate is created that belongs to the trustee that is assigned to the case. All of a person's interests in property (houses, cars, money, lawsuits, etc.) at this point belong to the estate, which is controlled by the trustee. (Certain property defined by law, such as some social security benefits, are never part of the estate. They are specifically excluded from the estate by law.) When a person files for bankruptcy, exemptions are used to remove that property from the estate. That is, although all of the property combined create the estate under control of the trustee, the law also states that a person can use exemptions to remove certain property from the estate and protect it. There are state law exemptions and federal law exemptions. A person that files for bankruptcy must choose one or the other. If the exemption limits are enough to cover the value of the asset, that property is protected.

In the case of bank accounts, it all really depends on which exemptions you will use, so be sure to read and understand both sets of applicable laws. Moreover, any money that is in a bank account that is traceable to a non-estate source or exemptible source (again, such as social security) is, generally, protected. Federal law gives a debtor a lump sum amount, often called a "wildcard" amount, to protect any and all property, including what may be in a bank account.

Some banks will jump to freeze a bank account when a person files for bankruptcy. Most will also prohibit access to any safe deposit box that may be held by a debtor. Credit unions are notorious for taking money in a deposit account to set off against any loan that may exist. What all this means is that some planning should be done. If possible, a person about to file for bankruptcy should reduce the funds in a bank account (on necessary expenses), especially if they owe that bank for a debt (such as for a credit card issued by the same bank). If possible, arrange for direct deposits to be entered into a new deposit account at a new bank prior to filing, so that the bank does not freeze access to an account.

## VIII. Lawsuits and Bankruptcy

Most people do not think of lawsuits, or potential lawsuits, as property. These things are intangible. If a lawsuit is pending, or has not been filed yet, there often is no money award out there. As such, it may not feel like property. Understand, however, that a lawsuit, or the potential to sue, is property of a bankruptcy estate.

When considering filing for bankruptcy, it is absolutely critical to think about whether any you can file any lawsuits, or if you have a lawsuit pending. If you have a lawsuit pending, the trustee assigned to the case steps into your shoes, and takes over the case. The trustee becomes vested with authority to control the case, such as to decide to settle.

If, at the time of filing a bankruptcy case, you are aware that you may sue someone but have not yet done so, it is still property of the estate. Failure to disclose the potential lawsuit can result in estoppel. That is, if you move forward with the lawsuit after the bankruptcy case, the defendant can look to the bankruptcy papers as sworn proof and evidence to dismiss your case.

If you are a defendant in a lawsuit, or potential defendant, bankruptcy may be helpful. The automatic stay that goes into effect with the filing of a bankruptcy case generally stays any and all lawsuits against you. Further, if you file for bankruptcy and include a debt that is dischargeable for which you are being sued, if you obtain a discharge, the discharge should generally result in the underlying lawsuit being dismissed.

## IX. Transfers of Property/Payments Made and Bankruptcy

It happens, and it is most often an unintended consequence. Someone you know – a family member, a friend, someone you did business with – has filed for bankruptcy. Out of the blue, you receive a Summons and Complaint from the "Trustee of the Estate of that person or business." You have no clue what the lawsuit is about, and you are pretty sure that you did nothing wrong. These cases, however, are not about breach of any contract, or any right versus wrong. When you get sued in a bankruptcy case, the trustee is trying to recover monies that may be part of the estate.

When a party files for bankruptcy, a theoretical estate is created. All of the ownership interests that the debtor has, and had, are part of that estate. A trustee is appointed to each bankruptcy case to oversee its administration, and to try and marshal any assets that may be available.

Transfers of assets by a debtor immediately before the filing of a bankruptcy are subject to more scrutiny by the trustee. In particular, trustees have the power to avoid and recover transfers of property by a debtor if they meet certain qualifications. Two kinds of transfers that trustees regular seek to set aside are 'preferential transfers' and 'fraudulent transfers.'

Preferential transfers are a kind of transfer where the debtor paid more to a certain creditor than other creditors prior to filing for bankruptcy. Normally, the payment is more than the creditor is likely to receive in the bankruptcy case. Common scenarios are when a debtor pays family or friends prior to a bankruptcy. A fraudulent transfer is when a debtor transfers property prior to a bankruptcy with the intent to defraud, delay or hinder the creditor. A common example is when, prior to filing a bankruptcy, a debtor transfers title to real property to a spouse or child for no value, increasingly common in uncontested divorce settlements.

Just like any case, it is the trustee's burden to prove a preference or fraudulent transfer. Moreover, just because you are being sued does not mean that you do not have valid defenses to overcome the trustee's case. Generally, if the transfer of asset(s) was for value and legitimate, the asset should not be recoverable.

If you find yourself as the defendant in a bankruptcy case (or any case, for that matter) do not delay in responding. Cases get only more complicated and difficult when a party waits too long to respond.

## X. Pets and Bankruptcy

Many of us own pets. Cats, dogs, birds, snakes. Some of us own even more exotic pets. Although many of us associate a pet as one of the family, laws in most places around the country do not reflect the value we place on pets. (I am speaking as an owner of a dog.) Pets are, largely and widely, still treated as items of personal property, no different from your clothing, a car or a watch.

What results for a pet when that pet owner files for bankruptcy? Again, reading and understanding the laws that govern bankruptcy is critical. For instance, (at the time of this writing, under New York State law, a person who files for bankruptcy may exempt "domestic animals with the necessary food for those animals for one hundred twenty days, provided that the total value of such animals and food does not exceed one thousand dollars." Under federal law, no specific exemption is provided for animals. Rather, animals may be exempted if the debtor can fit it in: "[t]he debtor's interest, not to exceed $550 in value in any particular item or $11,525 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, ANIMALS . . ."

What does this mean for someone filing for bankruptcy? It means that a trustee may inquire as to any pets owned and, if so, what kind of pets. Under the New York law, if those pets are more exotic and can command some money on the market (such as over one thousand dollars), if not properly exempted, a trustee can sell that animal. (For instance, I own a pitbull. The market value for a neutered pitbull is, likely, zero. If, however, I owned a Pomeranian or an English Bulldog, which often cost over one thousand dollars to purchase, a trustee may want to take the dog and sell it.) Things get much more complicated for people who own other kinds of animals, such as horses, which often serve both as pets and for commercial gain.

Until the laws catch up with the values we place on our pets, they remain personal property. In a bankruptcy case, be sure to disclose that you own a pet because if it is a pet that can be sold for a profit (and not appropriately exempted), a trustee may seek turnover of the pet to sell.

## XI. Taxes and Bankruptcy

Many people generally think of bankruptcy as a device to use just when there is significant credit card or medical debt. While there are certain kinds of debts that bankruptcy cannot really tackle (including debts based on fraud or debts that are domestic support obligations), bankruptcy can be a very effective tool in evaluating how to handle outstanding tax liabilities.

While certain types of taxes are never dischargeable in bankruptcy, liabilities that arise from late filed tax returns or unpaid assessments from properly filed tax returns may be dischargeable. Further, the penalties and late fees associated with such assessments are also dischargeable. To be dischargeable, the tax liability must meet certain minimum criteria, including that a return was filed in good faith and an assessment has been made. Tax liabilities that have not yet been assessed, such as in the case of an amended filing, are not dischargeable.

When dealing with outstanding tax liabilities, the taxpayer must be careful not to jeopardize any of their rights, either in dealing with the tax-collecting entity, or prejudicing themselves in their ability to file for bankruptcy. An unwary taxpayer can, unknowingly, take steps or actions that would extend (or toll) certain important time periods (for example, collecting assessments or filing for bankruptcy) that could hurt them - and by hurt, I mean cost thousands of dollars more - in the long term.

Do not let someone tell you that you cannot discharge tax assessments in bankruptcy. You can. With knowledge and some planning, you can effectively discharge tax liabilities that may be outstanding.

## XII. Student Loans and Bankruptcy

If you are considering filing for bankruptcy, be sure to do research on how your specific court has treated discharging student loans. Student loans, generally, are not dischargeable in bankruptcy. They are protected from discharge by the Bankruptcy Code. There are circumstances, however, where a court may use its equitable power to enter an order discharging the student loans. These cases traditionally involved factual circumstances that were exceptionally tragic, such as a terminal illness. The three-part test that most courts have applied in determining student loan dischargeability is as follows: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependent if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor had made good faith efforts to repay the loans. Courts are left to make its decisions on a case-by-case, fact-specific basis.

At the time of this writing, the student loan landscape has changed dramatically. More and more debtors have student loans - and large ones - to struggle with. Courts and legislatures around the country are, it appears, starting to recognize this. Though the law has not changed, there is an increasing push to create legislation to have student loans become dischargeable in bankruptcy. Additionally, decisions have been coming out in bankruptcy courts where student loans are being discharged.

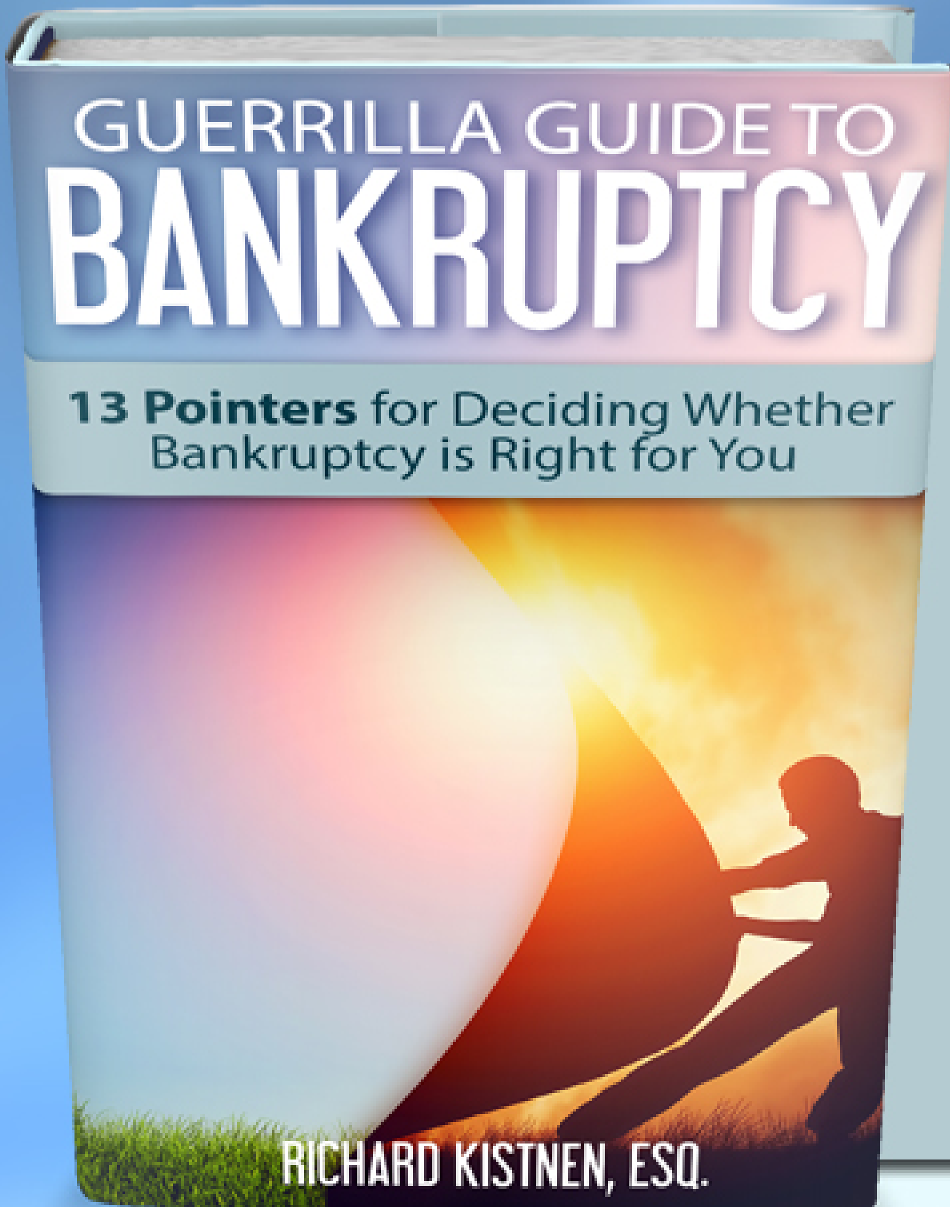
## XIII. Businesses and Bankruptcy

As the economy of the United States continues to grow, and access to lines of credit are opening to people, new businesses are starting to proliferate. Unfortunately, however, the reality is that many new businesses fail. Whether it was due to poor planning, inefficient distribution of resources and capital, or just bad luck, many new businesses often take on liabilities in order to get through the first years of starting. When a business is failing, individuals ought to understand the options available for them.

One of these options is bankruptcy – maybe. People file for bankruptcy, generally, to obtain a discharge of debts. That is, a discharge provides that a creditor can no longer take any action to enforce the claim owed to it by the debtor. In chapter 7 and chapter 13 cases, if the debtor obtains an Order of Discharge, those debts that do not survive bankruptcy are no longer enforceable. Business associations, however (such as corporations), are not entitled to a discharge. So why do so many big companies in the news file for bankruptcy?

The reason for a business to file for bankruptcy would be to centralize the affairs of the business as it i winding down, or to give it a chance to reorganize. If a corporation files a chapter 7 bankruptcy, it is not entitled to any discharge. It would provide, however, one forum for all creditors to submit claims, and one forum for the marshaling and liquidation of assets. A business owner might prefer this rather than having to fight several lawsuits in different courts. If a corporation files a chapter 11 bankruptcy, there has to be a realistic prospect that the company can come out of bankruptcy successfully by putting forth a plan acceptable to creditors that pays some of their claims back.

Outside of bankruptcy, a business can shut down its affairs with the state. Many times, though, creditors will continue to pursue and hound the business and its principals, often resulting in costly litigation. Ultimately, when dealing with a new business, be sure to understand what kinds of liabilities are being undertaken (secured, unsecured, personal, etc.).




Bankruptcy is a great option for many people, but many people do not understand how bankruptcy works. This resource discusses some of the more down-and-dirty questions (with real life examples) you should ask yourself when wondering whether bankruptcy could be a solution. From cars and real estate to student loans and even pet issues, this resource touches on issues that are important to you.