

BANKRUPTCY

The term bankruptcy comes from two Latin words meaning “bench” and “break”; thus its literal meaning is “broken bench.” Under Roman law, after gathering together and dividing up the assets of a delinquent debtor, the creditors would break the debtor’s workbench as a punishment and a warning to other indebted tradesmen. Bankrupt individuals were regarded as thieves who deserved severe penalty. Romans deprived such persons of their civil rights, and many other societies stigmatized them by requiring them to dress in a particular identifying garb.

In our society today, revisions to the bankruptcy laws and changes in consumer attitude toward bankruptcy have fostered a climate in which people regard bankruptcy as a more plausible remedy for financial problems than they once did—a fact that recent statistics support.

In 1988 there were 549,612 personal bankruptcies in our country. By 1998, 10 years later, there were a total of 1,398,182 personal bankruptcies in America and another 44,367 business bankruptcies. In the year 2001 there were almost 1.5 million personal bankruptcies filed. Assuming that this trend continues, we can realistically expect to see two million bankruptcies each year by the year 2008!

These statistics spell great difficulty for many smaller merchants and for the credit industry as a whole. But, even more, they reflect a decline in the responsibility index for the average American family, Christian and non-Christian alike.

A revised Bankruptcy Code, enacted in 1978 (The Bankruptcy Act of 1978), took effect on October 1, 1979. The Code consolidated some chapters of previous law pertaining to business reorganizations and sought to streamline the administration of the bankruptcy courts, but its most sweeping changes involved personal bankruptcy. This revision made bankruptcy a more attractive option to troubled debtors, especially because it increased the amount of assets that could be exempt from liquidation.

Filing for Bankruptcy

Filing for bankruptcy is a deceptively simple procedure, and the same initial forms are used regardless of the Chapter of bankruptcy selected.

Under all Chapters of bankruptcy the debtor must supply certain basic personal information (ie., name, address, Social Security number), a list of all assets and all creditors to whom money is owed, and a form that shows the debtor’s monthly income and monthly living expenses.

Depending on the Chapter selected, additional information may be required that is particular to that Chapter. Under Chapter 13 the debtor must file a proposed plan for payment to creditors within 10 days after the initial petition is filed.

An attorney should be consulted prior to filing under any Chapter.

The filing of any Chapter of bankruptcy temporarily stops all creditor collection efforts, which is known as the *automatic stay*. This *automatic stay* allows the debtor, and especially the trustee, to evaluate the debtor’s condition and determine the best course of action concerning creditors. It is important to realize that creditors are placed in two basic categories: *secured* and *unsecured*.

Secured creditors have special rights in the item that was pledged as collateral for the debt, and the debtor must choose whether to surrender the collateral, reaffirm the debt, or redeem the collateral.

Unsecured creditors, such as credit cards, personal loans, and medical bills, do not have any rights to specific assets of the debtor and simply share in any distribution from the estate. Whether there is a distribution depends on the assets owned by the debtor and the exemption laws of the state in which the debtor resides.

Debts also are placed in two basic categories: *dischargeable* and *nondischargeable*. It is the *dischargeable* debts, such as credit card debts, personal loans, and medical bills, that are forgiven by the Bankruptcy Code. *Nondischargeable* debts, which must be repaid, include student loans, alimony and child support, and most taxes. Certain debts that otherwise would be classified as dischargeable may be reclassified as nondischargeable if the debt was created through fraud or misrepresentation on the part of the debtor.

Bankruptcy Chapters

Bankruptcy laws and procedures are much too complicated to cover in this pamphlet, and individual circumstances can effect the choice of which bankruptcy chapter to select. Therefore, to help show the basic differences among the various Chapters of the Bankruptcy Code, only a simple overview is presented here. *Specific advice should be sought from a qualified attorney.* The following Chapters of bankruptcy are presented in the order in which they are most frequently filed.

Chapter 7—This Chapter represented 70 percent of all bankruptcies filed during the first quarter of 2002 and is available to both individuals and businesses.

In Chapter 7 a trustee is immediately appointed to administer the bankruptcy proceedings. In most cases the debtor will never see the judge and will deal only with the appointed trustee.

The function of Chapter 7 is liquidation of all nonexempt assets and distribution to creditors. All nonexempt assets are sold by the trustee and the proceeds are distributed to creditors based on the proof of claim filed by the creditor and allowed by the trustee.

In most instances the creditors will receive only a small percentage of the original outstanding debts. Certain specified items are considered exempt and the debtor is allowed to retain those items. If the debtor has not withheld any nonexempt assets and has been honest in dealing with the trustee, the court will grant a discharge: the formal forgiveness of all remaining debt.

Chapter 13—This Chapter affords personal debtors an opportunity to repay their creditors, based on the ability to pay. The majority of Chapter 13 cases are filed by individuals facing a foreclosure against their homes, since Chapter 13 will allow them to pay any arrearage and reinstate their mortgages.

Chapter 13 has very specific limits concerning the amount and type of debt that a person can have in order to qualify for protection under Chapter 13, and it is not available to corporations.

Under Chapter 13 a trustee is immediately appointed to administer the case and review the initial schedules filed, as well as the proposed plan for payment to creditors. The debtor

pays the trustee the amount specified in the plan each month, and the trustee pays the bills and deals with all the creditors. The proposed plan may provide for distributions of payments to creditors for a period of time, not to exceed 60 months. It could be a shorter period, depending on the debtor's ability to pay as determined by the trustee. On the successful completion of the payment plan, the court will formally discharge (forgive) any remaining balance that is due to creditors.

Chapter 11—This Chapter, although available to individuals, is most frequently filed by corporations. Chapter 11 permits a company to continue operating its business under the supervision of the Bankruptcy Court, for a period not to exceed four months, while formulating a plan of repayment to its creditors.

The plan that a corporation may propose must provide for a distribution to creditors of at least the amount that the creditors would receive if the company were immediately liquidated under Chapter 7. Otherwise the corporation may face the possibility of conversion to Chapter 7 and liquidation. The plan submitted by the debtor is voted on by the creditors, who decide whether to allow the corporation to reorganize.

Chapter 12—Historically, farmers have been treated differently from other debtors under the Bankruptcy Act, and that special treatment continues under the Bankruptcy Code. In the 1930s and 1940s farmers were given special consideration under Section 75 of the Bankruptcy Act, known as the Frazier-Lemke Act of 1933. This section stipulated that a farmer could not be the subject of an involuntary petition (creditor-initiated liquidation).

The farmers' special status was broadened even more with the passage of Chapter 12 of the 1986 amendment to the Bankruptcy Code. Prior to Chapter 12, Chapter 11 relief was the principal method of reorganization utilized by farmers.

Chapter 12 is limited to individuals (and sometimes corporations or partnerships) engaged in farming operations with debts totaling not more than \$1.5 million and with a sufficient annual income to make payments under a Chapter 12 plan.

In a Chapter 12 case, a trustee is automatically appointed, but the debtor continues as a "debtor-in-possession" and has similar powers as a trustee serving in a Chapter 11 case. The farmer may choose to convert to a case under Chapter 7. Because of the unique particulars of a Chapter 12 case, a qualified attorney should be consulted.

Is Bankruptcy Unscriptural?

This is not a simple question to answer. God's Word clearly says that believers should be responsible for their promises and repay what they owe. *"When you make a vow to God, do not be late in paying it; for He takes no delight in fools. Pay what you vow! It is better that you should not vow than that you should vow and not pay"* (Ecclesiastes 5:4-5).

Does that mean that in the interim you should not take the legal remedy of court protection until you have the ability to repay? Often that will be an individual decision. First and foremost, a Christian must be willing to accept the absolute requirement to repay every debt.

Next, the issue of motive must be addressed. Is the bankruptcy action being taken to protect the legitimate rights of the creditors? The answer to this question can be found in whether assets are purposely withheld from the creditors. For example, many times when someone files for corporate or personal bankruptcy protection, assets already have been transferred to the spouse or other family members.

So, if the intent is merely to protect the assets of the debtor, without due consideration of the creditors, the action is unscriptural. It would be better to suffer the loss of all assets than to lose your integrity. *“Do not withhold good from those to whom it is due, when it is in your power to do it. Do not say to your neighbor, ‘Go, and come back, and tomorrow I will give it,’ when you have it with you”* (Proverbs 3:27-28).

Bankruptcy is a serious matter and, at best, both sides lose. The creditors lose much of the money they are owed, and the debtors lose some of the respect they previously had. There is still a stigma associated with any bankruptcy, and it will remain until the last creditor is repaid. However, a person who has filed for bankruptcy can turn an otherwise negative situation into a positive one by making a commitment to repay what is legitimately owed. Once that commitment is made, the individual should look to God to provide the means to do so.

ANSWERS TO QUESTIONS ABOUT BANKRUPTCY

If I file for bankruptcy protection, what happens to debts cosigned by friends or relatives?

Any cosigners are still liable to pay whatever portion of the debt is unpaid.

Can I avoid the IRS through a bankruptcy?

Many people have the mistaken impression that filing for bankruptcy voids an obligation to the IRS. Not so. The Bankruptcy Code excludes several categories of debt from the set-aside provisions of the law (nondischargeable debts), including most federal and state income tax liabilities. Also excluded are federally backed school loans.

Should I file for bankruptcy because of a large lawsuit judgment?

In these times it is not impossible or unlikely to be sued for millions of dollars over an accident. In light of this, it is prudent for individuals to carry appropriate amounts of liability insurance. However, in the face of an unreasonable judgment in which damages are clearly punitive rather than compensatory, filing for protection may be an option to prayerfully consider.

What is the difference between a “straight” bankruptcy and a Chapter 13 plan?

Straight bankruptcy (Chapter 7) is a legal way to make most debts disappear with no legal requirement to repay them. A Chapter 13 plan provides a systematic way to repay most, if not all, debts under court supervision and protection.

What will Chapter 13 repayment proceedings do to my credit rating?

Credit reporting agencies currently report the filing of any bankruptcy for a period of 10 years. In a Chapter 13 filing, the reporting includes the amount of the debts owed, the amount of the repayment to creditors, and whether the debtor successfully completed the plan.

Will I lose my job if I go through bankruptcy?

Employers are forbidden to fire an employee because of bankruptcy proceedings. However, certain jobs in which the employee must be bonded (such as a jewelry clerk or bank teller) may be jeopardized.

Am I obligated to repay if my creditors force me into bankruptcy?

This is a situation in which many people feel justified in not repaying their debts, because *they* did not choose bankruptcy; their creditors did. However, Psalm 37:21 says, “*The wicked borrows and does not pay back, but the righteous is gracious and gives.*” God’s Word is clear: You are obligated to repay what you borrow.

Additionally, by repaying all debts your credit rating can be restored. Be sure the credit bureau’s files reflect your changed status. (A letter from your creditors verifying that all debts have been paid would be very helpful.)

All Scripture quotations are taken from the *New American Standard Bible* (updated). Used by permission.

©1985, 2003 by Crown Financial Ministries. All rights reserved. Written permission is required for any other copying or other means of reproduction.

Visit Crown Financial Ministries online at www.crown.org or contact us by telephone at 1-800-722-1976.