

Chapter II

Bankruptcy Chapter 7 vs. Chapter 13 Bankruptcy

Chapter 7 and Chapter 13 are the two primary portions of the bankruptcy code designed from consumers. A few high profile debtors will file under Chapter 11, but it is expensive and rarely well suited for an individual. There is also a farm bankruptcy chapter that some farmers will utilize, although farmers with limited farm assets often file under Chapter 7. If you do have a farm bankruptcy you are well advised to seek out an attorney who specialized in farm cases.

A. Chapter 7 (so called “Liquidation”)

“Liquidation”, it sounds like something Tony Soprano does to his enemies. In fact, in the vast majority of Chapter 7 cases nothing is liquidated at all. Theoretically when you file Chapter 7, your property goes into a bankruptcy estate. The estate is then sold (liquidated) and the proceeds are paid over to your creditors. However, in the real world, unless your name is Trump, you are going to have little or no non-exempt property to liquidate. Also, pre-bankruptcy planning is perfectly legal so long as it is all disclosed. So your experienced attorney may be able to help you liquidate any non-exempt assets you may have before filing, instead of giving them to your creditors. See Chapter 4, “Iowa Bankruptcy Exemptions” for more information on Iowa exemptions in Chapter 7. However, if you think you have an asset that will not be exempt, you should talk to a bankruptcy attorney before drawing any conclusions. You may be surprised to find that you can manage to keep it after all. A common example is a boat with a lien. If there is little or no equity, then the boat will be of little interest to the trustee since he would have to satisfy the lien if he wanted to take the (otherwise non-exempt) boat.

B. Chapter 13 (Repayment)

While the vast majority of clients will file under Chapter 7, some may be ineligible due to income being too high for expenses. Others may wish to keep property that may not be exempt in Chapter 7 or may want to include overdue home payments or other obligations in their plan payments. In some cases back taxes can be better managed in a Chapter 13. In any case, if you choose to file under Chapter 13 you will repay based on your ability, normally over 5 years. But beware, most Chapter 13 plans fail because the debtor is unable to make the payments, often due to another emergency like job loss, illness or divorce. If your Chapter 13 plan is dismissed you are once more “fair game” for creditors who can come after you with lawsuits, garnishment of your bank accounts and wages, judgments and liens. In that case, most debtors will “convert” to a Chapter 7, doing what many should have done in the first place. Of course if you are not eligible for Chapter 7 you may have to file Chapter 13 anyway and just hope for the best.

Chapter 13 to “Save the Home”

Doomed from the start, this is probably the #1 reason that most Chapter 13 cases fail. If a debtor is unable to make their house payment before adding past due payments to the Chapter 13 plan, it is even less likely they will be able to make the new, larger payments. So, it is best to “wake up and smell the coffee” early, surrender the house and file a Chapter 7. Otherwise, you are just throwing good money after bad.

Attorney Fees

There is a lot more care and feeding required by your attorney in a Chapter 13 than in a Chapter 7. While a Chapter 7 can usually be completed in 3-4 months, a Chapter 13 will normally go on for five years. Hence, attorneys must charge more. If you are eligible for Chapter 7 you may find it better to pay the lower fee up front and be done with it, particularly since most clients that start in a Chapter 13 end up converting to a Chapter 7 eventually anyway and paying two fees instead of one.