

# **BANKRUPTCY LAW OFFICE OF MICHAEL J. O'CONNELL**

**FAIRFAX, VIRGINIA**



## **QUESTIONS AND ANSWERS ABOUT CHAPTER 7**

### **1. What is chapter 7 and how does it work?**

**Chapter 7 is that part (or chapter) of the Bankruptcy Code that deals with liquidation. The Bankruptcy Code is that part of the federal laws that deal with bankruptcy. A person who files under chapter 7 is called a debtor. In a chapter 7 case, the debtor must turn his or her nonexempt property, if any exists, over to a trustee, who then converts the property to cash and pays the debtor's creditors. In return, the debtor receives a chapter 7 discharge, if he or she pays the filing fee, is eligible for such a discharge, and obeys the orders and rules of the court.**

### **2. What is a chapter 7 discharge?**

**It is a court order releasing a debtor from all of his or her dischargeable debts and ordering the creditors not to attempt to collect them from the debtor. A debt that is discharged is one that the debtor is released from and does not have to pay. Some debts, however, are not dischargeable under chapter 7, and some persons are not eligible for a chapter 7 discharge.**

### **3. What debts are not dischargeable under chapter 7?**

**All debts of any kind or amount, including out-of-state debts, are dischargeable under chapter 7 except the debts listed below. The following is a list of the most common debts that are not dischargeable under chapter 7:**

- (1) Most tax debts and debts that were incurred to pay federal tax debts.**
- (2) Debts for obtaining money, property, services, or credit by means of false pretenses, fraud, or a false financial statement, if the creditor files a complaint in the case (included here are debts for luxury goods or services and debts for cash advances made within 60 days before the case is filed).**
- (3) Debts not listed on the debtor's chapter 7 forms, unless the creditor knew of the case in time to file a claim.**
- (4) Debts for fraud, embezzlement, or larceny, if the creditor files a complaint in the case.**
- (5) Debts for alimony, maintenance, or support and, if the creditor files a complaint in the case, certain other divorce-related debts including property settlement debts.**
- (6) Debts for intentional or malicious injury to the person or property of another, if the creditor files a complaint in the case.**
- (7) Debts for certain fines and penalties.**
- (8) Debts for educational benefits and students loans, unless a court finds that not discharging the debt would impose an undue hardship on the debtor and his or her dependents.**
- (9) Debts for personal injury or death caused by the debtor's operation of a motor**

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vehicle while intoxicated.

(10) Debts that were or could have been listed in a previous bankruptcy case of the debtor in which the debtor did not receive a discharge.

### **4. What persons are not eligible for a chapter 7 discharge?**

The following persons are not eligible for a chapter 7 discharge:

- (1) A person who has been granted a discharge in a chapter 7 case filed within the last six years.
- (2) A person who has been granted a discharge in a chapter 13 case filed within the last six years, unless 70 percent or more of the unsecured claims were paid off in the case.
- (3) A person who files a waiver of discharge that is approved by the court in the chapter 7 case.
- (4) A person who conceals, transfers, or destroys his or her property with the intent to defraud his or her creditors or the trustee in the chapter 7 case.
- (5) A person who conceals, destroys, or falsifies records of his or her financial condition or business transactions.
- (6) A person who makes false statements or claims in the chapter 7 case, or who withholds recorded information from the trustee.
- (7) A person who fails to satisfactorily explain any loss or deficiency of his or her assets.
- (8) A person who refuses to answer questions or obey orders of the bankruptcy court, either in his or her bankruptcy case or in the bankruptcy case of a relative, business associate, or corporation with which he or she is associated.

### **5. What persons are eligible to file under chapter 7?**

Any person who resides in, does business in, or has property in the United States may file under chapter 7, except a person who has been involved in another bankruptcy case that was dismissed within the last 180 days on certain grounds.

### **6. What persons should not file under chapter 7?**

A person who is not eligible for a chapter 7 discharge should not file under chapter 7. Also, a person who has substantial debts that are not dischargeable under chapter 7 should not file under chapter 7. In addition, it may not be wise for a person with current income sufficient to repay a substantial portion of his or her debts within a reasonable period to file under chapter 7, because the court may dismiss the case as constituting an abuse of chapter 7. Although it is not a legal requirement, some experts say that a chapter 7 case should not be filed unless a person's dischargeable debts exceed the value of his or her nonexempt assets by at least two thousand dollars.

### **7. How much is the chapter 7 filing fee and when must it be paid?**

The filing fee is \$200 for either a single or joint case. If the debtor is unable to pay the filing fee when the case is filed, it may be paid in installments due within 120 days. The period for payment may later be extended to 180 days by the court, if there is a valid reason for doing so. The entire filing fee must ultimately be paid, however, or the case will be dismissed and the debtor will not receive a discharge. The fee charged by the debtor's attorney for handling the chapter 7 case is in addition to the filing fee.

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### **8. Where is a chapter 7 case filed?**

In the office of the clerk of the bankruptcy court in the district where the debtor has resided or maintained a principal place of business for the greatest portion of the last 180 days. The bankruptcy court is a federal court and is a unit of the United States district court.

### **9. May a husband and wife file jointly under chapter 7?**

Yes. A husband and wife may file a joint petition under chapter 7. If a joint petition is filed, only one set of bankruptcy forms is needed and only one filing fee is charged.

### **10. Under what conditions should both spouses file under chapter 7?**

Both husband and wife should file if one or more substantial dischargeable debts are owed by both spouses. If both spouses are liable for a substantial debt and only one spouse files under chapter 7, the creditor may later attempt to collect the debt from the nonfiling spouse, even if he or she has no income or assets. In community property states it may be necessary for both spouses to file if all substantial dischargeable debts are community debts. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington.

### **11. When should a chapter 7 case be filed?**

The answer depends on the status of the debtor's dischargeable debts, the nature and status of the debtor's nonexempt assets, and actions taken or threatened to be taken by the debtor's creditors. The following rules should be followed:

- (1) Don't file under chapter 7 until all anticipated debts have been incurred, because it will be another six years before the debtor is eligible for a chapter 7 discharge. For example, a debtor who has incurred substantial medical expenses should not file under chapter 7 until the illness or injury has either been cured or covered by insurance, as it will do little good to discharge, say, \$50,000 of medical debts now and then incur another \$50,000 in medical debt in the next few months.**
- (2) Don't file under chapter 7 until the debtor has received all nonexempt assets to which he or she may be entitled. If the debtor is entitled to receive an income tax refund or a similar nonexempt asset in the near future, he or she should not file under chapter 7 until after the refund or asset has been received and disposed of. Otherwise, the refund or asset will become the property of the trustee.**
- (3) Don't file under chapter 7 if the debtor expects to acquire property through inheritance, life insurance or divorce in the next 180 days, because the property will have to be turned over to the trustee unless it is exempt.**
- (4) If hostile creditor action threatens a debtor's exempt assets or future income, the case should be filed immediately to take advantage of the automatic stay that accompanies the filing of a chapter 7 case (see Question 12, below). If a creditor has threatened to attach or garnish the debtor's wages or if a foreclosure action has been instituted against the debtor's residence, it may be necessary to file a chapter 7 case immediately in order to protect the debtor's interest in the property.**

### **12. How does the filing of a chapter 7 case affect collection and other legal proceedings that have been filed against the debtor in other courts?**

The filing of a chapter 7 case automatically stays (or stops) virtually all collection and other legal proceedings pending against the debtor. A few days after a chapter 7 case is filed, the court mails a

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notice to all creditors ordering them to refrain from any further action against the debtor. If necessary, this notice may be served earlier by the debtor or the debtor's attorney. Any creditor who intentionally violates the automatic stay may be held in contempt of court and may be liable to the debtor in damages. Criminal proceedings and actions to collect alimony, maintenance, or support from exempt property or property acquired by the debtor after the chapter 7 case is filed are not affected by the automatic stay. The automatic stay also does not protect cosigners and guarantors of the debtor, and a creditor may continue to collect debts of the debtor from those persons after the debtor files a chapter 7 case.

**13. May a person file under chapter 7 if his or her debts are being administered by a financial counselor?**

**Yes. A financial counselor has no legal right to prevent anyone from filing under chapter 7.**

**14. How does filing under chapter 7 affect a person's credit rating?**

**It will usually worsen it, if that is possible. However, some financial institutions openly solicit business from persons who have recently filed under chapter 7, apparently because it will be another six years before they can again file under chapter 7. If there are compelling reasons for filing under chapter 7 that are not within the debtor's control (such as illness or injury), some credit rating agencies may take that into account in rating the debtor's credit after filing.**

**15. Are the names of persons who file under chapter 7 published?**

**When a chapter 7 case is filed, it becomes a public record and the name of the debtor may be published by some credit-reporting agencies. However, newspapers do not usually report or publish the names of consumers who file under chapter 7.**

**16. Are employers notified of chapter 7 cases?**

**Employers are not usually notified when a chapter 7 case is filed. However, the trustee in a chapter 7 case often contacts an employer seeking information as to the status of the debtor's wages or salary at the time the cases was filed. If there are compelling reasons for not informing an employer in a particular case, the trustee should be so informed and he or she may be willing to make other arrangements to obtain the necessary information.**

**17. Does a person lose any legal or civil rights by filing under chapter 7?**

**No. Filing under chapter 7 is not a criminal proceeding, and a person does lose any civil or constitutional rights by filing.**

**18. May employers or governmental agencies discriminate against persons who file under chapter 7?**

**No. It is illegal for either private or governmental employers to discriminate against a person as to employment because that person has filed under chapter 7. It is also illegal for local, state, or federal governmental units to discriminate against a person as to the granting of licenses (including a driver's license), permits, student loans, and similar grants because that person has filed under chapter 7.**

**19. Does a person lose all of his or her property by filing under chapter 7?**

**Usually not. Certain property is exempt and cannot be taken by creditors, unless it is encumbered by a valid mortgage or lien. A debtor is usually allowed to retain his or her unencumbered (or unsecured) exempt property in a chapter 7 case. A debtor may also be allowed to retain certain encumbered (or secured) exempt property (see Question 28, below). Depending on the law of the local state, property**

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that is exempt in a chapter 7 case may be either property that is exempt under state law or property that is exempt under the Bankruptcy Code.

**20. When must a debtor appear in court in a chapter 7 case and what happens there?**

The first court appearance is for a hearing called the "meeting of creditors". This hearing usually takes place about a month after the case is filed. At this hearing the debtor is put under oath and questioned about his or her debts and assets by the hearing officer or trustee. In most chapter 7 consumer cases no creditors appear in court; but any creditor that does appear is usually allowed to question the debtor. If the bankruptcy court decides not to grant the debtor a discharge or if the debtor wishes to reaffirm a debt and is not represented by an attorney, there will be another hearing about three months later which the debtor will have to attend.

**21. What happens after the meeting of creditors?**

After the meeting of creditors, the trustee may contact the debtor regarding the debtor's property, and the court may issue certain orders to the debtor. These orders are sent by mail and may require the debtor to turn over certain property to the trustee, or provide the trustee with certain information. If the debtor fails to comply with these orders, the case may be dismissed and the debtor may be denied a discharge.

**22. What is a trustee in a chapter 7 case, and what does he or she do?**

The trustee is an officer of the court, appointed to examine the debtor, collect the debtor's nonexempt property, and pay the expenses of the estate and the claims of creditors. In addition, the trustee has certain administrative duties in a chapter 7 case and is the officer in charge of seeing to it that the debtor performs the required duties in the case. A trustee is appointed in a chapter 7 case, even if the debtor has no nonexempt property.

**23. What are the debtor's responsibilities to the trustee?**

The law requires the debtor to cooperate with the trustee in the administration of a chapter 7 case, including the collection by the trustee of the debtor's nonexempt property. If the debtor does not cooperate with the trustee, the chapter 7 case may be dismissed and debtor may be denied a discharge.

**24. What happens to the property that the debtor turns over to the trustee?**

It is usually converted to cash, which is used to pay the fees and expenses of the trustee and to pay the claims of the unsecured creditors. The trustee's fee is usually \$60 plus a percentage of the amount collected from the debtor.

**25. What if the debtor has no nonexempt property for the trustee to collect?**

If, from the debtor's chapter 7 forms, it appears that the debtor has no nonexempt property, a notice will be sent to the creditors advising them that there appears to be no assets from which to pay creditors, that it is unnecessary for them to file claims, and that if assets are later discovered they will be given an opportunity to file claims. This type of case is referred to as a no-asset case. Approximately one-half of all Chapter 7 cases that are filed are no-asset cases.

**26. How are secured creditors dealt with in a chapter 7 case?**

Secured creditors are creditors with valid mortgages or liens against property of the debtor. Property of the debtor that is encumbered by a valid mortgage or lien is called secured property. A secured creditor is usually permitted to repossess or foreclose its secured property, unless the value of the secured property greatly exceeds the amount owed to the creditor. The claim of a secured creditor is

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called a secured claim and secured claims must be collected from or enforced against secured property. Secured claims are not paid by the trustee. A secured creditor must prove the validity of its mortgage or lien and obtain a court order before repossessing or foreclosing on secured property. A debtor should not turn any property over to a secured creditor until a court order has been obtained. The debtor may be permitted to retain or redeem certain types of secured personal property (see Question 28, below).

### **27. How are unsecured creditors dealt with in a chapter 7 case?**

An unsecured creditor is a creditor without a valid lien or mortgage against property of the debtor. If the debtor has nonexempt assets, unsecured creditors may file claims with the court within 90 days after the first date set for the meeting of creditors. The trustee will examine these claims and file objections to those deemed improper. When the trustee has collected all of the debtor's nonexempt property and converted it to cash, and when the court has ruled on the trustee's objections to improper claims, the trustee will distribute the funds in the form of dividends to the unsecured creditors according to the priorities set forth in the Bankruptcy Code. Administrative expenses, claims for wages, salaries, and contributions to employee benefit plans, claims for the refund of certain deposits, claims for alimony, maintenance and support, and tax claims, are given priority, in that order, in the payment of dividends by the trustee. If there are funds remaining after the payment of these priority claims, they are distributed pro rata to the remaining unsecured creditors.

### **28. What secured property may a debtor retain or redeem in a chapter 7 case?**

A debtor may retain and redeem certain secured personal and household property, such as household furniture, appliances and goods, wearing apparel, and tools of trade, without payment to the secured creditor, if the property is exempt and if the mortgage or lien against the property was not incurred for the purpose of financing the purchase of the property. A debtor may also retain and redeem without payment to the secured creditor any secured property that is both exempt and subject to a judgment lien. Finally, a debtor may redeem certain exempt personal, family, or household property by paying to the secured creditor an amount equal to the value of the property, regardless of how much is owed to the creditor. Deadlines are imposed on the enforcement of these rights by the debtor during the bankruptcy case.

### **29. How can a debtor minimize the amount of money or property that must be turned over to the trustee in a chapter 7 case?**

In a chapter 7 case the debtor is required to turn over to the trustee only the nonexempt money or property that he or she possessed at the time the case was filed. Many nonexempt assets of consumer debtors are liquid in nature and tend to vary in size and amount from day to day. It is wise, therefore, for the debtor to engage in some negative estate planning so as to minimize the value or amount of these liquid assets on the day and hour that the chapter 7 case is filed. The most common nonexempt liquid assets, and the assets the trustee will be most likely to look for, include the following:

- (1) cash,
- (2) bank accounts,
- (3) prepaid rent,
- (4) landlord and utility deposits,
- (5) accrued earnings and benefits,
- (6) tax refunds, and
- (7) sporting goods.

It is usually advantageous for the debtor to take steps to insure that the value of each of these assets is as low as possible on the day and hour that the chapter 7 case is filed. By doing this the debtor will not be cheating or acting illegally; the debtor will be simply using the law to his or her advantage, much the same as a person who takes advantage of loopholes in the tax laws.

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**Cash.** If possible, the debtor should have no cash on hand when the chapter 7 case is filed. Further, if the debtor has received cash or the equivalent of cash in the form of a paycheck or the closing of a bank account shortly before the filing of the case, the debtor should obtain receipts when disposing of the funds in order to prove to the trustee and the court that the funds were disposed of prior to the filing of the case. Money possessed by the debtor shortly before the filing of a chapter 7 case may be spent on such items as food and groceries, the chapter 7 filing fee, the attorney's fee in the chapter 7 case, and payment of up to \$600 to creditors whom the debtor intends to continue paying after the filing of the chapter 7 case. Payments should not be made to friends or relatives, however, as the trustee may later recover these payments

**Bank Accounts .** The best practice is to close out all bank accounts before filing under chapter 7. If a bank account is not closed, the balance of the account should be as close to zero as the bank will allow and all outstanding checks must clear the account before the case is filed. If the debtor has written a check to someone for, say, \$50 and if the check has not cleared the account when the case is filed, the \$50 in the account to cover the outstanding check will be deemed an asset of the debtor and will have to be paid to the trustee.

**Prepaid Rent.** If the debtor's rent is paid on the first day of the month and if the debtor's chapter 7 case is filed on the tenth day of the month, the portion of the rent covering the last 20 days of the month, if not exempt, will be deemed an asset of the debtor and will later have to be paid to the trustee. If possible, the debtor should make arrangements with the landlord to pay rent only through the date that the case is to be filed and pay the balance of the rent from funds acquired after the case is filed. If this is not possible, the case should be filed near the end of the rent period.

**Landlord and Utility Deposits.** Unless they are exempt, the debtor should attempt to obtain the refund of all landlord and utility deposits before filing the chapter 7 case. Otherwise, the deposits, or their cash equivalents, will have to be paid to the trustee.

**Accrued Earnings and Benefits.** In most states, and under the federal law, only a certain percentage (usually 75%) of a debtor's earnings are exempt. Therefore, the trustee may be allowed to take the nonexempt portion (usually 25%) of any accrued and unpaid wages, salary, commissions, vacation pay, sick leave pay, and other accrued and nonexempt employee benefits. Normally, then, the best time to file a chapter 7 case is the morning after payday. Even then, if the pay period does not end on payday, the debtor may have accrued earnings unless special arrangements are made with the employer. If annual leave or vacation pay is convertible to cash, it should be collected by the debtor before the chapter 7 case is filed, as should any other nonexempt employee benefits that are convertible to cash

**Tax Refunds.** In most states, a tax refund is not exempt and becomes the property of the trustee if it has not been received by the debtor prior to the filing of the chapter 7 case. Therefore, if the debtor is scheduled to receive a tax refund, a chapter 7 case should not be filed until after the refund has been received and disposed of. Even if the case is filed before the end of the tax year, if the debtor receives a refund, the trustee may be entitled to the portion of the refund earned prior to the filing of the case. The best practice, then, is to either file the chapter 7 case early in the tax year (but after the refund from the previous year has been received) or make arrangements to insure that there will be no tax refund for that year.

**Sporting Goods** If the debtor owns guns, fishing gear, skis, cameras, or similar items of value that are not exempt, he or she will later have to turn them, or their cash equivalent, over to the trustee. Such items should be disposed of prior to the filing of the case, especially if they are of considerable value.

**30. May a utility company refuse to provide service to a debtor if the company's utility bill is discharged under chapter 7?**

If, within 20 days after the chapter 7 case is filed, the debtor furnishes a utility company with a deposit or other security to insure the payment of future services, it is illegal for a utility company to refuse to

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provide future utility service to the debtor, or to otherwise discriminate against the debtor, if its bill for past utility services is discharged in the chapter 7 case.

**31. What should the debtor do if he or she moves before the chapter 7 case is closed?**

The debtor should immediately notify the bankruptcy court in writing of the new address. Because most communications between a debtor and the bankruptcy court are by mail, it is important that the bankruptcy court always have the debtor's current address. Otherwise, the debtor may fail to receive important notices and the chapter 7 case may be dismissed. Many courts have change-of-address forms for the debtors to use when they move, and the debtor should obtain one if a move is planned.

**32. What if a debtor wishes to repay a dischargeable debt?**

A debtor may repay as many dischargeable debts as desired after filing under chapter 7. By repaying one creditor, a debtor does not become legally obligated to repay any other creditor. The only dischargeable debt a debtor is legally obligated to repay is one for which the debtor and the creditor have signed what is called a "reaffirmation agreement". If the debtor was not represented by an attorney in negotiating the reaffirmation agreement with the creditor, the reaffirmation agreement must be approved by the court to be valid. If the debtor was represented by an attorney in negotiating the reaffirmation agreement, the attorney must file the agreement and the attorney's statement with the court in order for the agreement to be valid. If a dischargeable debt is not covered by a reaffirmation agreement, a debtor is not legally obligated to repay the debt, even if the debtor has made a payment on the debt since filing under chapter 7, has agreed in writing to repay the debt, or has waived the discharge of the debt.

**33. How is a debtor notified when his or her discharge has been granted?**

Usually by mail. Most courts send a form called "Discharge of Debtor" to the debtor and to all creditors. This form is a copy of the court order discharging the debtor from his or her dischargeable debts, and it serves as notice that the debtor's discharge has been granted. It is usually mailed about four months after a chapter 7 case is filed.

**34. How long does a chapter 7 case last?**

A chapter 7 case begins with the filing of the case and ends with the closing of the case by the court. If the debtor has no nonexempt assets for the trustee to collect, the case will most likely be closed shortly after the debtor receives his or her discharge, which is usually about four months after the case is filed. If the debtor has nonexempt assets for the trustee to collect, the length of the case will depend on how long it takes the trustee to collect the assets and perform his or her other duties in the case. Most consumer cases with assets last about six months, but some last considerably longer.

**35. What should a person do if a creditor later attempts to collect a debt that was discharged under chapter 7?**

When a chapter 7 discharge is granted, the court enters an order prohibiting the debtor's creditors from later attempting to collect any discharged debt from the debtor. Any creditor who violates this court order may be held in contempt of court and may be liable to the debtor for damages. If a creditor later attempts to collect a discharged debt from the debtor, the debtor should give the creditor a copy of the order of discharge and inform the creditor in writing that the debt has been discharged under chapter 7. If the creditor persists, the debtor should contact an attorney. If the creditor files a lawsuit against the debtor on a discharged debt, it is important not to ignore the matter, because even though a judgment entered against the debtor on a discharged debt can later be voided, voiding the judgment may require the services of an attorney, which could be costly to the debtor.

**36. How does a chapter 7 discharge affect the liability of cosigners and other**

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**parties who may be liable to a creditor on a discharged debt?**

**A chapter 7 discharge releases only the debtor. The liability of any other party on a debt is not affected by a chapter 7 discharge. Therefore, a person who has cosigned or guaranteed a debt for the debtor is still liable for the debt regardless of the debtor's chapter 7 discharge. The only exception to this rule is in community property states where the spouse of a debtor is released from certain community debts by the debtor's chapter 7 discharge.**

**37. What if a debtor's bankruptcy forms are not prepared by an attorney?**

**It is not legally required that a debtor's bankruptcy forms be prepared by or under the direction of an attorney. However, it is difficult to properly prepare bankruptcy forms without giving legal advice to the debtor. Because many non-attorney bankruptcy preparers attempt to give legal advice to debtors without having the legal training and knowledge necessary to give such advice, Congress has passed an amendment to the Bankruptcy Code that deals with non-attorney preparers. This law requires all non-attorney preparers to sign and print their names on the documents that they prepare and to give copies of all filed documents to the debtor. This law also provides that if a bankruptcy case is later dismissed because of the fraud or incompetence of the preparer, or if the preparer commits an inappropriate or deceptive act, the debtor may recover actual damages from the preparer, plus statutory damages of \$2,000 or twice the amount paid to the preparer (whichever is greater), plus attorney's fees and costs. A bankruptcy preparer may also be enjoined from further work in the bankruptcy preparation business and may be criminally prosecuted if a bankruptcy case is dismissed because the preparer disregarded the requirements of the bankruptcy laws or rules.**

**38. Is the fee charged by an attorney for representing a debtor in a chapter 7 case subject to the review and approval of the bankruptcy court?**

**Yes. The fee charged by an attorney for representing a debtor in a chapter 7 case is subject to the review and approval by the bankruptcy court. This rule is followed whether the fee is paid to the attorney prior to or after the filing of the case. The court will only approve a reasonable fee.**