

Personal Bankruptcy Pros & Cons: A 30,000 Foot Level View

Not Exactly a “Get Out of Jail Free” Card

Too many people who find themselves in debt over their heads have the mistaken impression that filing for bankruptcy is the panacea for healing their self-inflicted financial wounds. While bankruptcy laws have been in place for many decades to provide relief for individuals who have seriously over-extended themselves financially, bankruptcy is not the simple monetary “do over” many consumers think it to be.

There is a price to be paid for seeking cover under the bankruptcy umbrella and in most cases it’s not a pretty picture. Let’s take a serious look at the big picture so we know exactly what we’re getting ourselves into.

Attitude and Strategy, the Cover Charge for the Bankruptcy Dance

Feeling the intense pressure from creditors and overdue payments, too many people rush to seek refuge in the seemingly convenient shelter of bankruptcy. They quickly plop down a filing fee thinking their worries will be behind them. Not!

Bankruptcy regulations and the process itself are far more complex than most people think. Who would start a business without first developing a competitive strategy and drafting a solid business plan? Well, a bankruptcy should be thought of in the same way. It’s kind of a small business and your profit goal is to rid yourself of the perils of insolvency.

You are the CEO of your own little loss prevention company and two of the most critical success factors are attitude and strategy.

Let’s start with attitude. It’s natural to be down on yourself when facing this financial upheaval. However, approaching this traumatic event in a weakened state spells failure. So, suck it up, put on your game face and prepare yourself to win the game. You know there will be penalties and turnovers, but you can also score some touchdowns if you know how to play the game.

Be sure to have some cheerleaders on the sidelines. The support of friends and family are essential but you may need more than that. Depending on your own knowledge of the rules of the game and the opposing team’s game plan, you may also want a coach or two. This is where attorneys and financial advisors can play a valuable role such as CFO for your fledgling company.

Never forget that your creditors and many financial institutions are the opposing team(s) and most of them have hefty game plans and playbooks that can get very intricate. This may be your first rodeo but it’s definitely not theirs. They have tricks up their sleeves and weapons at their disposal you probably have never thought of.

A key factor in developing your strategy is evaluating your negotiating skills, especially if you're opting for Chapter 13. Since these skills can make a difference of thousands of dollars, investing a few more dollars in some expert help can be well worth it.

Know Your Adversaries

A key part of your strategy that must be developed in advance of filing for bankruptcy is understanding what and who you're up against.

You may think the bankruptcy court is your friend in this fight but that's an invalid assumption. Much like the referees in a sports event, they can and will penalize you as they see fit and those penalties can sometimes be deal killers rather than just 15-yard setbacks. And remember, there are no instant replays so you need to get it right the first time.

If you think the referees are tough with their troublesome rule books, the judges are child's play in comparison to the opposing team made up of greedy creditors and sophisticated bankers. They come to win and intend on taking as few prisoners as possible.

This is where empathy (not sympathy) on your part is an essential arrow in your quiver. Step back and put yourself in their place for a minute. In many cases, they have extended you credit in good faith and now face the prospect of being "stiffed" and having money taken out of their pockets. This is the stark reality you face and sweeping it under the carpet is a huge mistake.

This is where getting advice from someone who understands all the weapons in their arsenals and how they can use them to protect their own assets can be incredibly valuable. Without understanding what weapons they may bring to the fight means you could be going into battle unarmed.

Beware the Quick Buck Con Artists

As is the case with wounded animals in the wild, it won't be long before vultures start to appear when word gets out about your financial troubles. Let's take foreclosures as a prime example of how the scent of financial peril gets into the wind. Before lenders can begin foreclosure proceedings, they must publish a legal notice – usually a Notice of Default – in at least in local periodical after you've missed a few mortgage payments.

The key word is "publish" and that means notice has been given to the public. Viola! Your name and address are instantly available to all the predators out there looking to take advantage of people in financial difficulty. It's likely your mailbox will soon be flooded with people and companies offering to "help you out."

And even if not all the predators come looking for you, the radio and television airwaves are chocked full of debt relief "saviors" looking for unsuspecting victims. Not to be overly cynical, some debt relief services are genuine and forthright, especially if they are true non-profit organizations. Proceeding with caution however is essential when evaluating such service

providers. If quick fixes sound too good to be true, they probably are. Do your homework before jumping on the bandwagon.

Careful Preparation is the Key to Success

For maximum self-protection, people preparing for bankruptcy need to take some proactive measures before filing, and the further in advance of the filing, the safer such measures will be when it comes to protecting your valuable assets. As you continue reading, you'll see that filing for bankruptcy definitely means you'll be forfeiting some financial assets. Just as there's no free lunch, there's no getting around that fact.

This preparation phase is another opportunity where expert advice can save you a great deal of money and heartache. Homes and cars are among the first assets that come to mind when bankruptcy fears first set in. In most states, bankruptcy laws are fairly forgiving in these two areas, but there are always limitations concerning the value of those assets. If you live in an expensive home or drive an upscale vehicle, downsizing may be mandatory...more on that below.

Protecting cash assets gets into a dicey territory. Your creditors are not going to take it on the chin while you sit on a pile of cash. Regulations on this vary by jurisdiction so it's essential to fully understand the rules of the game well in advance of taking protective action. Keep in mind that bankruptcy courts will be closely examining all your bank records and major financial transactions for the months preceding your filing.

Any attempts to "hide" assets prior to or after filing constitutes bankruptcy fraud and could easily mean jail time. The legal the more politically correct strategy called "asset conversion" involves methods of protecting assets by moving them into instruments that are exempt from forced forfeiture. Again, since rules can vary significantly by jurisdiction, it's dangerous to use such methods without expert advice. Heed the warning: "this is performed by trained professionals...do not try this at home."

At the risk of stepping out onto a shaky limb here, some components of a legal asset conversion strategy might be things such as:

- Paying down a mortgage to lower monthly payments
- Contributing to qualified retirement plans
- Purchasing essential items that will be exempt from bankruptcy forfeiture
- Buying life insurance policies
- Paying down debts that will not be discharged by the court such as taxes and student loans

Keep in mind that the above items may face regulatory restrictions based on jurisdiction. If a bankruptcy court feels the intent behind your asset conversion was primarily to defraud creditors, civil and/or criminal penalties may be in the offing. When in doubt, getting professional advice in your jurisdiction is a sound investment...and if it's money you would have forfeited anyway...well, no harm, no foul.

Since your credit rating will be destroyed for an extended period, factor this into your thinking. Imagine life without credit cards and plan accordingly. If possible, choose one of

your cards and keep it in good standing. Your spending limit may go down but at least you won't be cardless.

Not All Bankruptcies Are Created Equal

At the risk of having this article come across as a Bankruptcy 101 course, I'd be remiss if I don't touch on the most crucial differentiator, i.e. the difference between the two basic types of bankruptcy filings: Chapter 7 and Chapter 13. They are drastically different and choosing between them is perhaps the main key to your strategy. I'll try to be brief.

Anyone filing for personal bankruptcy is required by law to undergo certified credit counseling before filing and to complete an approved debtor education course after filing. Nominal fees must be paid for each. To satisfy these requirements, credit counseling organizations and debtor education course providers must be approved by the U.S. Department of Justice.

Chapter 7 – Discharge of Most Debts

This is not only the simplest form of bankruptcy but also the most common. It is generally available to individuals, married couples, corporations and partnerships. The debtor is freed of most financial obligations regarding unsecured debt, i.e. those not supported by collateral.

To qualify for Chapter 7, debtors must first pass an eligibility "means test," and those whose average monthly income exceeds an amount set by the IRS cannot take advantage of Chapter 7 protection. The means test limits vary by state and size of household. As an example, if a family of 4 in New York has a combined family income of over \$98,000 (2018 approx.), they are not eligible.

The debtor's material assets not protected by an exemption are surrendered to a court appointed trustee who may sell the assets. The sale proceeds are distributed to the various creditors according to guidelines set in each jurisdiction's bankruptcy code.

Except in extraordinary circumstances, these debts will not be discharged:

- Back taxes (varies by type and jurisdiction)
- Spousal or child support and associated attorney fees
- Alimony payments
- Student loans
- Government agency fines and penalties
- Homeowners' association fees

Chapter 13 – Repayment Plan

This is a more complex and time consuming scenario. Under Chapter 13, debtors may keep most or all of their property by filing a plan for repaying part or all of the debt over a period of

up to 5 years. The plan must be approved by all creditors and almost always reduces the amount owed as long as negotiated repayment schedules are met.

The Good – Benefits and What You Get to Keep

Filing bankruptcy does not mean you lose everything you own and end up on the street with no means of survival. In many cases, you'll be allowed to keep a roof over your head and a means of transportation to get you to work and back. However, this does not mean you'll be living in upscale accommodations and driving a luxury car.

Regarding your personal residence, bankruptcy laws include a "homestead exemption" that will essentially allow you to keep the court from selling your home to pay off other debts as long as that residence is considered modest. If you do happen to live in above average accommodations having a value above the homestead limit, you will still be allowed to retain a reasonable amount of your equity to reinvest in a more modest residence.

In New York, the "reasonable" equity you can retain varies greatly by county from a high end of over \$170,000 in places like the Bronx to a low end of about \$85,000 in rural areas.

Keep in mind that a homestead exemption will not shield you from foreclosure if you're not paying your mortgage after the filing.

Concerning automobiles, the rules are not very straightforward. Under Chapter 7 in New York for instance, you may be allowed to keep your car but equity comes into play and the rules are different depending on whether you're using the New York bankruptcy exemptions or the federal exemptions. Under the New York exemption, you can keep your car as long as the equity does not exceed \$4,425. However, if you're disabled and the car is equipped accordingly, that amount increases to over \$11,000. Also, New York has a \$1,100 "wildcard" kicker that applies to people not using New York's homestead exemption. The federal exemptions are not as generous.

Just to add to the complexity, these numbers are not cast in concrete because bankruptcy trustees have some discretionary leeway on what they will allow.

On the personal property side, the trustee will not be selling all of your belongings to settle with your creditors. Trustees have the leeway to make judgement calls but don't kid yourself - if you own expensive artwork, elaborate jewelry and the like, most of that will be gone. But you don't have to worry about things such as "nice" clothing, furniture, televisions, computers and cell phones. Items you own that might fall into the luxury category are at risk and this is where it's handy to have a knowledgeable attorney or expert negotiator on your team.

When it comes to non-salary income due to you, bankruptcy laws give you a break in many cases. Things such as pensions, social security payments and worker's compensation benefits are kept out of the hands of trustees. In most cases, child support and reasonable alimony payments are also exempt. Keep in mind the more you're confronted with

subjective conditions such as “acceptable” and “reasonable,” the more need you may have for an expert attorney specializing in bankruptcy

The Bad – The Downside and What You’re Giving Up

First and foremost, you’ll have to surrender cash and bank accounts over a set limit. In New York, you can keep only \$5,000 if you’re single or \$10,000 if married.

Expensive cars, jewelry, real estate and investments (except retirement accounts) will probably have to be surrendered under a Chapter 7. As mentioned above, your credit cards will likely disappear.

Strategies like putting assets in someone else’s name will usually get you in serious trouble. You might think of something clever like getting a prepaid credit card and putting some cash aside there, but consult a good bankruptcy attorney before trying anything “cute.” Bankruptcy judges and trustees are aware of all the tricks and getting caught will only get you in deeper trouble.

The Ugly – Short term and long term Gotcha’s

If you think you’ve ever been closely scrutinized before, “you ain’t seen nothin’ yet” until you’ve been subjected to a bankruptcy proceeding. You, your family and your lifestyle will be under a microscope of gigantic proportions. At the risk of being crass, it’s like getting a colonoscopy on the 50-yard line during half-time at the Super Bowl. Every financially sensitive aspect of your life will be totally exposed for all to see.

Putting the humiliation aside, you’ll be forced to curtail many positive aspects of your lifestyle. The “downsizing” adjustments that will be forced on you will have a ripple effect on all relationships you have with friends, family and the community. Also, keep in mind that any friends or associates who have co-signed for you on any obligations will still be on the hook even if your debt has been discharged.

Filing for bankruptcy is only the start of a very arduous journey fraught with unimaginable difficulties and you’ll find yourself on a very slippery slope. Financial relief is not ensured by filling out the required forms. Debtors who do not file all required paperwork and supporting documents risk dismissal of their cases, making their plight far more serious.

If you miss something in the petition paperwork, those unprotected assets are up for grabs, quite possibly with no recourse. Any “soft” assets you’ve overlook, perhaps like a personal debt you’re owed, may come back to haunt you.

Further, bankruptcy courts have no revolving doors. The shelter you find there will not be available to you again for quite some time should you slip back into financial trouble in the future. Under Chapter 7, you’ll be banned from another round for eight years. Under Chapter 13, it will be at least two years.

Your credit rating will of course be decimated. In the Chapter 7 case, it will be on your credit report for 10 years. This can hinder your ability to get credit, a job, insurance, or even a place to live.

And if you think your troubles are over when the gavel is struck for the final time, think again. Your creditors have a right to file an “objection to discharge” even after your case appears to be settled.

The Bottom Line

This article has only touched on the high points of bankruptcy regulations and you can see by now that it can be incredibly complex and confusing. Navigating the sea of intricacies and setbacks on your own is usually ill-advised.

Bankruptcy laws do not stand still because legislation never stops. A strategy that may have been valid last year may be a mistake this year. Jurisdictional differences can add to the confusion since state regulations and guidelines may differ from those of the Federal government.

Since debtors are strapped for cash, spending money on a good bankruptcy and/or financial advisor may seem imprudent on the surface. In reality however, it may be the wisest investment you’ll ever make.