

# BASICS OF BANKRUPTCY



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**A. Relief available under the Bankruptcy Code**

1. **Chapter 7:** Sometimes called a liquidating chapter but this should rarely be the case.
  - a. Available to individuals and businesses (corporations, LLC's, partnerships)
  - b. Chapter 7 Trustee is assigned and reviews the financial situation of the debtor, conducts the 341 meeting, and determines if there are any assets to liquidate or sell.
  - c. Debtor may retain some property but must consider equity. Unsecured creditors are entitled to equity beyond the exemptions. (See Section G. Exemptions: What can be kept in a bankruptcy case)
  - d. If there is no equity, debtor may retain collateral. Chapter 7 Trustees often leave very little on the table.
  - e. Most Chapter 7 cases are "no asset cases" which means the debtor loses no assets as a result of filing for relief.
  - f. Unsecured creditors typically get paid nothing.
  
2. **Chapter 13:** Reorganization for individual consumers and unincorporated business owners.
  - a. Available to individual or joint debtors but is not available to corporations.
  - b. Monetary limitations of a Chapter 13:
    - i. Non-contingent, liquidated unsecured debts: \$336,900.00
    - ii. Non-contingent, liquidated secured debts: \$1,010,650.00
  - c. Provides for payment of secured and priority debts and usually a percent repayment to unsecured creditors.
  - d. If household income is over the median income for South Carolina, the law provides for a method of calculating disposable income. IRS standards and a list of allowed expenses are deducted from a

calculated '*current monthly income*' to provide an amount that must be paid to unsecured creditors.

- e. Length of repayment plan:
  - 1. If over median income, plan must last 60 months.
  - 2. If under median income, plan will last 36-60 months, depending on needs of debtor.
- f. Chapter 13 Trustee is assigned. They receive monthly payments from the debtor and distribute to the creditors. Regular mortgage payments and leases are paid by the debtor outside the bankruptcy plan.
- g. Liquidation analysis: Non-exempt assets that have equity can be protected in a Chapter 13 but the unsecured creditors must be paid at least as much as they would have received had the debtor filed a Chapter 7 where the Trustee would have liquidated the asset to pay creditors.
- h. Confirmation is based upon compliance with rules set forth in the Bankruptcy Code.

3. **Chapter 11:** Reorganization for corporations and the very wealthy.

- a. Very few cases filed in South Carolina.
- b. It is the most expensive chapter to file.
- c. Creditors vote on the reorganization plan.
- d. Confirmation based upon consensus and agreement between debtor(s) and creditors.

4. **Chapter 12:** This chapter is for family farmers including some fishermen.

5. **Chapter 9:** This chapter is for municipalities.

**B. What does a bankruptcy do?**

- 1. It gives the debtor a fresh financial start.
- 2. It provides for fairness among creditors.
- 3. It provides an automatic stay which protects the debtor.

**C. The Means Test**

In order to file Chapter 7 bankruptcy, the debtor must prove his/her need by passing the means test. The means test looks at debts, income and assets. A major part of the Chapter 7 means test involves comparing a debtor's average **current monthly income** to the median income in their state.

**Current monthly income** is determined by averaging **all** income that came into the household over the most recent 6 full months prior to filing. If the average monthly income from all sources is less than the applicable median income, the test stops there and the debtor may be eligible to file a Chapter 7.

If, however, the income is greater than the applicable median, a Chapter 13 may be the option for the debtor and the means test must then be used to determine the household's **disposable monthly income**.

Disposable monthly income is determined by reducing the average monthly income by certain allowed expenses and it is this figure that is used to determine the repayment plan in a Chapter 13.

South Carolina median income as of March 15, 2009:

<u>Family size</u>	<u>Income Level</u>
1	\$38,728
2	\$50,823
3	\$54,834
4	\$65,974

(\$6,900 for each person in excess of 4)

**D. Automatic Stay**

The automatic stay stops all attempts by creditors listed in the bankruptcy petition to collect payments from the debtor. The automatic stay will not stop police powers, criminal prosecutions, and family court cases.

**E. Property of the estate**

Property of the estate includes everything the debtor now has an interest in. It also includes everything the debtor once had an interest in and disposed of for less than the fair market value within the previous 6 months prior to the date of filing which is known as the “look back” period. Assets also can include inheritance; bequests or devises; property settlement agreements or divorce decrees; or life insurance proceeds.

**F. The parties to a bankruptcy are:**

1. Debtor(s)
2. Creditors
  - a. Secured
  - b. Unsecured
  - c. Priority Unsecured
3. Either a Chapter 7 trustee or a Chapter 13 trustee
4. US Trustee who polices the bankruptcy court
5. Judge

**G. Exemptions are tangible and intangible items that can be kept by the debtor.**

1. The SC Bar sets the exemptions used in South Carolina which are:
  - a. Homestead \$51,450 per debtor (or cash)
  - b. Motor vehicle \$ 5,150 per debtor
  - c. Household goods \$ 4,125 per debtor
  - d. Jewelry \$ 1,025 per debtor
  - e. Cash/ liquid assets \$ 5,000 per debtor (or homestead)
  - f. Tools of trade \$ 1,550 per debtor
  - g. Life Insurance (CSV) \$ 4,000 per debtor

- h. 401k unlimited per BAPCPA
- i. IRA unlimited per BAPCPA
- j. Wild card \$ 5,150 per debtor

- 2. Life insurance exemption is governed by two different codes:
  - a. SC Code 38-63-40
    - i. All proceeds and the cash surrender value of policy that are payable to beneficiary other than insured estate, and expressed to be for primary benefit of the insured spouse, children or dependents are exempt with the following limitations:
      - 1) Funding within 2 years of filing; and/or
      - 2) Intent to defraud creditors.
  - b. SC Code 38-63-90
    - i. \$50,000 of proceeds and cash surrender value of policy payable to beneficiary other than insured estate, and expressed to be for primary benefit of the insured spouse, children or dependents are exempt with the following limitations:
      - 1) Intent to commit fraud on creditors; and/or
      - 2) No time limitation prior to filing bankruptcy.
- 3. An earned income credit is exempt.

#### **H. Residency & exemptions**

- 1. Section 522 of the Bankruptcy Code actually governs exemptions. Section 522(b)(3) sets out the requirements based on residency using the following guidelines:
  - a. Where was debtor's residency for 730 days (2 years) prior to filing?
  - b. If not a single place, then where was the debtor's residency for the majority of the 180-day period before filing?

- c. Federal exemptions can be used if residency renders debtor ineligible for state exemptions.
  - d. Some states, such as Florida and South Carolina, only permit current residents to claim their state's exemptions.
2. Sections 522(o), (p) & (q) also set some restrictions on exemptions, especially relating to the debtor's residence.

**I. Prior Bankruptcy Filing**

1. Debtors can file bankruptcy more than once but certain rules and time limitations apply. If the time limitation between filings shown below is not adhered to, there can be no discharge of debts but filing a Chapter 13 can be a useful tool to stop a foreclosure sale and provide for payment of arrearages. There are other considerations that will be discussed with you by your certified bankruptcy specialist.

	<u>From filing of</u>	<u>To filing of</u>	<u>Debtor must wait</u>	<u>Code Section</u>
a.	Chapter 7	Chapter 7	8	727 (a)(8)
b.	Chapter 13	Chapter 7	6*	727(a)(9)
c.	Chapter 13	Chapter 13	2	1328(f)(2)
d.	Chapter 7	Chapter 13	4	1328(f)(1)

\* Unless 100% was paid to unsecured creditors or 70% was paid, and that was the debtor's best effort.

**J. Credit Counseling and Debtor Education**

1. **Pre-Petition Credit Counseling** - required before bankruptcy petition can be filed on behalf of the debtor. Counseling must be completed within 180 days of filing and can be gotten from an approved non-profit budget and credit counseling agency. Your certified bankruptcy specialist will provide a list of approved agencies.
2. **Post-Petition Debtor Education** - must be completed before case can be discharged and in the case of a Chapter 7 filing, debtor

must complete this course within 45 days after the first meeting of the creditors (FMOC).

**L. 341 meeting or first meeting of creditors (FMOC)** – debtor is required to attend this hearing which usually takes place about 30 days after the date the case is filed. Typically, this is where the trustee has an opportunity to question the debtor about specific issues of interest in his/her petition. Debtor's attorney or his/her representative will be there as well but the meeting is really a question/answer session between the debtor and the assigned trustee.

**M. Exceptions - A bankruptcy filing will not automatically discharge all debts. Some debts are subject to exceptions and restrictions, such as:**

1. Taxes - Some taxes can be discharged if:
  - a. The tax has been due and payable for more than 3 years. This period is extended by any extensions that were requested.
  - b. The tax return was filed more than 2 years before the bankruptcy filing.
  - c. 240 days has passed since the tax was assessed.
  - d. There are also exceptions to the rules:
    - ii. Tax Liens secured by property of the debtor will cause at least some portion of the otherwise dischargeable debt to not be discharged.
    - iii. An *Offer in Compromise* will extend the time lines.
    - iv. Bad conduct and fraud will also be considered.
    - v. Others. (This can be a tricky area)
2. Consumer debt "run-ups" made immediately prior to filing may not be discharged:

- a. \$500 for luxury goods or services incurred by an individual debtor on or within 90 days before filing.
  - b. Cash advances aggregating more than \$750 within 70 days before filing.
3. Fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.
4. Domestic support obligation such as alimony, child support, other support obligations cannot be discharged in a bankruptcy filing.
5. Willful and malicious injury by the debtor to another entity or to the property of another entity.
6. Student loans, even those not federally guaranteed are non-dischargeable.
7. Debt (other than a domestic support obligation to a spouse, former spouse, or child) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree, or other order of a court of record, or a determination made in accordance with state or territorial law by a governmental unit is not dischargeable in Chapter 7.
9. Post petition regime and condo fees for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit cannot be discharged.

## **N. Bankruptcy and the Family Court**

1. The automatic stay will prevent further harassment from creditors but its impact on a Family Court case is limited. The automatic stay does **not** prevent the following actions from moving forward:
  - a. Establishing or modifying order for support
  - b. Establishing paternity
  - c. Collecting support, alimony or maintenance
  - d. Litigation concerning child custody or visitation
  - e. Dissolution of a marriage

- f. Dealing with allegations of domestic violence
  - g. The following actions to collect support obligations are permitted without violating the automatic stay:
    - i. Withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license under state law, as specified in Section 466(a)(7) of the Social Security Act;
    - ii. Reporting to a credit reporting agency.
    - iii. Interception of tax refund under 464 or 466(a)(3) of SSA or under analogous State law;
    - iv. Enforcement of a medical obligation as specified under Title IV of the Social Security Act (Sections 401-479A).
2. Discharge of property settlements
- a. Property settlements are not dischargeable in a Chapter 7.
  - c. A Chapter 13 filing may discharge a property settlement.
3. Chapter 13 & support obligations
- a. Failure to stay current on support obligations are grounds for dismissal or conversion on request of a party of interest or the US Trustee.
  - b. Plan must provide for payment in full of all past due support obligations that are payable to the custodial parent. If plan includes all disposable income for five (5) years, debtor can pay less than full payment of pre-petition support obligations directly owed or assigned to a governmental unit.
  - c. Chapter 13 plan cannot be confirmed unless debtor is current in post-petition domestic support obligations.
  - d. Debtor cannot receive a discharge until debtor certifies that support obligation is current.

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