

## Filing for Bankruptcy

There are several types of bankruptcy, but they are divided into two forms: straight and reorganization. The first is Chapter 7, which is the only kind of straight bankruptcy. Under Chapter 7, most or all debts may be canceled and the debtor retains a certain amount of "exempt" property. The other kinds are reorganizations, or repayment plans. Repayment may be in whole, or only a part, depending on the situation. Chapter 13 is for individuals and lasts for three to five years. Filing a bankruptcy petition normally has an adverse effect on your credit rating and a bankruptcy filing can be reported on your credit record for up to 10 years. Chapter 12 reorganization is similar to Chapter 13 but is restricted to family farmers. Chapter 11 is much more complicated reorganization in which the debtor (usually a company) continues to operate under the supervision of the Bankruptcy Court. Chapter 11 also might be helpful to individuals where the amount of the debt is extremely large. Because Chapter 11 and 12 bankruptcy cases are so complex, and because consumers rarely use them, they will not be discussed in this pamphlet. Please consult with an attorney should you have questions regarding corporate and farm reorganizations.

Bankruptcy is a federal court procedure governed by federal laws. When individuals cannot pay their creditors, they may seek a fresh start through a "straight" bankruptcy liquidation under Chapter 7, or may seek to restructure their debts through a Chapter 13 payment plan which is approved by the bankruptcy court and monitored by a trustee. A company can also file for bankruptcy and seek either to restructure its debts or to liquidate its assets and have those proceeds used to pay its creditors. North Carolina is divided into three federal districts which administer bankruptcy cases. Normally, you should file for bankruptcy in a district where you live. In all bankruptcy cases, the person filing the bankruptcy petition is called the "debtor," and a person to whom the debtor owes money is called a "creditor."

Bankruptcy cases begin when a "petition" is filed with the bankruptcy court. The petition has several parts which disclose all of the debtor's assets, liabilities, income and expenses. The petition, schedules and statement of financial affairs are court-authorized forms which must be completed, signed under penalty of perjury, and filed with the bankruptcy court, along with the payment of the filing fee. All debts owed by a debtor must be listed on the schedules, and all property must be revealed. There is no such thing as leaving a debt or property outside of bankruptcy and it is impermissible to attempt to do so. However a certain amount of property is protected as exempt, and therefore, many debtors keep some or all of their property after filing bankruptcy. During the bankruptcy case, creditors generally are "stayed," meaning they are not allowed to collect pre-bankruptcy debts or recover collateral from the debtor unless they have the permission of the bankruptcy court.

While you are not required to have a lawyer, the bankruptcy laws are complicated. It is always advisable to consult with an attorney before filing for bankruptcy to discuss how bankruptcy operates and how it affects you.

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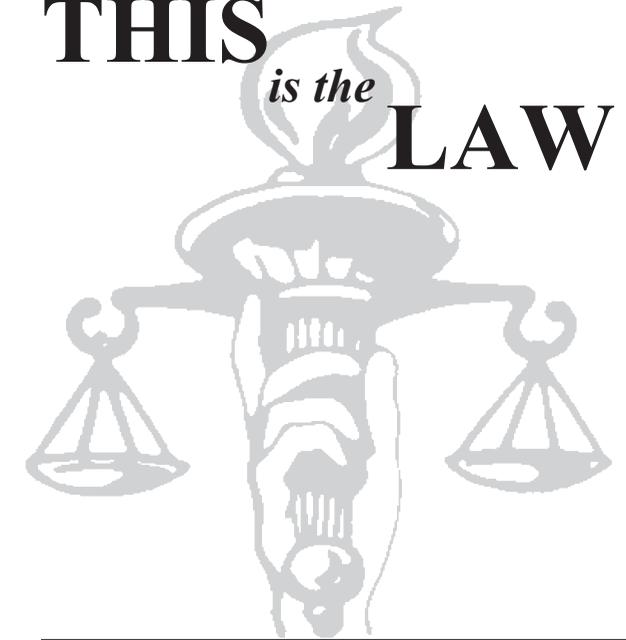
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## Bankruptcy Overview

Most individuals who file bankruptcy find it most beneficial to file a Chapter 7 or a Chapter 13 bankruptcy. There are certain things that virtually all Chapter 7 and 13 bankruptcies have in common.

A bankruptcy case is begun by the debtor filing an official bankruptcy “petition” with the Bankruptcy Court. The court will require the payment of a filing fee when the petition is filed. Once the petition is filed, a trustee is appointed by the court to administer the case. The individual filing bankruptcy, called the “debtor,” has the responsibility to give a full and complete disclosure of all assets, liabilities, income, expenses and other financial affairs of the debtor by signing under penalty of perjury, and filing with the court, official court-approved schedules and a statement of financial affairs. Individuals may be ineligible for Chapter 7 bankruptcy if their annual income, less certain expenses, is more than the annual median income in North Carolina and they are able to pay back a certain amount to unsecured creditors out of their disposable income. This is determined with a “means test” which is part of the petition documents for consumer debtors, which uses the debtor’s income for six months before filing and certain of the debtor’s expenses, along with various set deductions, to determine if there is a presumption that the debtor has enough income to make payments through a Chapter 13 instead of writing off the debt in Chapter 7. Only debtors who earn more than the median income for North Carolina have to take the test. However, it is not true that if you earn above median income that you don’t qualify for Chapter 7 – only that you have to apply to the means test to see if you do.

Before an individual files the bankruptcy petition they must also obtain a special bankruptcy briefing from an approved nonprofit budget and credit counseling agency. All bankruptcy attorneys have information on the required counseling, and you do not have to get the counseling before you see a lawyer. A second course must be taken after an individual files a bankruptcy petition. They must complete an approved instructional course concerning personal financial management. After the case is filed, the debtor must attend required hearings, cooperate with the trustee in administering the estate, and provide copies of the debtor’s tax returns and other financial documentation to the trustee in order to receive their discharge, which is the legal release of personal liability from most debts.

A creditor in a bankruptcy case is designated a “secured creditor” if the debtor has pledged property as collateral for a debt. For example, if the debtor purchases furniture, a vehicle or a home through monthly installments, the item being purchased may be security or collateral for the installments yet to be paid. The lien held by the secured creditor on the property usually remains intact throughout the proceeding and continues even after the debtor receives a discharge and the case is closed. If a valid secured claim is not paid or arrangements are not made to pay the debt, the secured creditor may bring an action to repos-

sess the collateral once the case is closed, or during the case if relief from the automatic stay is granted by the court. In certain limited situations, the lien of a secured creditor may be avoided in its entirety by the debtor.

An “unsecured creditor” is a creditor whose claim is not secured by any property. Examples include an open account with a store, a credit card account or medical bills. A federal bankruptcy judge presides over the bankruptcy case, and resolves any disputed issues which may arise while the case is pending. For example, the judge may determine whether a claim is secured or unsecured, whether a creditor is entitled to repossess property pledged as collateral for a debt which is not being paid by the debtor, and whether or not the debtor is entitled to a discharge.

When someone files for bankruptcy, the clerk of the Bankruptcy Court notifies all of the creditors listed in the debtor’s petition of the filing of the case, and schedules a meeting of creditors. The meeting of creditors is conducted by the trustee and is usually held at a nearby federal courthouse. At this meeting the trustee reviews the petition, schedules and statement of financial affairs, and may ask questions about the debtor’s assets, liabilities and financial affairs. Creditors are also allowed to ask the debtor questions. The debtor is required to attend and testify at this meeting.

While both Chapter 7 and Chapter 13 bankruptcies have these things in common, there are several important differences between these two types of bankruptcy most suited for individuals.

## Chapter 7: Straight Bankruptcy

In a Chapter 7, or “straight” bankruptcy, the debtor is unable to repay their debts and seeks an immediate discharge of their debts in exchange for the surrender of any non-exempt property. Once the bankruptcy petition is filed, the clerk of court schedules the meeting of creditors and a trustee is appointed by the court to administer the case. Most, or all, debts remaining unpaid are canceled or “discharged” at or before the conclusion of the case. Normally, most unsecured claims are discharged in Chapter 7 bankruptcies. However, exceptions to the discharge include money owed for certain taxes, most student loans, fraudulent debts, child support, alimony, obligations arising out of the equitable distribution of marital property, and governmental fines. In most cases, the debtor’s bankruptcy discharge is granted within several months after the filing of the case. The debtor cannot receive a discharge in Chapter 7 if the debtor has received a Chapter 7 or Chapter 11 discharge in a case filed within the preceding eight years. They may be able to file a Chapter 13 even though they filed Chapter 7.

Exempt property is protected from the debtor’s creditors. Certain dollar amounts of the value of a car, a home, household furnishings, clothing, tools of the trade, and certain other property are exempt and cannot be used to pay creditors. The trustee’s main job is to conduct the meeting of creditors and to gather all

non-exempt property (if there is any) and sell it to pay creditors. However, for most individuals, much or all of their property may be exempt from sale by the trustee. Not only do trustees have the power to take possession of non-exempt property, they may also, in certain situations, recover money or property transferred to creditors, relatives or friends before the debtor filed the bankruptcy petition. The trustee also may oppose the discharge of the debtor if the debtor has been dishonest or has failed to comply with certain bankruptcy laws. Most Chapter 7 bankruptcies are determined to be “no-asset” cases because there is not any non-exempt property to sell to generate funds for creditors.

After the meeting of creditors, the trustee may arrange for the sale of any non-exempt property. Once the trustee has completed such sales and other administrative duties, the trustee prepares a report to the court, and with the court’s approval, distributes funds, if any, to the creditors. The Chapter 7 case is over when any and all funds have been distributed by the trustee and when the bankruptcy court enters an order officially closing the case. If the trustee determines that the case is a no-asset case because there is no money for the trustee to distribute to creditors, the case may be closed shortly after the debtor is granted a discharge.

If the trustee is able to collect money to pay creditors, the creditors will be notified and instructed by the clerk of court to file a “proof of claim,” which is an official form used by creditors to present their claims to the court for payment. Generally, creditors must file a proof of claim by the deadline set by the court in order to participate in any distribution of funds from the trustee.

## Chapter 13: “Wage Earners” Plan

Rather than seeking an immediate discharge of debts in exchange for the sale of their non-exempt property under Chapter 7, an individual with regular income may file a Chapter 13 bankruptcy. During the Chapter 13 case, creditors generally are “stayed” and cannot attempt to collect their debts unless permission is given by the Bankruptcy Court. A Chapter 13 filing can be used to stay foreclosure proceedings and allow the debtor additional time to cure a default on a residential mortgage through the Chapter 13 plan. Also, persons who are not eligible to file a Chapter 7 bankruptcy because their annual income is more than the annual median income such that they are able to pay back a certain amount to unsecured creditors, may be eligible to file Chapter 13 in order to receive a discharge.

In Chapter 13, the debtor proposes a “plan” of repayment under which they offer to pay a fixed monthly payment to a Chapter 13 trustee for a period of time, typically from 36 to 60 months (3 to 5 years), beginning when the case is filed. The trustee distributes these funds to the creditors until the debtor has made all monthly payments required under the plan. The plan typically provides for the repayment of only a percentage of a debtor’s debts. However, in certain circumstances such as when the debtor has a high disposable income or substantial non-

exempt assets, a debtor may be required to pay all debts in full. After the debtor completes all payments required under the plan, most, if not all, unsecured debts remaining unpaid are canceled or “discharged.”

Once the petition is filed, the clerk of court schedules a meeting of creditors, notifies the creditors listed on the debtor’s schedules that the debtor has filed for Chapter 13 bankruptcy protection, and instructs creditors to file a “proof of claim,” which is an official form the court mails to all scheduled creditors. Creditors must be mailed a copy of the plan and will be given an opportunity to object to the plan on the grounds that it does not meet certain legal guidelines. Creditors must file a proof of claim by the deadline set by the court (approximately three months after the first meeting of creditors) in order to participate in any distribution of funds from the trustee. At the creditor’s meeting, the trustee reviews the petition, schedules, statement of financial affairs, and plan, and explains the plan to the creditors attending. The creditors may inquire about the location of collateral or how their claim is to be paid within the Chapter 13 plan. If the plan satisfies certain legal guidelines, the trustee will request that the plan be reviewed and approved, or “confirmed,” by the judge. In order for a plan to be confirmed, the debtor must be current on all post-petition child support and alimony payments and must have filed all required tax returns, and the plan must satisfy other legal requirements. If the plan is confirmed, the trustee will disburse funds each month to the creditors as set out in the plan.

If the debtor fails to make monthly payments to the Chapter 13 trustee as required by the plan, the bankruptcy case may be dismissed by the court upon the request of the trustee or any creditor. If the debtor fails to make monthly payments to a secured creditor as required by the plan, that creditor may request that the stay be lifted to allow it to repossess its collateral. While the Chapter 13 plan is pending, the debtor may also convert the case to a Chapter 7 straight bankruptcy or may voluntarily dismiss the case.

When the Chapter 13 plan is successfully completed, the debtor’s personal liability for debts listed on the original schedules are discharged. As in Chapter 7 bankruptcy, certain debts including some long-term debts, alimony, child support, and most student loans are not dischargeable in Chapter 13. The debtor cannot receive a discharge under Chapter 13 if the debtor received a discharge in a prior Chapter 7, 11 or 12 case filed within four years of the present case or if the debtor received a discharge in a Chapter 13 case filed within two years of the present case.

## Chapters 11 and 12

Business bankruptcies and reorganizations under Chapter 11, and farm reorganizations under Chapter 12, are beyond the scope of this pamphlet. Please consult with an attorney should you have questions regarding corporate and farm reorganizations.