



BANKRUPTCY

(11 U.S.C. §§ 1 - 1330)

Office of the Staff Judge Advocate, Luke AFB, AZ, (623) 856-6901

WHAT IS BANKRUPTCY?

Bankruptcy is a legal mechanism through which individuals may obtain relief from financial obligations. A person who files for bankruptcy is known as a “debtor”. By filing for bankruptcy, a debtor is petitioning a bankruptcy court to discharge the debtor from their existing financial commitments. The effect of a discharge is to release the debtor from any future liability on all debts incurred prior to filing bankruptcy. If the court grants the discharge, affected creditors are prohibited from attempting to enforce the debt against the debtor. The purpose of bankruptcy, therefore, is to provide deserving debtors with a financial “fresh start”. Bankruptcy will discharge most unsecured debts. However, it will eliminate a secured debt *only* if the collateral placed for the debt is relinquished by the debtor. For example, if you owe money on a car, you must either continue to make the car payments or surrender the car back to the secured creditor. The same is true with a house, furniture or any other purchase on which the seller or the financial institution holds a lien.

AIR FORCE POLICY REGARDING BANKRUPTCY

Air Force members are expected to pay their financial obligations in a proper and timely manner. With respect to bankruptcy, however, the Air Force has a policy of strict neutrality. Air Force members have a statutory right to invoke the procedures of the Bankruptcy Act. No adverse action may be taken against a member of the Air Force for filing a petition for bankruptcy, discharging debts in bankruptcy, or consolidating debts under a Chapter 13 bankruptcy plan. Commanders and first sergeants may not require Airmen to seek financial counseling assistance before allowing them to file bankruptcy. Certain underlying facts, such as mismanagement of personal affairs or dishonorable failure to pay just debts, may form a basis for adverse action against an Air Force member. However, neither filing a petition for bankruptcy nor a discharge in bankruptcy is considered “mismanagement” or “dishonorable.” In short, if you have made a ***good faith attempt*** to honor your debts but find yourself declaring bankruptcy, your Air Force career will not be adversely affected.

HOW DOES BANKRUPTCY WORK?

Once the debtor has decided to seek bankruptcy protection, he/she must first file a petition for bankruptcy. In addition, no individual may be a debtor under any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing. The filing of the petition operates as a stay, prohibiting creditors from making any further attempts to collect or enforce debt. The debtor will receive a discharge, but creditors will share in the debtor’s

available assets to reduce the financial impact. Upon filing for bankruptcy, the debtor's property becomes property of the bankruptcy estate, subject to distribution. Property exempted from the bankruptcy estate include equity in the debtor's house as well as personal items or necessities, such as clothing, an automobile, and tools of the debtor's trade. The amount of equity in the debtor's house that is exempt is determined by state law and thus varies. The same is true of personal property value. An outline of property exemptions allowed in Arizona is attached to this handout. The debtor's nonexempt property is collected, sold, and used to pay creditors.

Property of the estate is subject to creditors' claims in order of precedence. If the property was used as collateral to secure a loan or credit transaction, the creditor holding the secured claim is the first to be paid from the collateral. If the value of the collateral exceeds the amount owed to the secured creditor, unsecured creditors may share in the remaining funds. If, however, the value of the collateral is less than the amount owed to the secured creditor, he/she will get paid to the extent of the value of the collateral and will be deemed to have an unsecured claim for the balance of the debt. Property not collateral is pooled and assessed, the proceeds of which are distributed to the unsecured creditors on a pro rata basis. There are various levels of priority among unsecured creditors, i.e., certain categories of unsecured creditors are paid in full before others. For example, creditor claims for child support and alimony as well as most claims of tax agencies are priority claims.

Once the debtor complies with his/her obligations under bankruptcy, he/she is discharged from any outstanding debts. The effect of a bankruptcy discharge is that any creditor named in the discharge is barred from collecting moneys from the debtor. Evidence of misconduct by the debtor could serve as grounds for setting aside the discharge. An example of this is if a debtor lied concerning his/her assets.

TYPES OF BANKRUPTCY

The most common types of individual bankruptcies are Chapter 7, otherwise known as liquidation bankruptcy, and Chapter 13, is a debt adjustment. A Chapter 7 bankruptcy proceeds as described above. If a debtor has received a discharge based on a filing under Chapter 7 within 6 years prior to the current filing, he/she would be ineligible for another discharge.

Chapter 13 differs from Chapter 7 in that the debtor's nonexempt property is not sold to pay creditors. Instead, the debtor proposes a repayment plan to the court under which creditors will be repaid through the debtor's future earnings or income. The plan must provide for payment in full to secured creditors and must ensure unsecured creditors receive at least as much as they would under Chapter 7. A repayment period may not exceed 3 years, unless the court approves a longer duration. Even then, this time cannot exceed 5 years.

Unlike Chapter 7, no one can be forced into a Chapter 13 bankruptcy by creditors. Chapter 13 is only available to debtors with regular income, less than \$383,175 in unsecured debts and less than \$1,149,525 in secured debts. An automatic cost of living increase will increase these levels every 3 years. The next year where an increase may occur is 2017. The same dollar limits apply to married couples filing for Chapter 13 bankruptcy. Regular income includes not only future earnings from employment, but also other stable forms of income such as disability or social

security benefits. Self-employed individuals may also file for Chapter 13 bankruptcy, provided their debts do not exceed the prescribed maximums.

ADVANTAGES AND DISADVANTAGES OF BANKRUPTCY

There are positive and negative aspects of seeking protection under the bankruptcy laws. Some of the most notable advantages have already been discussed, i.e. the stay on debt collection by creditors. Bankruptcy has disadvantages as well. It is a complicated, technical proceeding. Many important decisions made during the process may hinge on nuances or subtleties in the law. **A successful bankruptcy requires retaining an attorney who is well-versed in bankruptcy laws.** Expect creditors to be represented by competent bankruptcy attorneys. Another negative aspect of bankruptcy is the effect on your credit. Although recently bankruptcy has lost some of its stigma, bankruptcy filing on a credit report represents a substantial hurdle. By the time a debtor resorts to bankruptcy, creditors have already reported the debtor as delinquent. In these instances, there is little hope of preserving a favorable credit rating. While bankruptcy is among the most negative of credit indicators, sophisticated creditors understand the benefits of bankruptcy and how it operates. These creditors perceive that bankruptcy is sometimes the most viable alternative available and that filing makes good business sense. Bankruptcy will appear on your credit report for 7 years, after the three year repayment period.

SECURITY CLEARANCE

The status of your security clearance can be affected, but it is not automatic. The outcome depends on the circumstances that led up to the bankruptcy and a number of other factors, including your job performance and relationship with your chain of command. Whether your bankruptcy was caused by financial irresponsibility or by unexpected financial hardship will be examined. The recommendations of your chain of command and co-workers may also be considered. As a practical matter, your security clearance probably should not be a significant factor in making a decision about whether to file bankruptcy. The amount of your unpaid debts may jeopardize your clearance, regardless of whether you file bankruptcy. Thus, not filing may be more of a security risk due to the size of outstanding debts, whereas using a government-approved means of dealing with your debts may be viewed as an indication of financial responsibility.

ALTERNATIVES TO BANKRUPTCY

Once you realize you are unable to successfully manage your finances alone, be proactive. Your financial problems will not take care of themselves. Immediately seek professional assistance in creating a budgeting plan. A financial counselor is available, free of charge, at the Airman and Family Readiness Center. He/She can evaluate your situation and assist in negotiating repayment plans with your creditors. Alternatively, you may wish to seek the assistance of a counselor at the Consumer Credit Counseling Services of Arizona (CCCS), a nonprofit organization. Counselors both at Luke and CCCS have successfully negotiated the reduction of

interest rates, temporary stays in the accrual of interest, and extended repayment periods on behalf of debtors. Do not wait until it is too late to seek the services of these trained professionals.

Loans and grants may also be available to qualified active duty members and their dependents. For more information, contact the Airman and Family Readiness Center.

RESOURCES

- **American Bar Association**
http://www.abanet.org/publiced/practical/books/family_legal_guide/chapter_8.pdf
- **United States Bankruptcy Court for the District of Arizona**
<http://www.azb.uscourts.gov/>
- **U.S. Bankruptcy Court Help Line**
(866)553-0893

PROPERTY EXEMPTIONS

(Arizona) (Revised September 1, 2015)

I. Homestead Exemption - \$150,000 (A.R.S. § 33-1101)

- Debtor's residence, condominium, or mobile home
- A homestead exemption is automatic. No filing is necessary.
- Only one homestead exemption at a time may be held by a person.

II. Exemptions for Married Persons (A.R.S. § 33-1121.01)

- "In the case of married persons, each spouse is entitled to the exemptions provided in this article which may be combined with the other spouse's exemption in the same property or taken in different exempt property." (does not include homestead exemption)
- Declaring property exempt will not, in most cases, prevent a secured creditor from foreclosing on a home or repossessing items of personal property.

III. Household Goods Exemption - \$6,000 (A.R.S. § 33-1123)

- Household furniture, furnishings and appliances, including tables, chairs, beds, and one TV or radio or stereo, stove, refrigerator, washing machine, clothes dryer, vacuum cleaner and couch.

IV. Food & Fuel Exemption - No Dollar Amount (A.R.S. § 33-1124)

- Food, fuel and provisions for six months.

V. Personal Items Exemptions- As Listed Below (A.R.S. § 33-1125)

- Clothing - \$500
- Musical instruments - \$400
- Pets, domestic animals - \$800
- Engagement, wedding rings - \$2,000
- Library - \$250
- Watch - \$150
- Misc. (bicycle, sewing machine, typewriter, family bible, burial plot, gun) - \$1,000
- Motor vehicle - \$6,000 (If physically disabled \$12,000)
- Professionally prescribed prostheses for the debtor or a dependent of the debtor, including a wheelchair

VI. Money Benefits or Proceeds Exemption - As Listed Below (A.R.S. § 33-1126)

- Life insurance proceeds (spouse or parent/legal guardian) - \$20,000
- Life insurance - cash surrender value (policy must have been in effect for 2 years)
- Money in one bank account - \$300
- Personal property homestead in prepaid rent (or 1 1/2 months rent, whichever is less; does not apply if also claiming homestead in real property) - \$1,000
- Earnings of minors - No limit
- Health, accident and disability insurance payments (with qualifications) - No limit
- Court-ordered child support and spousal maintenance - No Limit
- Certain retirement and deferred compensation payments - No limit

VII. Tools & Equipment Exemption - \$5,000 (*A.R.S. § 33-1130*)

- Tools and equipment of debtor's trade, with certain limitations.

VIII. Salary Exemption - 75% of Disposable Earnings (*A.R.S. § 33-1131*)

- Wages, salary or compensation for personal services, and pension, retirement and deferred compensation payments

IX. Government Benefits Exemptions (with limitations):

- Railroad Retirement (*45 U.S.C. 231m*)
- Social Security (retirement and disability) (*42 U.S.C. 407*)
- SSI (Supplemental Security Income) (*42 U.S.C. 1383(d)*)
- Veteran's Benefits (*38 U.S.C. 5301*)
- Federal Civil Service Retirement (*5 U.S.C. 8346*)
- Unemployment Insurance (*A.R.S. § 23-783*)
- Workmen's Compensation (*A.R.S. § 23-1068(b)*)
- AFDC (Aid to Families with Dependent Children) (*A.R.S. § 46-208*)
- GA (General Assistance) (*A.R.S. § 46-208*)
- Military survivor annuities paid pursuant to the Survivor Benefit Plan (*10 U.S.C. 1450(i)*)

If the property is worth more than the exempt amount, it may be sold to satisfy the debt. The debtor receives the exempt amount and the creditor receives the remaining.

Revised September 2015